NOT MUCH TO GO AROUND, YET NOT THE RIGHT HANDS AT THE TILL

CONSOLIDATED GENERAL REPORT *on the local government audit outcomes*

MFMA 2018-19

AUDITOR-GENERAL
SOUTH AFRICA

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Auditing to build public confidence

MFMA 2018-19

CONSOLIDATED

GENERAL REPORT ON THE LOCAL GOVERNMENT AUDIT OUTCOMES

The information and insights presented in this flagship publication of my office are aimed at empowering oversight structures and executive leaders to focus on those issues that will result in reliable financial statements, credible reporting on service delivery and compliance with key legislation.

I have titled this report *Not much to go around, yet not the right hands at the till* to reflect the state of financial management in local government. Billions of funds allocated to municipalities are managed in ways that are contrary to the prescripts and generally recognised accounting disciplines. In some cases those responsible for the transparent management of these resources do not do it while no proper oversight over these lapses is effected. This makes for very weak accountability and the consequent exposure to abuse of the public purse. There are limited resources across all provinces, however, no proper care is applied to manage and spend diligently.

I wish to thank the audit teams from my office and the audit firms that assisted with the auditing of local government for their diligent efforts towards fulfilling our constitutional mandate and the manner in which they continue to strengthen cooperation with the leadership of government.

Kimi Makwetu
Auditor-General

Our reputation promise/mission

The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

PERFORMANCE SNAPSHOT

OVERALL AUDIT OUTCOMES

OVERALL REGRESSION IN AUDIT OUTCOMES

46 Regressed
33 Improved

Outstanding audits

The audits of **28** municipalities were not finalised by 31 January 2020

Clean audits

8%
(2017-18: 7%)

Quality financial statements

48%
(2017-18: 52%)

18% (43)
Municipalities submitted financial statements without material misstatements

Cost of consultants to assist in financial statement preparation

R1,26 billion *

59% (134)
Financial statements submitted for auditing included **material misstatements in areas in which consultants did work**

* Consultant costs include **R741 million** for audits completed by 31 January 2020 and **R522 million** relating to outstanding audits or audits subsequently finalised

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No findings on performance reports

33%
(2017-18: 37%)

48% (109)
Achievement reported not reliable

No findings on compliance with legislation

9%
(2017-18: 8%)

Irregular expenditure

R32,06 billion**
(2017-18: R24,38 billion)

Irregular expenditure includes **R21,46 billion (2017-18: R16,63 billion) for audits completed by 31 January 2020 and **R10,60 billion** (2017-18: R7,75 billion) relating to outstanding audits or audits subsequently finalised

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MATERIAL IRREGULARITIES

6 material irregularities identified from 6 completed audits
R24 499 866 likely financial loss (**R2 421 897** known and **R22 077 969** estimated)

Nature of material irregularities

Payment for **goods or services not received**
33% (2)
R11 418 843

Assets **not safeguarded** resulting in **theft/vandalism**
50% (3)
R11 849 379

Unfair procurement leading to **overpricing**
17% (1)
R1 231 644

FINANCIAL HEALTH

REVENUE AND EXPENDITURE

Municipal revenue was R324 billion: **R226 billion (70%)** own revenue, **R55 billion (17%)** equitable share and **R43 billion (13%)** other conditional grants

Salaries and wages (including councillor remuneration) of **R91,3 billion** – 40% of revenue and 166% of equitable share

Deficit (expenditure exceeded revenue)	Creditor-payment period > 30 days	Average creditor-payment period	More than 10% of debt irrecoverable
2018-19 34% (65)	2018-19 89% (173)	2018-19 180 DAYS	2018-19 93% (181)
2017-18 32% (57)	2017-18 85% (152)	2017-18 146 DAYS	2017-18 90% (161)

VULNERABLE FINANCIAL POSITION

2018-19 31% (72) 2017-18 30% (68)

Fruitless and wasteful expenditure of **R1,47 billion** incurred by those in vulnerable financial position

ASSURANCE PROVIDERS

Senior management, municipal managers and mayors **slightly regressed**

Internal audit units and audit committees **slightly regressed**

National and provincial role players **slightly regressed**

Municipal public accounts committees **regressed**

STATUS OF CONTROLS

19% Overall internal controls **regressed**

12% Basic financial and performance management controls **regressed**

27% Human resource management controls **slightly regressed**

2% Information technology controls **slightly regressed**

INFRASTRUCTURE

ROAD INFRASTRUCTURE

27% did not develop or approve road maintenance plan

16% did not determine backlog in renewal and routine maintenance

WATER INFRASTRUCTURE

41% had no policy / an approved policy on water maintenance

36% did not establish standard procedures for assessment of water infrastructure

Water losses above 30% at **36%** of municipalities

Water losses not disclosed at **12%** of municipalities

SANITATION INFRASTRUCTURE

41% had no policy / an approved policy on sanitation maintenance

35% did not assess condition of sanitation infrastructure

NOTES

CONTENTS

ANNEXURES

The annexures containing information on the following are available on **www.agsa.co.za** *(our website)*:

- **Annexure 1**: Auditees' audit outcomes; areas qualified; and findings on performance reports, compliance, specific risk areas and unauthorised, irregular as well as fruitless and wasteful expenditure
- **Annexure 2**: Auditees' financial health indicators, supply chain management findings and root causes
- **Annexure 3**: Auditees' audit opinions over the past five years
- **Annexure 4**: Assessment of auditees' key controls at the time of the audit

To access the content of this report on our website, simply use the **QR code scanner** on your mobile phone or tablet to scan the code.

CLEAN AUDITS 2018-19 (municipalities)

Unqualified financial statements with no material findings on the quality of the performance report or compliance with key legislation

EASTERN CAPE	Senqu
FREE STATE	No municipality in the Free State achieved a clean audit
GAUTENG	Midvaal
KWAZULU-NATAL	Okhahlamba
LIMPOPO	Capricorn District
MPUMALANGA	Gert Sibande District Nkangala District
NORTHERN CAPE	John Taolo Gaetsewe District
NORTH WEST	No municipality in North West achieved a clean audit
WESTERN CAPE	Cape Winelands District West Coast District Bergriver Cape Agulhas Cederberg Drakenstein Hessequa Langeberg Overstrand Prince Albert Saldanha Bay Theewaterskloof Witzenberg

SECTION 1

Executive summary

AUDITOR-GENERAL'S OVERVIEW

The safe and clean hands that can be relied upon to look after the public's finances in local government are few and far between. This is found to be so in the custodial roles in financial management across a number of provinces.

Those that are required to supervise and monitor adherence to fiscal management laws are not doing so or are not effective in the steps they have taken so far. This problem is compounded by the indisputable reality that the money allocated to the delivery of certain specified outcomes is no longer in the bank and that for which it was earmarked has not been delivered or achieved. ***There is not much to go around, yet the right hands are not at the till.***

Services are rendered and goods are delivered to consumers in all municipalities with the expectation that they will pay for them. Yet there has been a growing trend of established businesses across the chain showing signs of diminishing ability to pay for these services, or completely refusing to pay. Individuals and households also feel the same pressures and are not forthcoming with payments for these consumed goods and services. To illustrate the prevalence and pervasiveness of this across the country, on average almost 60% of the revenue shown in the books will never find its way into the bank account. The accounts we are covering in this report already take into account the extent of this impairment. The system has generally been unsuccessful in converting debt into cash over a number of years, as evidenced by the age of the debt. However, this does not mean that the constant pursuit of this money should cease.

In the meantime, those that render services on behalf of the municipality or provide administrative and other functions continue to receive their income, largely and almost exclusively in some cases from the income that is raised from the national purse. This area of municipal finances is compounded by the fact that not all those that are part of the payroll were brought along with the intention to directly deliver the services that are part of the municipality's plans. This leaves the municipality with little else but to seek external help – even in areas where they already have warm bodies in employment. This comes at a significant cost. The common consequence of this is that those that provide goods and services with a promise to be paid in the future have to wait for new money to be allocated for future spending before they can be paid for past deliverables. The ultimate outcome of this is an inevitable downward spiral to a financial cul-de-sac that many of the local municipalities and districts have already reached across the whole country, with a few and limited exceptions.

Fundamentally, this is what characterises the outcomes of the audit of financial statements of local government across the country. It should be appreciated that there are some exceptions; a large number of which are concentrated in the Western Cape (although there are dotted areas of concern in the Central Karoo and Garden Route districts of this province).

When the different audit conclusions are analysed in this report, the above context must always be kept in mind. It is no longer about an accelerated drive to achieve a particular audit conclusion, but whether the municipality is investing in qualitative and preventative controls to avert this systematic decline in financial fortunes within a sphere where all matters. The value of this report should therefore not be about a clever, intelligent analysis of concepts where the temptation is to rationalise the problem as if to soften the blow or divert attention from the core issues. It should rather be about how firm steps are going to be taken to restore the integrity of these institutions and place them in a position to manage their finances towards the achievement of citizens' needs.

When looking across the board and after carefully analysing the financial statements we audited, we can safely conclude that local government does have sufficient money and assets to fulfil most of the basic needs and aspirations of its citizens. But a lot of work is needed to make sure that this is realised. Proper administration and superintendence over the financial affairs of local government were not exercised and were found, through this audit examination, to be seriously lacking with some devastating consequences already evident in certain identified areas.

Kimi Makwetu
Auditor-General

There is not much to go around, yet the right hands are not at the till

GENERAL OVERVIEW OF THIS REPORT

This general report gives an account of our audits and experiences in the different provinces and dives deeper into the stories told by the financial statements of the municipalities in those provinces.

The financial statements of a municipality tell the story of how well a municipality is managed. It can be a good story of disciplined spending that achieves value for money; meticulous billing and collecting practices; assets that are maintained and safeguarded; careful investments and savings for emergencies and future projects; and commitments to creditors and the community being honoured. The tale most often told in local government, however, is of municipalities crippled by debt and being unable to pay for water and electricity; inaccurate and lacklustre revenue collection; expenditure that is unauthorised, irregular, fruitless and wasteful; and a high dependence on grants and assistance from national government. Most concerning are those municipalities that cannot even prepare credible financial statements, even after paying millions to consultants for assistance and receiving sizeable support from national and provincial government. The financial statement stories of these municipalities remain untold or are unreliable, with their communities, creditors as well as current and future investors being left in the dark.

When we share the audit outcomes and messages on the financial statements and financial management of municipalities, as in this report, it is a reflection of the picture the municipal administration themselves are also painting through their financial statements and performance reports.

Every province has a unique story that we summarise below, but we invite you to read the detailed stories of the different municipalities in the provincial overviews in section 2.

EACH PROVINCE HAS A UNIQUE STORY

EASTERN CAPE

*A **widespread lack of financial controls and project monitoring**, an ongoing culture of a lack of accountability as well as a tolerance of transgressions resulted in a further regression in audit outcomes in the province – improvements were rare and the general trend over the past three years remained negative. Eight municipalities were unable to adequately support the information reported in their financial statements and received disclaimed opinions.*

The cost of accountability failures is high as the province is hampered by poverty. Instead of the responsible and diligent financial management of the limited resources available, we see dysfunctional control environments, extensive disorder in accounting records, prolonged vacancies in key positions and instability in councils, poor procurement processes, no consequences for poor performance and transgressions, unreliable reporting on municipal finances and programmes, and accumulated irregular expenditure of just over R11 billion.

The impact is evident from the financial statements of municipalities – 83% had significant cash-flow constraints and could not pay their creditors on time. In total, 38% of the municipalities' expenses exceeded their revenue at year-end. At some municipalities, the equitable share (an unconditional grant that enables municipalities to provide basic services to poor households, afford basic administrative and governance capacity, and perform core municipal functions) was not enough to cover the salary bill. Revenue from service charges was used for the shortfall before paying for the costs of delivering the services – further exacerbating the impact on those supplying goods and services to the municipality. The development and maintenance of infrastructure and the delivery of basic services across the province suffered from poor planning, weak project management, and the mismanagement of conditional grants. Constant service delivery protests bear evidence of municipalities' failure to respond to the needs of their residents. Wastefulness and poor financial management will create a situation that will become untenable in the near future.

FREE STATE

The audit outcomes in the province continued to regress for the third consecutive year. Ten municipalities did not submit financial statements on time – even more than in prior years, which resulted in eight audits not having been completed by the time of this report. Additionally, three municipalities received disclaimed opinions. This means that almost half of the municipalities in the Free State have not yet accounted for the manner in which they used taxpayers' money in 2018-19 or did it so poorly that their financial statements cannot be trusted.

The outcomes were characterised by a lack of basic financial disciplines, an unwillingness to comply with legislation, and a general disregard for internal controls and accountability. Last year we reported on the total breakdown in internal control and poor leadership responses towards improving the situation. The trend continued this year, inevitably leading us to the conclusion that there is a ***deliberate lack of accountability by the political and administrative municipal leadership*** in the province. The failure of infrastructure projects and the lack of infrastructure maintenance are costing municipalities millions, with little consequences for the responsible officials and contractors and no effort to recover the losses, with communities suffering the most for the poor tone set by the leadership.

The use of consultants to do the work of municipal officials remained the order of the day – even for project management and normal financial activities such as reconciliations and the maintenance of registers. The investment of R29 million in consultants to assist with financial reporting had little impact on the quality of financial statements submitted for auditing, while the lack of skills transfer was evident by some officials not even being able to provide the most basic of financial information without the help of a consultant.

Some internal audit units and audit committees were dysfunctional, while the recommendations of others were not implemented to improve controls and audit outcomes. District municipalities did not have the capacity and resources to provide the required technical, administrative or financial support to their local municipalities, and did not transfer any good practices regarding financial and performance management. Provincial government interventions have failed, as evidenced by the continued inability of municipalities under administration to produce credible financial statements or deliver on their service delivery objectives.

The financial statements reflect the dire state of local government in the province. Municipalities will not be able to continue on their current path of financial maladministration, as their financial health has consistently deteriorated over the last five years to a point where 80% of municipalities are now in a vulnerable financial position. Current liabilities exceeded current assets by R2,1 billion and total expenditure exceeded total revenue by R2 billion. Poor financial discipline in the province had a significant impact on the country as a whole, as municipalities did not prioritise payments to Eskom and water boards, who were collectively owed R3,1 billion at year-end.

GAUTENG

The picture in Gauteng held steady with all municipalities again maintaining their good audit outcomes for completed audits. This was the only province in which all the municipalities had unqualified audit opinions, but as in prior years only Midvaal obtained a clean audit opinion. This continued to elude the other municipalities as we observed ***good financial accounting but inadequate monitoring of the preventative controls*** *necessary to ensure compliance with legislation and accurate reporting on service delivery achievements.*

Municipalities that have both attracted and retained staff with the right skills have benefited from this continuity and managed to maintain good audit outcomes. Midvaal has benefited from a high level of institutional knowledge as key management officials such as the municipal manager, chief financial officer and head of supply chain management have been at the municipality for at least five years. By contrast, municipalities characterised by instability in political or administrative leadership, such as the City of Tshwane and City of Johannesburg metros, were unable to improve their outcomes.

The current economic climate has resulted in municipalities' financial sustainability remaining under pressure, as they continued to experience difficulties in collecting debt from residents. This had a negative impact on these municipalities' ability to pay suppliers timeously for basic services, which in turn led to non-delivery or delays in municipal services. The expanding Gauteng population, as well as the resultant increased infrastructure development and maintenance needs, has also placed a strain on municipal finances, as there are limited funds for the various desired projects. It is further becoming apparent that the financial model for district municipalities is not sustainable and needs to be reconsidered. The operational expenses (mainly salaries) of the two district municipalities were very high due to a large staff structure relative to the limited functions they performed.

KWAZULU-NATAL

There was ***little change in the audit outcomes of the province, accountability was not adequately practised and enforced by leadership, and the failure of key controls continued.***

Most district municipalities continued to struggle with basic financial and performance management processes, displayed a lack of responsiveness to implement and monitor action plans, and had weak governance structures that did not enable effective accountability. Some municipalities were unable to avoid setbacks when vacancies arose and were in a constant state of volatility due to failed preventative controls. Municipalities continued to place high reliance on consultants without adequate assurance from internal audit units, audit committees and municipal public accounts committees.

Leadership did not always influence robust systems of internal control to drive good governance and discipline – more focus must be placed on exercising political oversight and addressing the aspirations of citizens. The impact is evident in the increasing irregular expenditure (from R3 billion to R6,5 billion) in the province – eThekwini Metro incurred R2,34 billion of this irregular expenditure.

The financial statements showed low debt-collection levels, which in turn affected municipalities' ability to pay creditors on time. Some municipalities depended heavily on the equitable share to pay for salaries and councillor remuneration. The dire financial health of municipalities was made even worse by high water losses due to ageing infrastructure.

LIMPOPO

Six municipalities in the province improved their audit outcomes and three regressed. The improvements were mostly consultant-driven, but despite the province having spent R122 million on consultants for financial reporting purposes, many municipalities continued to receive qualified opinions. There was a high reliance on consultants, skills were not transferred, and some officials became complacent when consultants were appointed and did not perform the jobs they were appointed to do, raising questions about municipalities paying for officials and consultants to do the same job. ***Millions were spent to improve the outcomes, but there were no consequences for poor performance.***

Conditional grants provided for infrastructure development and maintenance were not always used for their intended purposes or were poorly managed. The province further reported water losses of R341 million due to poor management and monitoring.

The impact of the R1,2 billion loss following the liquidation of VBS Mutual Bank is still being felt by the municipalities concerned, where service delivery has been affected. Cost-containment measures and recovery plans have been introduced in the hope of recovering from this huge financial loss. The process of identifying the responsible parties and implementing consequences is still ongoing, with chief financial officers and municipal managers being suspended or resigning and mayors being recalled. Various court cases are underway and the provincial treasury's investigation report has been handed over to the Directorate for Priority Crime Investigation (Hawks) for further action.

The financial woes of the province are also reflected in municipalities' inability to pay creditors on time (the average payment period was approximately six months) – which put a significant strain on service providers, especially upcoming businesses. Poor debt collection and revenue management were at the root of these financial health challenges. Amounts owed to Eskom and water boards at year-end increased significantly to R1 billion and R2 billion, respectively.

The municipal public accounts committees were not adequately capacitated and were still uncertain about their role, which led to them not providing adequate assurance by, for example, investigating unauthorised, irregular and fruitless and wasteful expenditure. This ultimately affected the accountability cycle.

MPUMALANGA

***Deteriorating accountability and financial management coupled with weakened oversight is at the centre of the significant regressions in audit outcomes** in the province – six municipalities regressed and only two improved. There was a breakdown in internal control across various municipalities, which included basic financial disciplines such as record keeping, reconciliations and verifications.*

Only two municipalities that made use of consultants improved their audit outcomes despite consultants being used to do the work of employed staff at a cost of R95 million across the province. This was mainly due to management not being effectively involved and monitoring the work of consultants, which would have enabled them to implement consequences for non-performance. Instead, chief financial officers did not take accountability but rather delegated their responsibilities for the financial statements to consultants.

A trend of underspending on conditional grants reflects poor planning by municipalities – a total of R154,3 million was unspent. We also continued to see a blatant disregard for compliance with key legislation without any consequences. Only a small portion of the previously reported unauthorised, irregular and fruitless and wasteful expenditure was investigated and dealt with by the council. This also points to the ineffectiveness of most municipal public accounts committees, who did not receive enough assistance in the form of further research on the reports referred to them and did not have appropriate competencies to successfully execute their responsibilities.

Apart from very few exceptions, the political and administrative leadership did not demonstrate decisiveness in dealing with the deteriorating internal control environment and had – for far too long – allowed unethical behaviour, misconduct and a culture of no consequences despite recommendations from various assurance providers on how to deal with this.

The financial statements show that financial resources continued to dwindle at a time when municipalities are under increasing pressure to provide services. Challenges with maintaining reliable valuation rolls, deficiencies in billing systems, and high distribution losses affected the ability of municipalities to increase their revenue capacity to meet planned spending. The low revenue-collection rate made it difficult for municipalities to honour their financial commitments. At some municipalities, the amount spent on salaries far exceeded what consumers were billed for the sale of basic services such as service charges and property rates. This means that these municipalities had to use the equitable share to be able to service the whole wage bill, taking away from what was allocated to basic services.

NORTHERN CAPE

The province is in a ***prolonged state of undesirable audit outcomes****, with yet another overall regression – six municipalities regressed and only three improved. As in prior years, not all the audits were completed on time for inclusion in this report, as the financial statements were submitted late.*

The breakdown in the control environment continued with little response by the leadership to our messages to implement preventative controls. The result has been an environment in which supply chain management processes are abused, bank accounts are not properly scrutinised, revenue is lost due to system failures and transactions that are recorded twice, and proper reconciliations are not performed.

Over the years, municipal managers and chief financial officers remained slow in responding to the challenges faced by their municipalities. Vacancy rates contributed to this, as over a fifth of municipalities did not have a chief financial officer and/or a municipal manager. Where these positions were filled, incumbents struggled to perform their required duties despite having the necessary qualifications. At many municipalities, internal audit units and audit committees did not provide the required level of assurance, while the lack of capacity in municipal public accounts committees and councils contributed to municipal officials not being held accountable.

In total, R42 million was spent on consultants for financial reporting services – yet their skills were not transferred to municipal staff and they prepared unreliable financial statements due to the poor financial information received. Consultants were appointed at municipalities with a full finance unit complement, which can only mean that some finance officials are not able to perform their required duties.

Service delivery was severely hampered by the dire state of municipal finances. Most municipalities were crippled by poor and aged infrastructure, resulting in them struggling to render services to their communities. Salaries and councillor remuneration were substantially more than the equitable share received. The shortfall between own revenue and expenditure severely affected municipalities' ability to ensure service delivery and pay service providers. Pressure on the cash flow resulted in some municipalities using conditional grants to fund their operations, which means that funds earmarked for infrastructure development and maintenance were misspent.

Despite the overall poor performance of municipalities in the province, a handful of municipalities continued to deliver good audit results, such as the John Taolo Gaetsewe District which achieved a clean audit outcome. It is a pleasure to audit at the municipality – the officials are disciplined and the control environment is sound. The municipal manager has set the correct ethical tone, is highly involved in the audit process, and holds staff members accountable for audit findings.

NORTH WEST

The regression in audit outcomes completes a three-year downward trajectory in the province: nine municipalities received disclaimed opinions and eight received qualified opinions. The availability of documents or evidence to support financial activities remained a vast challenge across the municipalities, as evidenced by the number of repeat disclaimed opinions. The inability of the province to reverse the trend of negative audit outcomes points to a culture that is not proactive in dealing with control weaknesses flagged in prior years.

Accountability failures by senior management, municipal managers, mayors, internal audit units, audit committees, municipal public accounts committees and councils are indicative of a ***systemic breakdown in the discipline of financial control.*** Ten municipalities submitted their financial statements after the legislated deadline and not a single municipality was able to achieve a financially unqualified audit outcome. The political leadership failed to set the right tone for clean administration by creating an environment conducive to accountability, good governance and the effecting of consequences. The intervention by the provincial treasury and cooperative governance department was riddled with political infighting and caused further instability within the municipalities, which also had a negative impact on service delivery.

The cost of using consultants increased significantly to R180 million, with municipalities paying their staff and the consultants for the same service without any value being realised and resulting in a waste of scarce public resources. Even when consultants were used to prepare financial statements, they would not be credible because the in-year preventative controls (such as proper record keeping and daily and monthly reconciliations) were not in place to enable reliable and timeous financial reporting. In spite of spending the most on consultants of all the provinces, North West was the only province without a single unqualified financial audit outcome.

The total unresolved balance of irregular expenditure stood at R17,8 billion, demonstrating that compliance was not proactively monitored, transgressions and poor performance were not dealt with decisively, and proper investigations into the expenditure were not conducted.

The high number of municipalities with disclaimed and qualified opinions on their financial statements makes it difficult to analyse the financial health of local government in the province. What can be observed, however, is cause for concern: the deficit increased by 243% to R2,3 billion and the equitable share, which enables municipalities to provide basic services to poor households and perform core municipal functions, did not even cover salaries. Financial management was characterised by poor budgeting, lack of in-year monitoring, and inadequate cash-flow management.

WESTERN CAPE

The largest concentration of clean audits remained in the Western Cape (45%), with 93% of the province's municipalities receiving unqualified opinions on their financial statements. Eight municipalities retained their clean audit status – six of which have maintained this status for the past five years or longer.

Municipalities that sustained their clean outcomes are characterised by control environments that are institutionalised, preventative in nature and reinforced by a strong tone set by leadership. This includes operational controls that are institutionalised within their systems independent of individuals, which implies that staff turnover will not result in the failure of controls. In addition, there is a low tolerance by management for audit findings and a high level of accountability; and all the relevant assurance providers know their roles and do their part in the control environment. In these instances, municipalities focus on their own processes by incorporating robust risk analysis into their action plans, thus enabling audit outcomes to be a by-product.

While the province showed ***improved outcomes, concerns remain*** at municipalities where controls were not institutionalised, possibly leading to regressions; and at municipalities with dysfunctional control environments, which could lead to even worse audit outcomes than the already poor ones.

The financial statements generally correlated with the socio-economic climate of the respective municipalities as well as our assessment of financial discipline. More municipalities struggled to collect their debt, but overall the financial health of Western Cape municipalities was the strongest of all the provinces.

WHAT DO THE OVERALL TRENDS, OUTCOMES AND OBSERVATIONS TELL US?

Our audits of the 2018-19 financial year did not have a much different outcome than in prior years. Now in the third year of this administration, there was again a regression in the audit outcomes. Over the three-year period, the audit outcomes of 76 municipalities regressed with those of only 31 improving.

The following serious weaknesses in the financial management of local government had not been addressed over the past three years:

- Credible financial statements and performance reports are crucial to enable accountability and transparency, but municipalities are failing in these areas. Countrywide, 32 municipalities submitted their financial statements late and the financial statements of six were outstanding by 25 March. Not only did the unqualified opinions on the financial statements continue to show a steady decrease from 47% to only 43% (and a significant drop from 58% in 2016-17), but the quality of the financial statements provided to us for auditing again showed no improvement from the previous year. Only 18% of the municipalities could give us financial statements without material misstatements. In addition, the performance reports of 67% of the municipalities that produced such reports had material flaws and were not credible enough for the council or the public to use.
- Municipalities spent R1,26 billion on consultants for financial reporting services, of which only 7% was as a result of vacancies in municipal finance units. This amount includes R522 million for consultant costs at municipalities with outstanding audits where financial statements were received. Only 14% of the municipalities using consultants showed an improvement in their audit outcomes, while 22% regressed.
- The financial statements show increasing indicators of a collapse in local government finances – we assessed 79% of the municipalities as having a financial health status that was either concerning or requiring urgent intervention. Just under a third of the municipalities were in a particularly vulnerable financial position.

  The inability to collect debt from municipal consumers was widespread. In these circumstances, it is inevitable that municipalities will struggle to balance the books. Overall, 34% of the municipalities disclosed a deficit (in other words, their expenditure exceeded their income) – the total deficit of these municipalities amounted to R6,29 billion.

  The financial woes of local government also weighed heavily on municipal creditors. The average creditor-payment period was 180 days. At year-end, R53,52 billion was owed to municipal creditors but the cash available amounted to only R43,20 billion. The money owed to Eskom by year-end was in arrears of R11,31 billion, of which R9,02 billion had already been outstanding for more than 120 days. The water boards also struggled to collect money owed by municipalities – their accounts were R6,24 billion in arrears, of which R5,38 billion was for more than 120 days.

While the poor economic climate does play a role in the deterioration of municipalities' financial health, many are just not managing their finances as well as they should.

- Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continued to see a rise in fruitless and wasteful expenditure, with 200 municipalities losing R2,07 billion in the current year. Over the three-year period, R4,27 billion of government expenditure was fruitless and wasteful.

- In total, 91% of the municipalities did not comply with legislation. The outcome is similar to the previous year and slightly higher than the 85% in 2016-17. The lapse in oversight and lack of controls relating to compliance were evident in a number of areas, including supply chain management.

- The compliance with supply chain management legislation regressed since 2016-17. We remain concerned that only 2% of the municipalities are fully complying. This is in spite of all the reporting we have done in this area, the red flags we have raised, and the many recommendations we have made. Uncompetitive and unfair procurement processes and inadequate contract management were common.

- Irregular expenditure increased to R32,06 billion from the R25,2 billion we reported last year. It includes the irregular expenditure (R10,60 billion) of those municipalities of which the audits were completed after the cut-off date for this report (31 January) as well as the unaudited amounts disclosed in the financial statements of the municipalities whose audits were still outstanding by the date of this report. The amount could be even higher, as 55% of the municipalities were qualified because the amount they disclosed was incomplete and/or they disclosed that they had incurred irregular expenditure but that the full amount was not known. In addition, we could not audit R0,36 billion worth of contracts due to missing or incomplete information. The top 10 contributors to irregular expenditure were responsible for 43% of the total amount of irregular expenditure disclosed in 2018-19.

  Municipalities have a poor track record of dealing with irregular expenditure and ensuring accountability. The year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with (through recovery, condonement or write-off) stood at R65,59 billion.

- Our audits again identified a number of shortcomings in the development and maintenance of infrastructure. Infrastructure development projects displayed widespread underspending of budgets, delays in project completion, non-compliance with supply chain management legislation, and irregular expenditure.

  A key concern is the lack of attention being paid to water and sanitation infrastructure – the condition of water and/or sanitation infrastructure was not assessed at over a third of the responsible municipalities; and 41% of the municipalities did not have policies for maintenance. It is not unexpected then, that 36% of the municipalities responsible for water services and related infrastructure disclosed water losses of more than 30%. The overall water losses disclosed amounted to R6,56 billion.

  The maintenance of roads did show some improvement, but 27% of the municipalities did not develop or implement approved road maintenance plans for renewal and routine maintenance. We also continued to see a backlog in renewal and routine maintenance at 16% of the municipalities.

A NEW CHAPTER: FIRST-TIME IMPLEMENTATION OF THE MATERIAL IRREGULARITY PROCESS

The amendments to the Public Audit Act became effective on 1 April 2019 and we started implementing the material irregularity process at nine selected municipalities. We completed six of these audits by the date of this report. In this first year, we focused on non-compliance with legislation that resulted in, or is likely to result in, a material financial loss.

We identified a total of six material irregularities at three of the municipalities, which resulted in a financial loss of R24 499 866: R2 421 897 is known as the municipal manager quantified the loss, and the remainder is an estimate of the loss. The most material irregularities (three) were identified at Ngaka Modiri Molema District in North West.

The material irregularities we identified and reported are not complex accounting or procurement issues and could have been prevented through basic controls. It related to assets not being safeguarded resulting in theft or vandalism, payments for goods and services not received, and an unfair procurement process that resulted in overpricing.

Municipal managers reacted positively to the notifications they received of the material irregularities we identified, and all of them are taking appropriate action to address these. Some had already started taking action within the 20 working days we gave them to respond to our notification. This demonstrates that municipal managers understand what they are required by legislation to do when they become aware of irregularities and that they are willing and able to take on these responsibilities. It also signals a behavioural change towards responding in a decisive and timely manner to our findings.

HOW CAN PREVENTATIVE CONTROLS IMPROVE THE PICTURE?

Internal controls are the preventative mechanisms, rules and procedures implemented by a municipality to ensure the integrity of financial and accounting information, to promote accountability, and to prevent fraud and error. Besides complying with legislation, and protecting the entity's assets from theft or preventing fraudulent activities, preventative controls can help increase operational efficiency by improving the accuracy and timeliness of financial reporting.

These mechanisms, rules and procedures include the separation of duties – separating the preparer, reviewer and approver roles; access controls – limiting access to certain information and assets to specific individuals; physical verification – checking whether what is recorded in the books actually exists; documentation standardisation and management – ensuring that each transaction is supported by valid documents; regular reporting – updating the ledger and trial balances on a daily or weekly basis in order to provide regular insight into the state of the system, allowing management to discover and investigate discrepancies; periodic reconciliations – to ensure that balances in the accounting system match up with balances in accounts held by other entities, including banks, suppliers and credit customers; and approval authority – requiring specific managers to authorise certain types of transactions to add a layer of responsibility to accounting records by proving that transactions have been seen, analysed and approved by appropriate authorities.

Preventing poor-quality financial statements and performance reports, non-compliance and material irregularities is more effective than having to deal with the consequences thereof – money and time are lost, costly investigations have to be instituted, and officials are subjected to the discomfort and anxieties associated with these processes – which often take a number of years.

Our message has been consistent over the years that a strong control environment and processes are the key to achieving strategic objectives, addressing risks, ensuring compliance with legislation, and managing public sector funds to the benefit of citizens. We acknowledge that it takes time to institutionalise good preventative controls, especially in large and complex environments, but municipal managers – supported by their political leadership – need to build their institutions towards accomplishing this in a deliberate manner.

The detail on the weaknesses in internal control and identified risks that we include in our management, audit and general reports, will assist in identifying the other areas that need attention. The status of records reviews we perform and engage on with municipal managers also provide an early warning system whereby they are alerted to matters that can potentially lead to undesirable audit outcomes. All of these measures are aimed at assisting the leadership to prevent accountability failures, or to provide them with information on how to deal with such failures where they have occurred.

Councils can also play an important role in strengthening preventative controls through the municipal public accounts committees. A proactive approach aimed at identifying risks and requiring assurance from municipal managers that these risks are being mitigated through preventative controls will have a positive impact on the control environment of municipalities. Our reports and briefings will be a good source of information in this regard, but we also strongly encourage engagement with the chair of the audit committee and the head of the internal audit unit on their perspective, as they have a key responsibility towards risk management and the implementation of controls at municipalities.

We remain committed to working tirelessly within our new mandate to strengthen financial and performance management in local government in South Africa, emphasising the need for accountability and doing the basics right. We encourage the municipal leadership and all stakeholders involved in local government to intensify their efforts to ensure that communities experience an improvement in the way their municipalities operate.

SECTION 2

Provincial overviews

2.1 INTRODUCTION

In **section 2**, we provide an overview of the results and reflections per province with a focus on the current state of financial health and financial management of municipalities. We share our insights on the analysis of the financial statements and use examples to demonstrate both good and poor financial management practices adopted by municipalities. In addition, we explore the challenges and underlying reasons for the growing number of district municipalities with poor audit outcomes. We further reflect on the need to strengthen the control environment through the use of good preventative controls and call on the political and administrative leadership to build their municipalities towards accomplishing this in a deliberate manner. We also include a schedule of **consultant costs** for accounting, financial and asset management as well as other internal control services rendered by external service providers at the end of each individual provincial overview. The story in most provinces reflect the reality – which is also the title of this report: **There is not much to go around, yet the right hands are not at the till.**

Further details on the overall audit outcomes in local government can be found in the following sections:

- **Section 3** deals with the first year of implementation of our expanded mandate, provides comprehensive insight on the material irregularity process, and includes the outcomes of those audits signed off by 30 April 2020.
- **Section 4** summarises the audit outcomes and covers all the areas we had reported on in previous general reports. We also highlight the outcomes of audits concluded since our initial cut-off date up to 25 March 2020.

Refer to **section 5** to learn more about our audit process and the terminology used in this report.

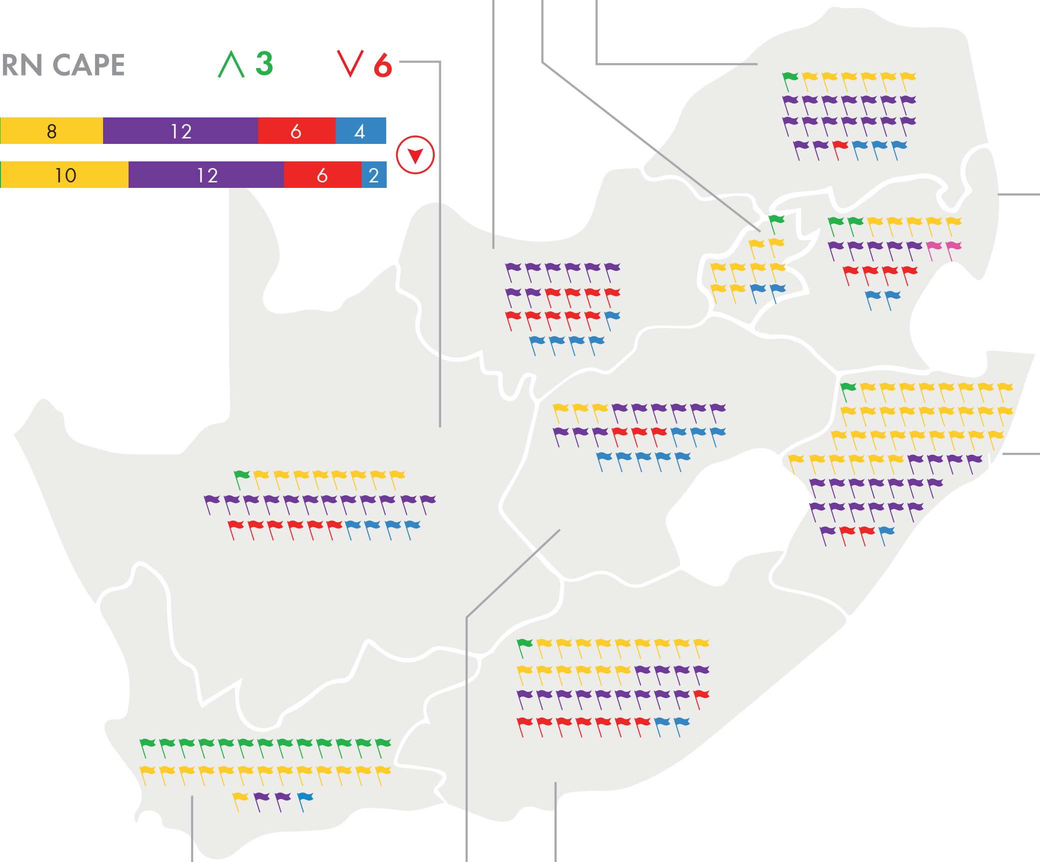
Please note the following important matters when reading the different sections of this report:

- We audited 257 municipalities and 21 municipal entities in 2018-19. To simplify our reporting and ensure that our message is focused, **this report covers only the municipalities**. The outcomes of the municipal entities are included in the annexures to this report (which are available on our website), but not in the analysis of this report unless specifically highlighted.
- We set the cut-off date for inclusion of audit outcomes in this report as 31 January 2020, by which time the audits of 28 municipalities had not yet been completed. Therefore, when studying the figures, please note that the percentages are calculated based on all **completed audits of 229 municipalities** unless indicated otherwise.
- We applied a **reduced audit approach at nine municipalities** in response to the disclaimed opinions they receive year after year and the general limitations experienced in performing audits in these environments. The reduction in work relates to areas such as financial health, supply chain management, use of conditional grants, assurance providers, use of consultants, and infrastructure projects. In some instances, when we report on these areas, the percentages are calculated based on only 220 or fewer of the completed audits.
- To determine the **movements** from the previous year, and over the three-year period, we compared the results of the municipalities with completed audits with their results in 2017-18 and 2016-17. These movements are depicted as follows:

Improved	Unchanged	Regressed

Movement of 5% or less:	Slightly improved	Slightly regressed

AUDIT OUTCOMES PER PROVINCE



GAUTENG — ⋀ 0 ⋁ 0 (Unchanged)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	1	8				2
2017-18	1	10				

NORTH WEST — ⋀ 2 ⋁ 3 (Regressed)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19			8		9	5
2017-18		1	8		13	

NORTHERN CAPE — ⋀ 3 ⋁ 6 (Regressed)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	1	8	12		6	4
2017-18	1	10	12		6	2

LIMPOPO — ⋀ 6 ⋁ 3 (Improved)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	1	6	16		1	3
2017-18		8	13	2	4	

MPUMALANGA — ⋀ 2 ⋁ 6 (Regressed)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	2	5	5	2	4	2
2017-18	1	7	9	2	1	

WESTERN CAPE — ⋀ 7 ⋁ 4 (Improved)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	13	14	2			1
2017-18	12	14	4			

KWAZULU-NATAL — ⋀ 8 ⋁ 7 (Slightly improved)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	1	32	18		2	1
2017-18	1	33	13	6	1	

FREE STATE — ⋀ 2 ⋁ 4 (Regressed)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19		3	9		3	8
2017-18		3	15		3	2

EASTERN CAPE — ⋀ 3 ⋁ 13 (Regressed)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19	1	15	13		8	2
2017-18	2	19	13	2	3	

⋀ Number of municipalities that improved ⋁ Number of municipalities that regressed

Improved | Slightly improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

NOTES

2.2 EASTERN CAPE

AUDIT OUTCOMES

CHRIS HANI

	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19	3	2	1	1
2017-18	4	2	1	

Regressed

- Chris Hani DM
- Emalahleni LM
- Engcobo LM
- Enoch Mgijima LM
- Intsika Yethu LM
- Inxuba Yethemba LM
- Sakhisizwe LM

JOE GQABI

	Unqualified with no findings	Unqualified with findings	Adverse with findings	Disclaimed with findings
2018-19	1	2		1
2017-18	2		1	1

Unchanged

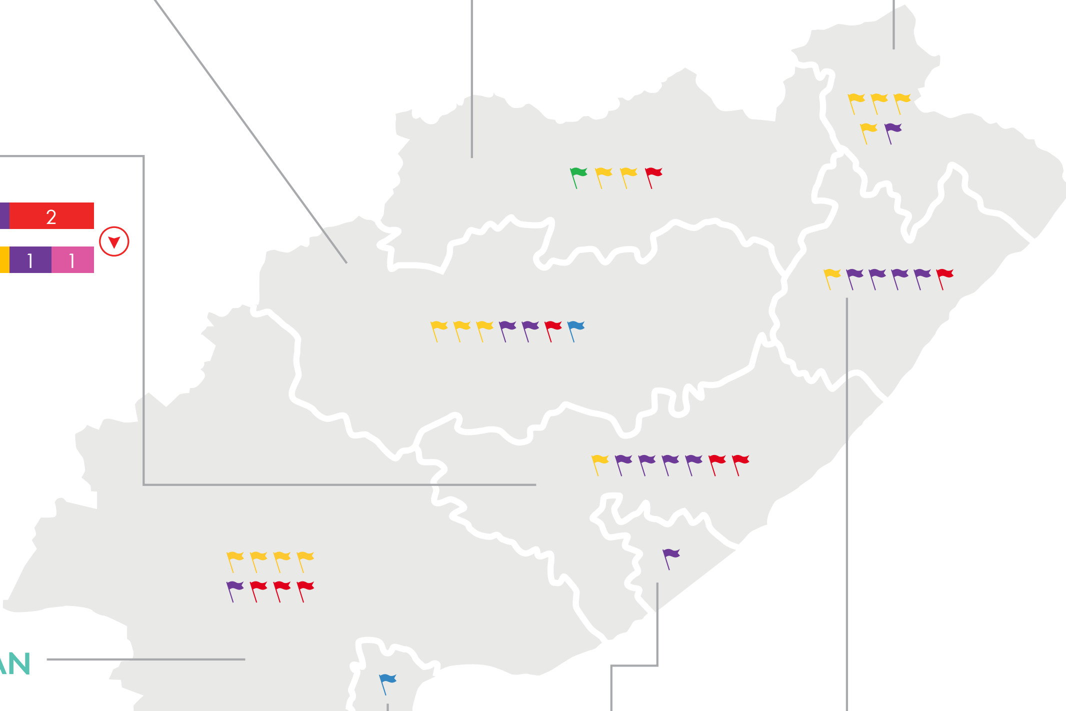
- Joe Gqabi DM
- Elundini LM
- Senqu LM
- Walter Sisulu LM

ALFRED NZO

	Unqualified with findings	Qualified with findings
2018-19	4	1
2017-18	4	1

Unchanged

- Alfred Nzo DM
- Matatiele LM
- Mbizana LM
- Ntabankulu LM
- Umzimvubu LM



AMATHOLE

	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings
2018-19	1	4		2
2017-18	5	1	1	

Regressed

- Amathole DM
- Amahlati LM
- Great Kei LM
- Mbhashe LM
- Mnquma LM
- Ngqushwa LM
- Raymond Mhlaba LM

SARAH BAARTMAN

	Unqualified with findings	Qualified with findings	Disclaimed with findings
2018-19	4	1	3
2017-18	4	3	1

Regressed

- Sarah Baartman DM
- Blue Crane Route LM
- Dr Beyers Naudé LM
- Kou Kamma LM
- Kouga LM
- Makana LM
- Ndlambe LM
- Sundays River Valley LM

NELSON MANDELA METRO

	Qualified with findings	Outstanding audits
2018-19		1
2017-18	1	

BUFFALO CITY METRO

	Qualified with findings
2018-19	1
2017-18	1

Unchanged

OR TAMBO DISTRICT

	Unqualified with findings	Qualified with findings	Disclaimed with findings
2018-19	1	4	1
2017-18	2	4	

Regressed

- OR Tambo DM
- Ingquza Hill LM
- King Sabata Dalindyebo LM
- Mhlontlo LM
- Nyandeni LM
- Port St. Johns LM

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

The Eastern Cape local government consists of 39 municipalities and 10 municipal entities. The audit outcomes of the municipal entities are not included in the analysis in this report. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, two audits were outstanding.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

13 Regressed

3 Improved

Clean audits

3%

(2017-18: 5%)

Financially unqualified financial statements

43%

(2017-18: 57%)

8% (3)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

3%

(2017-18: 5%)

Irregular expenditure

R2,5 bn

(2017-18: R4,3 bn)

Audits subsequently finalised

R4,2 bn

(2017-18: R3,1 bn)

No findings on performance reports

19%

(2017-18: 32%)

38% (12)

Reported achievement reliable

FINANCIAL HEALTH

Deficit

(expenditure exceeded revenue)

2018-19	38% (11)
2017-18	27% (9)

Creditor-payment period > 30 days

2018-19	83% (24)
2017-18	82% (27)

Vulnerable financial position

2018-19	27% (10)
2017-18	30% (11)

Widespread lack of financial controls and project monitoring

The province reflected a net regression consisting of three improvements and 13 regressions. When this is evaluated within the districts of the province, four of the six districts had a net regression in overall outcomes. Vacancies and instability in key positions resulted in a lack of preventative controls being implemented over financial and performance reporting as well as non-compliance with legislation. Additionally, there was a general tolerance for transgressions and this led to an ongoing culture of poor performance and inadequate consequence management processes. This dire situation was aggravated by the fact that eight municipalities were unable to adequately support the information reported in their financial statements and received disclaimed audit opinions. The constant lack of accurate financial and performance information also put those in leadership in a vulnerable position, as the information used for decision-making was compromised. This affected the effectiveness of administrative and political leaders in their monitoring and oversight roles, as information was not always verified before being used for decision-making. Specific examples that demonstrate the impact of the failures in the above-mentioned areas are further analysed below.

VACANCIES AND INSTABILITY IN KEY POSITIONS AFFECTED THE ABILITY OF COUNCILS TO HOLD INDIVIDUALS ACCOUNTABLE

During the year under review, 49% of the municipalities had vacancies and instability in their senior management which compromised their operations and accountability. Acting officials did not implement decisions made by their predecessors, and leadership was not able to hold acting officials accountable for their actions. The absence of senior management at these municipalities also resulted in poor control environments. Additionally, there was inadequate monitoring of the delivery of various performance objectives and key service delivery projects due to these vacancies. This did not bode well for the delivery of services and the achievement of commitments contained in integrated development plans.

CHRIS HANI DISTRICT is situated in the town of Komani (formerly Queenstown) in the northern region of the province. Only 35,2% of the population lives in areas classified as urban, while 63,8% lives in predominantly rural areas. The core mandate of this municipality is the supply of bulk water and sanitation infrastructure. The audit outcome of the municipality regressed from qualified in the previous year to disclaimed. The municipal council failed to appoint a municipal manager and the position has been vacant since 2018, while the chief financial officer was suspended for alleged financial misconduct during the year. The municipality was unable to implement any long-term initiatives to turn the situation around as various officials were appointed for three-month periods to act interchangeably in the position of municipal manager for the entire financial year.

With no municipal manager and no chief financial officer, there was a lack of proper expenditure management and monitoring of the spending of funds. As a result, R308 million in conditional grants remained unspent at year-end. The municipality requested a rollover so that the funds could be used in the next year. This was denied by the National Treasury who requested that the municipality pay back R181 million, as the municipality could not provide sufficient evidence to support the commitments against some of their conditional grants and they had not appointed a municipal manager. These are funds that should have been used to improve and maintain the water infrastructure in the district. As a result, most of the objectives relating to the supply of water infrastructure were not achieved, with major planned infrastructure not being completed. Furthermore, the municipal council failed to investigate irregular expenditure, and this resulted in a high tolerance for non-compliance with no consequences for the deteriorating state of the district.

MAKANA is situated in Makhanda (formerly Grahamstown), approximately 130 km from Port Elizabeth, and is part of the Sarah Baartman district. The municipality's council had failed to appoint a permanent municipal manager for more than four years. Over this period, numerous people acted in this position, including secondments from both the provincial cooperative governance and traditional affairs department and the provincial treasury. During the financial year, the council passed a vote of no confidence in the mayor, who then resigned. A new mayor was appointed during the second half of the financial year. The municipality finally appointed a new municipal manager during the year, with the incumbent thus being in the position for less than 12 months. Furthermore, the internal audit unit was understaffed and the position of the internal audit manager was not filled for the full year. The prolonged instability resulted in a dysfunctional internal control environment where there was extensive disorder in the accounting records. As a result, the municipality was unable to support the transactions reflected in the financial statements. For example, the municipality did not produce a credible asset register and could not verify the amounts disclosed as revenue or payables. These deficiencies resulted in the municipality receiving a disclaimed audit opinion. The reported service delivery in the performance report was likewise not supported by evidence and the reported achievements were not reliable.

A LACK OF PREVENTATIVE CONTROLS RESULTED IN POOR-QUALITY FINANCIAL STATEMENTS, NON-COMPLIANCE WITH LEGISLATION AND HIGH LEVELS OF IRREGULAR EXPENDITURE

The internal control environment of municipalities across the province regressed in the year under review. This is evidenced by the fact that only two municipalities (5%) had good leadership controls and only one (3%) had good financial and performance management controls. These controls were compromised by ineffective operational policies and procedures as well as instability and vacancies in the positions of accounting officer and chief financial officer. As a result, many municipalities continued to submit poor-quality financial statements as they struggled with basic controls such as adequate records management, daily and monthly processing and reconciling controls, as well as regular and accurate financial reporting.

The levels of irregular expenditure remained high despite the warning signals we raised with accounting officers to implement appropriate preventative and detection measures. Municipalities continued to abuse supply chain management prescripts. In total, 76% of the municipalities did not comply materially with legislation in this area. The province incurred irregular expenditure of R2,5 billion during the year, which had accumulated to a closing balance of R11,1 billion. This amount is understated as 15 municipalities were qualified on the completeness of their irregular expenditure and the information for two audits was outstanding. As a result, the actual irregular expenditure for the province could potentially be much higher. Management did not ensure that controls over the review and monitoring of compliance with supply chain management legislation, such as compliance checklists, were in place. The lack of consequences for legislative transgressions also contributed to the large amounts of irregular expenditure.

OR TAMBO DISTRICT, situated in Mthatha, is the district municipality that serves King Sabata Dalindyebo, Nyandeni, Port St. Johns, Mhlontlo and Ingquza Hill local municipalities with water and sanitation. The municipality received a qualified audit opinion on property, infrastructure and equipment and on irregular expenditure. Controls over the preparation, reconciling and review of the fixed asset register were not adequate and the municipality continued to rely on the audit process to identify errors. Consequently, the municipality was unable to correctly account for infrastructure assets and work-in-progress.

The municipality did not adequately plan for the procurement of their goods and services, which then resulted in deviations from supply chain management legislation by using numerous instances of emergency procurement without adequate justification. This non-compliance also occurred in prior years. The municipality further awarded a number of infrastructure tenders when the committees that adjudicated those bids were not always correctly constituted. These transgressions contributed to the disclosed irregular expenditure incurred of R981 million with a cumulative balance amounting to R1,4 billion, which accounted for 39% of the total irregular expenditure in the province (excluding that of the two outstanding municipalities). This figure could potentially be higher, as the municipality did not have controls in place to identify and correctly disclose all prior year irregular expenditure. These transgressions occurred due to the poor control environment and a culture of non-compliance resulting from the lack of consequence management.

Municipalities purchase inventory that typically consists of spare parts, fuel, electrical cables and other consumables used in delivering their services. In the previous financial year, **KING SABATA DALINDYEBO** (also situated in Mthatha) did not have sufficient controls to safeguard these items. As a result, a large number of these items could not be found when they were compared to the accounting records, and the figure disclosed in the financial statements was incorrect. This was reported in the previous year's audit report. In the year under review, management recommended to council that they write off the missing inventory. However, the amount of R12,1 million written off was only an estimate of the value of those items. There were no verification processes in place to evaluate if the write-off was correct before approval. As a result, the full extent of the financial loss from the missing inventory was not determined and could not be verified during the audit.

DR BEYERS NAUDÉ, situated in Graaff-Reinet in the Karoo region, is the fourth oldest town in South Africa and a tourism hub with many attractions in the vicinity. Management at the municipality did not implement adequate financial disciplines. Supervisory reviews and monthly reconciliations were not taking place and document management was lacking, resulting in evidence not being available to support the figures in the financial statements. Additionally, the internal audit unit was not fully capacitated with the result that they could not complete all their planned audits for the year, which included the review of the financial statements and the relevant supporting schedules. As a result, numerous errors were not identified and corrected.

The municipality disclosed R85 million in irregular expenditure at the end of the financial year. This included the irregular expenditure that they had inherited from the merger of the municipalities of Camdeboo, Ikwezi and Baviaans in 2016. The council, through their municipal public accounts committee, investigated transactions making up the irregular expenditure balance to determine if value was received and if a financial loss was incurred that should be recovered. The committee recommended that R79 million of the irregular expenditure be re-investigated, as they did not have sufficient information to write this off. However, the accounting officer of the municipality approved and submitted financial statements with the write-off of irregular expenditure of R79 million. This resulted in irregular expenditure being understated in the financial statements.

The audit opinion of **BUFFALO CITY METRO** remained qualified. The metro recorded capital commitments of R592 million in the financial statements. However, the manual system used to calculate and record these amounts, along with weak controls over consolidating and reconciling the relevant information, resulted in this information being incomplete. Consequently, the metro was unable to correctly determine how much of their future budgets should be allocated to complete certain key projects. The review and monitoring of supply chain management had also lapsed, resulting in a qualification on the completeness of irregular expenditure and an increase in the number of material non-compliance findings reported in this area. This was mainly due to instability in the key monitoring positions of the supply chain management unit. Not all irregular expenditure was investigated in order for consequence management to take place and as a result the irregular expenditure had accumulated to R2,8 billion.

UNRELIABLE REPORTING OF ACHIEVEMENTS AND POOR SERVICE DELIVERY PERSISTED

The province's service delivery reporting did not improve in the year under review as only 19% of the municipalities were able to report without material findings on the services they had delivered to communities. This was the result of weak records management, inadequate standard operating procedures and a lack of in-year monitoring. Furthermore, a number of deficiencies were identified in the development and maintenance of infrastructure as municipalities did not have plans in place to deliver and maintain infrastructure to communities. This resulted in delays in project completion, underspending of conditional grants and inadequate monitoring of contractors. The constant service delivery protests further bear evidence of a lack of service delivery.

The delivery of infrastructure projects in **BUFFALO CITY METRO** was of great concern as some of the projects had been delayed between three and four years. On one housing and human settlements project, the village houses had been complete for over a year but at the time of our site visit had not been occupied by the beneficiaries, which exposed the houses to the risk of vandalism. In another instance, the work on a housing development project had come to a standstill, with the metro incurring standing costs as a result.

The **DR BEYERS NAUDÉ** region experienced a drought and received a drought relief grant of R30 million to assist. An amount of R5 million was spent and R25 million was recorded as an unspent conditional grant in the financial statements. This amount was not cash-backed as the municipality did not have cash reserves of R25 million in their bank account. This means that the unspent grant money was spent on expenses not relating to the drought relief. The municipality applied for a rollover of the grant even though the money had been spent. Due to the poor state of record keeping, we could not confirm on what the grant money had been spent. Furthermore, the municipality did not have evidence of the reported service delivery performance relating to water services.

At **MAKANA**, a history of poor decision-making because of a lack of leadership, as described above, negatively affected the delivery of basic services to the community. The municipal infrastructure grant of the municipality was managed by the district municipality, due to the municipality's mismanagement of the grant in prior years which included massive underspending as well as spending outside the conditions of the grant. Due to this mismanagement, some of the major challenges faced by the municipality are the ageing water and road infrastructure that have not been adequately maintained. This, together with the drought faced by the region, resulted in the town going without water frequently and for long periods. Numerous service delivery protests took place regularly to demand better services. Due to poor service delivery, the community took the municipality to court to have the council dissolved and the municipality placed under administration. Subsequent to year-end, the court ruled in favour of the community. The municipal council is currently appealing the court ruling.

WHAT DO THE FINANCIAL STATEMENTS SAY?

An analysis of the financial statements revealed that 24 municipalities (excluding the outstanding audits and the disclaimers that could not be analysed reliably) had significant cash-flow constraints, displayed signs of financial distress, and were unable to pay their creditors within the legislated time of 30 days. This had a negative impact on service delivery, as evidenced by the reports against predetermined objectives indicating that only 61% of the basic service delivery targets were achieved while 87% of the conditional grant funding was spent.

Government provides municipalities with an equitable share which is to be used to fund the provision of basic services to poor households and to perform core municipal functions. An analysis of the equitable share revealed that a big portion thereof was allocated to salaries and wages, indicating that a limited budget was available for key infrastructure and service delivery initiatives. Municipalities therefore funded infrastructure and operational expenditure out of their own revenue from the sale of municipal services. However, the cash generated in this way was eroded by municipalities being unable to collect the debts owed to them, which exacerbated the situation. An average of 69% of municipal debt was disclosed as irrecoverable at year-end. This had an impact on the municipalities' ability to make timely payments to creditors, which was most evident in the high amounts owed to Eskom for the provision of electricity. Municipalities also struggled to implement sound financial management principles such as expenditure management and the proper implementation of credit policies, as 38% of the municipalities reported deficits for the year. As a result, municipalities were then forced to pay the previous year's debt from the next year's equitable share, and so the cycle continues and the cash-flow constraints carry on increasing.

BUFFALO CITY METRO is the central urban hub for the eastern region of the province. The metro failed to deliver on core basic services due to rapid urbanisation and population growth without the necessary infrastructure to support such growth. This was further aggravated by poor maintenance of infrastructure assets already in use. Poor planning, delayed procurement processes and inadequate project management resulted in major delays in the implementation of infrastructure projects, which accumulated in a situation where the metro had to address a backlog in infrastructure development. State funding was simply insufficient to cover the costs of the backlog, with the result that the metro utilised 36% of their cash reserves at the beginning of the year on infrastructure development. Many infrastructure projects remained as capital work-in-progress, and therefore citizens are not enjoying the benefit of this infrastructure. The revenue generated for the financial year under review increased – and together with the equitable share received – was sufficient to cover operational costs including salaries of R2,1 billion. However, receivables continued to increase as debtors did not pay for those services, and R1,2 billion (46%) of the metro's debts were likely not to be collected. Furthermore, the metro took on average 86 days to pay creditors, which indicates that they struggled to pay their short-term debt as it fell due. The decrease in the cash reserves over the past year indicates that the metro's ability to pay creditors as and when they become due may not be sustainable in the long term.

DR BEYERS NAUDÉ was under increasing financial pressure and had realised net deficits (losses) since inception. For the year under review, expenditure exceeded revenue by R101 million, indicating that the municipality may struggle to continue operations and deliver services in the future. The equitable share grant funding for the year amounted to R83 million. This was, however, not enough to cover the salary bill of R169 million. This means that the cash collected from consumers for rates and service charges (R139 million) had to be used to first cover this shortfall before paying for the costs associated with delivering these services (for example paying Eskom, which at R89 million accounted for the majority of the municipality's payables). The municipality disclosed that 74% of people who were charged for services amounting to R47 million might never pay the amounts due, and as a result the municipality was unable to pay creditors on time. It should be noted that it was difficult to determine the full extent of the issues at the municipality as the documents presented could not support the amounts disclosed.

OR TAMBO DISTRICT is a water services provider and billed residents of the district for water and sanitation services; however, they were having trouble in collecting money owed by customers. It took the municipality's collection department 119 days to collect monies owed for these services, and 82% of their debtors (R359 million) were not expected to pay their bills at all. Currently the lack of collection of outstanding debt is affecting service delivery and the cash flow. Outstanding payables totalling R392 million exceeded the cash available of R270 million to pay them. Outstanding creditors further represented one third of the next year's budgeted resources, which would now be used to pay those creditors instead of funding the next year's service delivery priorities. The municipality took 163 days to pay their creditors. This alarming situation will only further hinder any progress the municipality plans to make, encourage undesirable decisions and drive the municipality into a state of chaos that will ultimately affect service delivery, resulting in community unrest.

KING SABATA DALINDYEBO found it difficult to collect money owed to them for services supplied to residents mainly in the form of electricity and refuse removal. The amounts owed by residents and businesses amounted to R672 million, of which 87% is not likely to be collected due to poor debt-collection practices. This made it difficult for the municipality to pay their own bills. The municipality incurred a loss of R16 million during the financial year. The salary bill of R457 million was more than the equitable share received of R292 million. The municipality did not have enough cash available (R22 million) to pay their creditors of R387 million, with Eskom making up R164 million of this amount. It took the municipality on average 223 days to pay their creditors, and the interest charged on amounts owed (R13 million) was categorised as fruitless and wasteful expenditure. As a result, the municipality disclosed an uncertainty regarding their ability to continue to fund existing levels of operation.

AUDITS SIGNED AFTER 31 JANUARY 2020

NELSON MANDELA BAY METRO

The metro is not included in the above summary as the audit report was delayed. The team was withdrawn from the audit due to a security risk and the metro was also one of the phased-in audits for implementation of the Public Audit Act amendments.

The metro received a qualified audit opinion for the third consecutive year. There was prolonged instability at council as well as administration level. The well-publicised instability and in-fighting in the municipal council caused numerous council meetings not to quorate or convene. This resulted in a lack of oversight and consequently the council did not investigate irregular expenditure, which continued to accumulate year on year with no one being held accountable. The city manager was suspended in September 2018 and the council had failed to resolve the situation as at year-end. Numerous executive and acting executive directors filled this position during the year – some only for a couple of days. The chief financial officer position remained vacant for the second successive financial year. Due to this leadership vacuum, proper financial disciplines were not in place, with the result that the metro was unable to account for items in the financial statements such as infrastructure assets, revenue and creditors.

In addition, recommendations from the external auditors, internal auditors and audit committee were not implemented. This resulted in a lack of proper processes and preventative controls which would have ensured accurate financial and performance reporting. Instead there was continued reliance on the external audit process to identify misstatements, which were then used as a basis to make multiple adjustments to the financial statements.

CONCLUDING REMARKS

The key messages included in this report highlight the deteriorating state of affairs in local government in the province and the impact of accountability failures at municipalities. The Eastern Cape has an economy that is hampered by poverty. Added to this is the fact that the national government is cutting down on spending. This means that municipalities have limited resources with which to carry out their legislated functions. Leadership and senior management need to own the business of local government and be accountable for their actions and those of their subordinates. They need to conduct themselves with impeccable standards of transparency in all activities undertaken to manage the scarce resources and deliver on their mandate. This demands that leadership fill key vacancies to create stability, address poor financial and performance management, and create a culture of zero tolerance for transgressions and non-compliance with legislation. Furthermore, audit action plans should not remain paper documents, but rather provide a road map to address the root causes and prevent the situation from spiralling further downwards.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Senqu	LM		2 013 857	-	2 013 857	28 710 404	7%	2
2	Alfred Nzo District	DM		8 564 750	-	8 564 750	Data not readily available		1
3	Joe Gqabi District	DM		5 900 000	-	5 900 000	Data not readily available		2
4	Elundini	LM		1 776 718	-	1 776 718	10 167 292	17%	2
5	Emalahleni	LM		3 362 107	-	3 362 107	27 069 951	12%	1
6	Engcobo	LM		1 989 681	-	1 989 681	12 200 000	16%	1
7	Inxuba Yethemba	LM		2 698 325	-	2 698 325	19 102 512	14%	1
8	Matatiele	LM		5 077 059	-	5 077 059	Data not readily available		2
9	Mbhashe	LM		4 130 999	-	4 130 999	7 723 547	53%	2
10	Ntabankulu	LM		1 598 683	-	1 598 683	8 154 685	20%	1
11	Nyandeni	LM		5 616 730	-	5 616 730	18 017 417	31%	1
12	Buffalo City Metro	MET		12 385 766	-	12 385 766	Data not readily available		2
13	Amahlati	LM		2 411 552	-	2 411 552	20 421 293	12%	3
14	Intsika Yethu	LM		218 200	-	218 200	11 427 619	2%	3
15	King Sabata Dalindyebo	LM		2 526 619	-	2 526 619	46 431 146	5%	1
16	Mhlontlo	LM		1 185 629	-	1 185 629	11 368 402	10%	1
17	Mnquma	LM		2 763 948	-	2 763 948	Data not readily available		1
18	Ndlambe	LM		1 794 552	-	1 794 552	14 126 413	13%	2
19	Ngqushwa	LM		2 100 482	-	2 100 482	10 835 843	19%	1
20	Port St. Johns	LM		3 113 107	-	3 113 107	5 027 860	62%	1
21	Raymond Mhlaba	LM		3 746 502	-	3 746 502	13 718 498	27%	1
22	Sakhisizwe	LM		1 099 023	-	1 099 023	12 640 782	9%	1
23	Umzimvubu	LM		147 775	-	147 775	7 225 445	2%	2
24	Amathole District	DM		27 560 352	-	27 560 352	96 082 719	29%	1
25	Chris Hani District	DM		2 481 689	-	2 481 689	40 962 889	6%	1

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM** = district municipality **LM** = local municipality

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
26	Dr Beyers Naudé	LM		897 414	-	897 414	21 057 959	4%	1
27	Great Kei	LM		636 200	-	636 200	Data not readily available		1
28	Ingquza Hill	LM		2 000 000	-	2 000 000	Data not readily available		1
29	Makana	LM		1 686 142	-	1 686 142	7 676 420	22%	1
30	Sundays River Valley	LM		675 793	-	675 793	Data not readily available		2
31	Walter Sisulu	LM		3 745 978	-	3 745 978	9 470 880	40%	2
32	Enoch Mgijima	LM		1 837 095	-	1 837 095	21 235 812	9%	2
TOTAL				**117 742 726**	-	**117 742 726**	**480 855 789**	**24%**	**47**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

2.3 FREE STATE

AUDIT OUTCOMES

LEJWELEPUTSWA

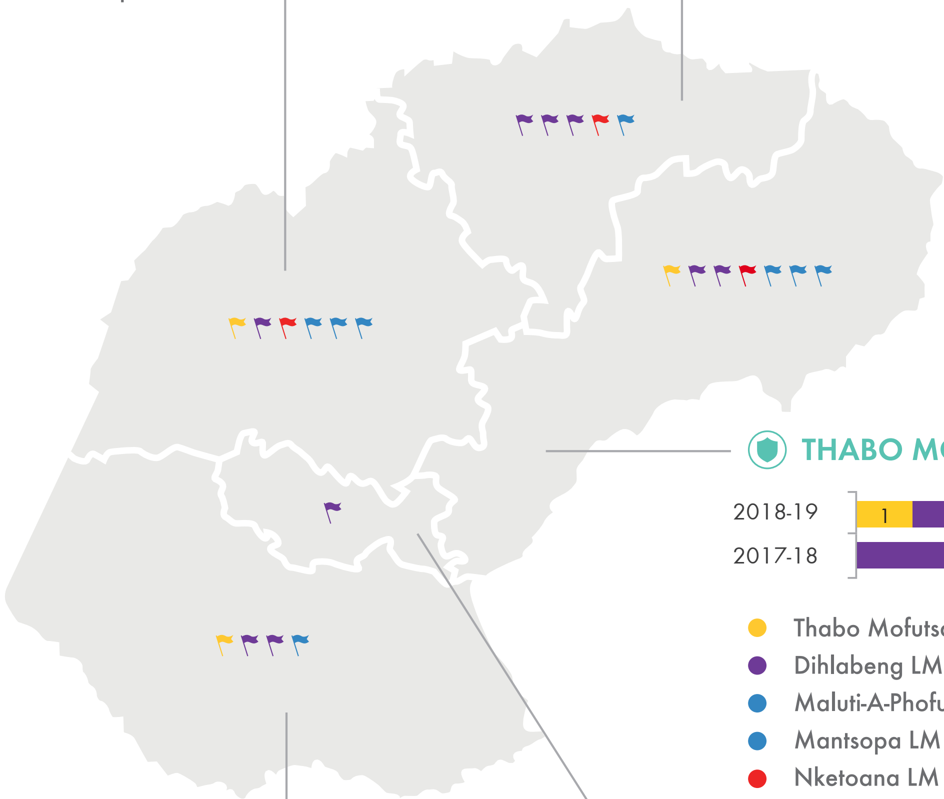
	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19	1	1	1	3
2017-18	1	3	1	1

- Lejweleputswa DM
- Masilonyana LM
- Matjhabeng LM
- Nala LM
- Tokologo LM
- Tswelopele LM

FEZILE DABI

	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19		3	1	1
2017-18	1	2	2	

- Fezile Dabi DM
- Mafube LM
- Metsimaholo LM
- Moqhaka LM
- Ngwathe LM



THABO MOFUTSANYANA

	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19	1	2	1	3
2017-18		6		1

- Thabo Mofutsanyana DM
- Dihlabeng LM
- Maluti-A-Phofung LM
- Mantsopa LM
- Nketoana LM
- Phumelela LM
- Setsoto LM

XHARIEP

	Unqualified with findings	Qualified with findings	Outstanding audits
2018-19	1	2	1
2017-18	1	3	

- Xhariep DM
- Kopanong LM
- Letsemeng LM
- Mohokare LM

MANGAUNG METRO

	Qualified with findings
2018-19	1
2017-18	1

Metropolitan municipality | District | **DM** District municipality | **LM** Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PERFORMANCE SNAPSHOT

The Free State local government consists of 23 municipalities. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, the audits of eight municipalities were outstanding.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

4 Regressed

2 Improved

Clean audits

0%

(2017-18: 0%)

Financially unqualified financial statements

20%

(2017-18: 20%)

0% (0)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

0%

(2017-18: 0%)

Irregular expenditure

R1,4 bn

(2017-18: R618,4 m)

Outstanding audits or audits subsequently finalised

R341,6 m

(2017-18: R432,8 m)

No findings on performance reports

13%

(2017-18: 7%)

29% (4)

Reported achievement reliable (excluding Letsemeng that submitted annual performance report without underlying planning documents)

FINANCIAL HEALTH

Deficit*

(expenditure exceeded revenue)

2018-19	58% (7)
2017-18	54% (7)

Creditor-payment period > 30 days*

2018-19	92% (11)
2017-18	92% (12)

Vulnerable financial position

2018-19	80% (12)
2017-18	87% (13)

* *Excluding three municipalities with disclaimed opinions*

Other financial health concerns

- Current liabilities exceeded current assets by R2,1 billion (2017-18: R1,7 billion)
- Eskom and water boards were owed R3,1 billion (2017-18: R2,5 billion)

Deliberate lack of accountability by political and administrative leadership

The overall audit outcomes continued to regress and the province did not achieve any clean audits for the third consecutive year. Two municipalities (Thabo Mofutsanyana District and Ngwathe) improved, while four (Fezile Dabi District, Moqhaka, Nala and Nketoana) regressed. These outcomes were characterised by a lack of discipline to implement the basic accounting principles of promptly processing and reconciling transactions, proper record keeping and regular reviews of work done by management. Another reason for the lack of improvement in these audit outcomes was the unwillingness to comply with legislation, specifically relating to supply chain management. In the previous year we reported a total breakdown in internal controls, as the political and administrative leaders did not exhibit any response to improve their accountability for financial and performance management. This was indicative of a deliberate lack of accountability by political and administrative leadership as the trend continued in the year under review, resulting in a further regression of the local government audit outcomes.

The efforts to eliminate disclaimed opinions in the province are commendable, but three of the auditees which regressed this year, regressed to disclaimed opinions (Fezile Dabi District, Nala and Nketoana), while nine municipalities (Dihlabeng, Letsemeng, Metsimaholo, Mohokare, Moqhaka, Ngwathe, Setsoto, Tswelopele and Mangaung Metro) received qualified opinions. The majority of the municipalities in all the districts received a qualified audit opinion as they were still struggling with the implementation of the basics for financial reporting and could not prevent findings on compliance and performance management.

Ten municipalities did not submit their financial statements on time due to an endemic culture of no accountability and a lack of the correct tone at the top that would ensure consequences for poor performance. As at the cut-off date of this report, eight audits were still outstanding and are therefore not included in this analysis. We anticipate that the outcomes of these auditees will not change the overall picture due to their record of undesirable financial management disciplines. Maluti-A-Phofung and Masilonyana have not submitted financial statements for two consecutive years without any action being taken, which is a testimony to the entrenched culture of a lack of accountability. Maluti-A-Phofung Water, excluded from the analysis in this report, has also not submitted financial statements for two consecutive years.

The Free State audit outcomes were mainly characterised by auditees' lack of the preventative controls needed to strengthen accountability and that would lead to desirable audit outcomes. There was no district that stood out as a good example, with the worst-performing district being Fezile Dabi, with three qualified opinions, one disclaimed opinion and one outstanding audit. The following summary illustrates instances of a dysfunctional control environment which requires leadership to immediately stop these practices and start implementing good practices that will improve provincial outcomes. We then also highlight the positive outcomes when a good tone is set at the top.

IMPORTANCE OF MANAGEMENT SETTING A TONE AT THE TOP THAT PROMOTES A CULTURE OF ACCOUNTABILITY AND GOOD ADMINISTRATION TO CREATE A SUSTAINABLE AND EFFECTIVE INTERNAL CONTROL ENVIRONMENT

WHAT HAPPENS WHEN A GOOD TONE IS NOT SET AT THE TOP?

METSIMAHOLO, situated in Sasolburg in the Fezile Dabi district, had a coalition council comprised of various political parties, which made the functioning of the council and decision-making difficult. Due to continual disruptions and/or the council not forming a quorum, council meetings had to be postponed, which delayed the critical decisions necessary to enable the effective functioning of the administration. One of the key decisions the council failed to implement, since the by-elections in November 2017, was the appointment of senior managers reporting to the municipal manager, which resulted in vacancies in all senior manager positions. Consequently, various lower-level managers were appointed to act for short periods, averaging three months per acting period. The lack of institutionalised internal controls, coupled with challenges in the council that filtered through to the staff, further weakened all areas in the internal control environment, especially assets, revenue and supply chain management. This contributed to the qualifications on assets and revenue and also had an impact on irregular expenditure. In addition, we raised material findings on performance information due to a lack of supporting documentation. These challenges were worsened by the municipal manager's suspension (with full benefits) in May 2018.

One of the key audit concerns was the various individuals on the municipality's indigent register who did not qualify for indigent status. This included officials working for government and individuals doing business with government. Additionally, more than 2 600 deceased individuals were still included on the indigent register, with the result that the municipality did not bill the current occupants and lost revenue that could have been directed to service delivery. We reported some of these findings in prior years and the municipality's leadership did not take any action to address them.

Another concern emanated from the previous year when the municipality spent R21,7 million from the municipal infrastructure grant, which was intended for the construction of a recreational facility for the community (the Oranjeville Sports Complex). For the amount spent, only a fence was visible during our site visit. During the year under review, an investigation was conducted by the municipal public accounts committee and they recommended that the expenditure of R21,7 million be disclosed in the financial statements as fruitless and wasteful expenditure, which was done. No further action was taken to recover the taxpayers' money from the responsible officials, illustrating the lack of accountability in the municipality's environment.

The escalation of the challenges above, a number of protest actions by residents and the lack of maintenance of infrastructure resulted in a dysfunctional municipality that, after year-end, was placed under administration by the provincial leadership.

At **DIHLABENG**, situated in Bethlehem in the Thabo Mofutsanyana district, management failed to implement preventative controls through proactively monitoring the work performed by contractors. As a result, they were dependent on the interim payment certificates and progress reports prepared by the consulting engineers for the municipality to release payments for the various stages of projects. The discipline of preventative controls for project management was lacking, even though the position of head of technical services was filled by an incumbent with the relevant skills and competencies and all the positions in the project management unit were filled at a salary cost of approximately R1,8 million.

The lack of monitoring was also observed in a contract that management entered into in 2018, by participating in a contract that had been entered into by another municipality, for the construction of a tarred road. The road would be built over a period of three months, from 25 May 2018 to 25 August 2018. However, the construction was only completed on 15 February 2019, almost six months after the planned date of completion. The project's contract value was R13,8 million but the municipality spent R15,3 million – R1,5 million more than the initial contract value. When management inspected the road immediately after completion, they identified cracks and patches, as well as the absence of stormwater channels in critical sections. This led to the recording of an impairment of R3,5 million in the financial statements. Despite having a fully resourced project management unit that should have monitored the projects, the municipality relied on consulting engineers to certify the work done. No consequences had been implemented against the contractor or the official who allowed the project to be completed with poor-quality workmanship at a cost higher than the contract value.

For another project that started in 2014, the municipality appointed a contractor for the construction of the Clarens Water Treatment Works for R16,7 million even though they only received municipal infrastructure grant funding of R9,5 million. The municipality did not budget for the shortfall of R7,2 million and, after paying the contractor R9,5 million for work certified by the consulting engineers, they cancelled the contract citing the lack of funds as the reason. This prompted the contractor to sue the municipality for the loss of income. The outcome of the court proceedings had not been reached by the conclusion of our audit. The municipality had recorded the amount paid as work-in-progress in their financial statements. However, when we visited the site we found that no work had been done. We then identified that R3 million had been paid for the project's designs and R6,5 million had been used by the contractor to purchase the material for the project, but this was stored at his own premises.

MOQHAKA, situated in Kroonstad in the Fezile Dabi district, did not adequately budget for the construction, upgrade and regular maintenance of their infrastructure as a preventative measure to safeguard against its collapse. The municipality did not prioritise repairs and maintenance as they only spent R32,5 million (2%) of the infrastructure asset base of R2 billion. This was contrary to MFMA Circular 71, which recommends that municipalities spend 8% of their infrastructure asset base to ensure adequate preventative maintenance of infrastructure assets. This would avoid unnecessary breakdowns and interruptions of service delivery. The lack of planning for repairs and maintenance, worsened by the vandalism and theft of infrastructure at the Kroonstad Wastewater Treatment Works, resulted in the collapse of the newly activated sludge plant, flooding the old biological plant with raw sewage. This sewage was pumped into the Vals River (the town's main source of drinking water) creating a health risk to the community. The spillage of sewage above the drinking water extraction point resulted in unnecessarily high purification costs for the municipality. Additionally, the municipality lacked skilled and experienced personnel to ensure the wastewater plant's continual maintenance and repairs. Due to the lack of preventative controls, the municipality spent a lot of money to remove the sewage from the river, which could have been avoided. No action was taken by the council against the officials responsible for these municipal failures.

WHAT HAPPENS WHEN A GOOD TONE IS SET AT THE TOP?

THABO MOFUTSANYANA DISTRICT, situated in Phuthaditjhaba, is a good example of the municipal manager setting the right tone to institutionalise preventative controls. The municipal manager monitored the audit action plans and enforced the principle of ensuring that the supporting evidence was obtained and attached prior to payment being made. The discipline for a culture of clean administration was demonstrated through the involvement of the municipal manager and senior managers during the audit, which resulted in their audit outcome improving from qualified to unqualified with findings. The municipality further strengthened their control environment for the collation of documentation in support of the reported performance information. In the previous year supporting information could not be provided for four indicators. However, in the current year material findings reported were only in respect of one indicator due to the unavailability of supporting information. The other area that needs attention and which management has acknowledged, is supply chain management. We commend the municipality for preparing their own financial statements, which required limited audit adjustments. Some of the good practices identified at the municipality, which supported the sustainability of the internal control environment, include:

- Stability in key leadership positions, including the position of the mayor and the municipal manager.
- A finance team that was adequately capacitated and understood their roles and responsibilities.
- Monthly management meetings where each directorate presented reports on their progress, including the implementation of internal controls. These reports were further presented at the monthly mayoral committee meetings.
- Institutionalisation of internal control disciplines such as regular maintenance of the asset register, bank reconciliations, and grant reconciliations.
- A functional municipal public accounts committee, which met four times. The committee thoroughly investigated prior year irregular expenditure and only recommended items to the council for write-off if the municipality had received value for money. Where they determined that value was not received, the recommendations were for the recovery of the municipal funds.

- Receptiveness to the support provided by the provincial government to improve the internal control environment.
- Receptiveness to the status of records review initiative. During the status of records review, the municipality was behind in addressing the prior year qualifications, which were highlighted to municipal management as an early warning sign. However, during the follow-up engagement, all the prior year qualification matters had been addressed, which resulted in an improvement of the audit outcome.

Another example of the importance of a good tone at the top was demonstrated at **NGWATHE**, situated in Parys in the Fezile Dabi district. The chief financial officer and municipal manager made a concerted effort to ensure that the supporting documentation for significant limitations that were the basis for the disclaimed audit opinion in the previous year, was made available – thus contributing to an improved audit outcome. The municipal manager worked with the chief financial officer to significantly reduce interest payable to Eskom by making, and honouring, a payment arrangement with them. Some of the good practices identified at the municipality, which supported the sustainability of the internal control environment, include:

- The chief financial officer reviewed the consultants' work to ensure its quality, as per their terms of reference. He also facilitated communication between the auditors and the consultants during the audit.
- The municipal manager, setting the right tone at the top as the leader of the institution, instructed all the directors to attend all audit steering committee meetings and to provide valid reasons for any non-attendance. The municipal manager also created a culture of zero tolerance for poor performance, with the result that some officials, especially those from the sections that had material findings in the audit report, resigned.
- The actions of the mayor and the municipal public accounts committee have always demonstrated their willingness for clean administration, shown by their continual requests for regular meetings with us to source guidance on how to implement proper controls to improve the audit outcomes.

STAGNATION AT MANGAUNG METRO

Although the metro was better positioned to attract skilled resources, it was struggling with basic financial and performance management processes. There was also a lack of responsiveness to implement and monitor the audit action plans to enable the implementation of effective accountability.

The metro's audit outcome stagnated on a qualified opinion for the third consecutive year. These outcomes were due to oversight not fulfilling their duties of holding the administration accountable. The municipal manager failed to exercise his authority to hold senior managers accountable for poor performance. The metro received a qualified opinion in the areas of accrued leave pay, employee benefit obligation, revenue from traffic fines and irregular expenditure. The basis for qualification was a lack of preventative controls as similar qualification areas recurred from the previous year. There had been a level of instability in the finance unit since the resignation of the chief financial officer in 2018. This resulted in the metro relying heavily on an individual that had been appointed on a temporary fixed-term contract for all matters related to the financial statements.

The practice of over-reliance on individuals was common in the metro and was evident in the areas of asset management, revenue management and supply chain management. The risk of such over-reliance is illustrated by the relied-upon person in the supply chain management unit being transferred, resulting in increased instances of material non-compliance with procurement legislation included in the audit report, as well as the magnitude of irregular expenditure. The over-reliance on certain individuals was a high risk for the metro as it disabled the basic principle of segregation of duties. It also hampered the institutionalisation of preventative internal controls, thus not ensuring the sustainability of the institution in the event of relied-upon officials resigning or being promoted.

Since 2016, the metro's financial position had deteriorated to such an extent that unspent conditional grants, namely the urban settlements development grant, the municipal disaster recovery grant and the public transport network grant, were utilised to fund operational activities. This had a negative impact on infrastructure development. The continued lapses in financial management resulted in suppliers not being paid within 30 days. In particular, the long-outstanding amounts owed to the water board prompted regular interruptions of the water supply, which was an infringement of citizens' basic human needs. In addition, water losses of R186,7 million (31%) were suffered mainly due to technical losses; burst water pipes and leaks indicating dilapidated infrastructure and a lack of maintenance; as well as faulty meters and unmetered sites. The metro had repeatedly recorded significant debt impairments due to the lack of collection of consumers' outstanding accounts, which put strain on honouring commitments and paying employees' salaries.

Leadership's lack of accountability for sound financial management had a negative impact on the metro's financial sustainability and resulted in overspending of the budget. The metro reported unauthorised expenditure of R1,4 billion due to overspending on salary cost, overtime, the unbudgeted settlement agreement with the water board and the under-budgeting of non-cash items.

The metro's internal audit unit was relatively effective. They issued relevant reports, which were approved by the audit committee. However, management failed to implement any of those resolutions. As a result, we raised similar findings to those raised by the internal auditors in our audit report, including those relating to predetermined objectives and compliance with legislation. The lack of implementation of the internal audit recommendations was an indication of the disregard for clean administration, despite the costs paid by the metro to maintain the internal audit unit as well as the audit committee.

Despite the training and awareness sessions conducted by the South African Local Government Association, treasuries and ourselves for municipal public accounts committee members, they still struggled to understand and/or fully discharge their responsibilities. Due to the lack of knowledge and understanding of their role, no tangible work was performed by the committee, which was sometimes caused by limited reports submitted to the council sittings. This lack of action by the committee resulted in the accumulation of unauthorised expenditure of R2,3 billion, irregular expenditure of R949,5 million and fruitless and wasteful expenditure of R78,7 million, without any individual being held accountable for the transgressions.

These conditions, together with downgrades by rating agencies, led to the provincial leadership placing the metro under administration after year-end.

DISTRICT MUNICIPALITIES NOT SUPPORTING LOCAL MUNICIPALITIES

Three of the four district municipalities in the province received unqualified audit opinions with findings; except for Fezile Dabi, which regressed from a qualified opinion to a disclaimed opinion. The support provided by districts to local municipalities or entities in their respective districts mainly related to tourism, farmer support, disaster management as well as health and environmental matters. District municipalities did not have the capacity and resources to provide technical, administrative or financial support that could improve accountability and controls as well as service delivery at local municipalities. They also did not transfer any good practices regarding financial and performance management to local municipalities, deal with performance reporting, or monitor compliance with legislation.

HUGE COSTS OF CONSULTANTS WITHOUT TANGIBLE VALUE

All municipal manager positions were filled during the year and only three municipalities had vacancies at chief financial officer level. All appointed municipal managers and chief financial officers met the minimum qualification and competency requirements. The actual salary cost of staff in the finance units of all these municipalities amounted to R340,7 million. Despite this, it remained a concern that a significant amount was spent on consultants as municipalities continued to appoint consultants for financial reporting at a cost of R29,2 million (2017-18: R45,2 million). A further R17,5 million was spent by the municipalities of which the audits had not been finalised by the cut-off date of this report. Notwithstanding the investment in consultants, no positive impact could be seen in the quality of the financial statements and performance reports submitted for auditing.

The audit opinion of **LETSEMENG**, situated in Koffiefontein in the Xhariep district, had stagnated for a number of years with most issues recurrent in nature despite the fact that they had a municipal manager and a chief financial officer. The municipality had a capacitated finance unit with a vacancy rate of only 11% at a salary cost of approximately R10,9 million. However, there was an over-reliance on consultants in the past, and for the year under review consultants were appointed at a cost of R2,1 million. The chief financial officer relied on the consultants instead of municipal staff to assist with the preparation of the financial statements and responses to audit findings, even on non-technical matters. The consultants were appointed to review and update all the registers and reconciliations necessary for the compilation of the financial statements. Where such registers and reconciliations did not exist, the consultants were required to compile them. This, coupled with the poor control environment at the municipality, was an indication that the municipality did not invest in any preventative controls and expected the consultants to perform miracles at year-end. The staff responsible for the municipality's day-to-day activities could not provide basic information without the consultants' help and there was no transfer of skills or a plan to upskill the staff to reduce the reliance on the consultants. Despite the use of consultants, the municipality received a qualified audit opinion, which included qualifications in the same areas as in the previous year, for which the consultants were responsible.

At **FEZILE DABI DISTRICT**, situated in Sasolburg, the financial statements were prepared by two different consulting firms. The first consultants were paid R0,3 million to prepare the financial statements – these financial statements were not submitted for auditing on 31 August 2019. The municipal manager cited the poor quality as the reason. However, no action was taken by the municipality to ask the consultants to re-perform the work or recover the funds paid to them. The second consultants were then appointed and paid R1,6 million for the preparation of a completely new set of financial statements. This set did not agree to the financial records and was not supported by the required documents, resulting in the municipality receiving a disclaimed audit opinion. Based on our findings on the financial statements, it is clear that the second firm of consultants did not apply due care when preparing them. They also did not get the support they needed from the municipal staff, as staff members were questioning the consultants' appointment. The invoices received from the consultants stipulated that they performed reconciliations, although the municipality had a fully capacitated finance unit to perform those daily disciplines. No action was taken against the officials for poor performance. Moreover, no action was taken against the second consultants for the poor delivery that resulted in the regression of the audit outcome.

Spending on consultants did not make an impact at **DIHLABENG** and **SETSOTO** in the Thabo Mofutsanyana district, where the consultants were contracted to address the shortcomings in the asset registers that had resulted in qualifications in the previous year. During the adjustments made to the fixed asset registers, the consultants incorrectly proposed the write-off or impairment of assets that were still in use of R124 million at Dihlabeng and R549 million at Setsoto. The errors in the proposed adjustments were because management delegated the responsibility of correcting the fixed asset registers entirely to consultants who did not have a proper understanding of the municipality's environment, with the result that consultants omitted certain assets when compiling the new asset registers. Management did not timeously review the work done by the consultants either, in order to prevent these errors. The errors made by the consultants resulted in both municipalities being qualified on property, infrastructure and equipment.

AUDIT COMMITTEES AND INTERNAL AUDIT UNITS NOT PROVIDING THE REQUIRED ASSURANCE

Dysfunctional internal audit units and audit committees and the disregard of their contributions as a management resource to enable the development and implementation of preventative controls

The primary purpose of the audit committee is to provide oversight of the financial reporting process, internal controls and compliance with legislation. They also oversee the internal audit processes. None of the audit committees in the Free State fully achieved this purpose. About 34% of audit committee members were senior government officials, many of whom were working in municipalities. At times, this made it difficult to schedule audit committee meetings because of the competing priorities between the demands of the audit committee and the members' responsibilities in their full-time jobs, especially the members that were also working for local government due to the same period of reporting. This resulted in the audit committees not adequately executing their functions as they did not meet regularly and did not report to councils. Overall, audit committees did not have a positive impact on the audit outcomes and did not hold management accountable.

Most of the internal audit units, as a layer of assisting management with checks and balances, did not have the desired impact on the audit outcomes, even though auditees spent R28,5 million on internal audit salaries. This was mainly because management did not address their findings and/or implement their recommendations, their work was not adequate, or they were not effective.

FEZILE DABI DISTRICT's audit committee included government officials who also served on other audit committees in the province. This committee provided little support to the council as they only met twice because these officials' schedules caused challenges in arranging meetings. Additionally, the audit committee did not adequately review, monitor and direct internal audit activities and this contributed to the weak internal controls and poor quality of financial and performance reports.

METSIMAHOLO's internal audit unit performed an audit on predetermined objectives; the completeness of irregular expenditure; supply chain management compliance; and property, plant and equipment. Their audit highlighted many instances of control weaknesses that were not corrected by management. For example, one report identified instances where supply chain management processes were not followed when procuring goods and services. The internal audit unit recommended that when the acting municipal manager approved deviations, the reasons provided for deviating from supply chain management prescripts should be justifiable and they should be recorded in the deviation register. However, management did not implement these recommendations. The internal audit unit's salary cost was R2 million and the municipality did not receive any benefit due to management not implementing their recommendations. Had the municipality implemented the recommendations made by this unit, there might have been improved internal controls and they could have avoided instances of irregular expenditure caused by deviations that were not approved or properly motivated.

Although the internal audit unit of **TSWELOPELE**, situated in Bultfontein in the Lejweleputswa district, was not adequately staffed (with only one acting internal audit supervisor and one internal auditor), they managed to produce close to 30 internal audit reports. These related to, amongst others, follow-up audits, supply chain management as well as asset management. The internal auditors indicated that the control environment was not effective in ensuring that the municipality maintained an efficient, fair, equitable, transparent, competitive and cost-effective supply chain process when sourcing and procuring goods and services. They also recommended that the municipal public accounts committee appropriately investigate unauthorised, irregular, and fruitless and wasteful expenditure. Despite this, there were still high levels of irregular expenditure reported but not properly investigated.

With regard to assets, the internal auditors recommended to management that the asset register be updated regularly and that monthly asset verifications be performed as they could not physically verify some assets and could not trace others in the asset register. Despite this warning, management did not implement the recommendations, resulting in the qualification of property, infrastructure and equipment in the audit report. Had the municipality addressed the recommendations made by this unit, they could have avoided the qualification and reduced their irregular expenditure.

At **NALA**, situated in Bothaville in the Lejweleputswa district, the internal audit unit was dysfunctional, as they had not produced any reports for the past five years, despite having a salary cost of R0,8 million per year. This was because the head of internal audit did not have the relevant qualifications and skills. The municipality had an established audit committee, but for the past three years, there had been no meetings due to the lack of coordination from the internal auditors. The municipality's annual report did not contain the audit committee's report and the council had not taken any steps to ensure that it was included. The municipality's internal control environment deteriorated over time, with an increase in the number of audit findings and the audit outcome of the municipality regressing from a qualified opinion to a disclaimed opinion.

FAILED INTERVENTION BY PROVINCIAL GOVERNMENT

The action by provincial government to place Maluti-A-Phofung, Mafube and Masilonyana under administration in terms of section 139 of the Constitution did not yield any results. These municipalities had not submitted all outstanding financial statements at the time of this report and received disclaimed audit opinions on the last submitted financial statements, all while service delivery and the reporting thereon did not improve. Administrators had not developed and implemented sustainable systems and preventative controls. Where section 139 had been instituted, administrators were not able to work effectively with municipal officials nor the council due to the respective parties not having clearly defined roles and responsibilities. This intervention was also implemented at Mangaung Metro and Metsimaholo after year-end. Metsimaholo had been under administration before when the council was dissolved due to their failure to approve the budget, which led to by-elections. A new council was elected and the municipality stabilised. However, this was not sustainable as the municipality was placed under administration again.

At **MALUTI-A-PHOFUNG** (which is excluded from the rest of the analysis as they have not submitted financial statements), situated in Phuthaditjhaba in the Thabo Mofutsanyana district, significant political instability resulted in the resignation of some councillors. This, amongst other challenges experienced by the municipality, resulted in the council not having enough members to form a quorum. Therefore, they were unable to make the key decisions and provide the leadership and oversight required for the delivery of municipal services to the local community in a financially and environmentally sustainable manner. As a result, there were a number of service delivery protests for electricity and water services due to their disrupted supply. Residents in Phuthaditjhaba did not have access to running water and relied on water tanks for daily use. Furthermore, the municipality's assets were attached by some creditors, which intensified the challenges faced by the municipality. The municipal employees had to be paid, even though they could not work, as the tools of trade necessary to fulfil their job responsibilities were not available for a prolonged period. Due to the escalation of all the challenges that resulted in the municipality's inability to provide services to residents, including the protest actions, the provincial leadership placed the municipality under administration. However, while the municipality was under the administration of provincial government, they were still unable to provide services to the community. This resulted in the responsibility for the municipality's administration being taken over by the national government.

The municipality's last audited set of financial statements, which received a disclaimed opinion, was in 2016-17. The council did not prioritise the preparation and submission of the financial statements for audit purposes and no official was held accountable for such a significant failure to account for public spending. The municipality also did not implement controls for supply chain management, resulting in significant irregular expenditure, especially the expenditure related to water distribution by using water tanks. The financial statements for 2017-18 were only submitted for auditing on 6 February 2020.

WHAT DO THE FINANCIAL STATEMENTS SAY?

The financial statements submitted for auditing reflected the dire state and poor financial management of the municipalities in the province. Municipalities will not be able to continue providing basic services as their financial health has consistently deteriorated over the last five years. Current liabilities exceeded current assets by R2,1 billion (2017-18: R1,7 billion) at the 11 local municipalities where the audit was completed (including the metro and excluding the district municipalities). Poor financial discipline at Free State municipalities also has a significant impact on the country as a whole, as they did not prioritise payments for electricity and water purchased from Eskom and water boards, who were collectively owed R3,1 billion (2017-18: R2,5 billion).

Total expenditure (current and capital) exceeded total revenue (consisting of revenue from services rendered and grants received from government) by R2 billion (2017-18: R2,2 billion). If the total operational expenditure is compared to the cash collected from consumers, the shortfall was R7,6 billion (2017-18: R7,1 billion) due to the poor rate at which municipalities collected the debts for the services rendered. Deteriorating infrastructure due to a lack of maintenance, unmetered consumption, leakages and illegal connections resulted in municipalities incurring significant water and electricity losses of R404,1 million (2017-18: R457,1 million), as the number of units they were able to sell to consumers was significantly less than the number of units they had to buy from Eskom and water boards. These amounts exclude water and electricity losses at Ngwathe and Nketoana as they were not able to accurately determine the losses they had incurred. The following examples are not isolated instances, but rather reflect the overall situation in the province.

METSIMAHOLO significantly relied on government grants to fund service delivery as their salary bill (including councillor remuneration) of R306,1 million accounted for 48% of the cash they collected from consumers of R636,7 million. Significant pressure was placed on the municipality's financial health due to poor collection from consumers. This was evident in the time it took to collect money owed by consumers, which increased from 609 days in the previous year to 644 days in the current year. The municipality also did not follow up on consumers with long-outstanding amounts but, instead, provided for 87% of them as uncollectable – an increase from the 85% provided for in the previous year. The municipality only collected R636,7 million of the R2 billion (30%) in outstanding debt from consumers, most of which was from amounts billed in the current year. Poor cash flows continued to affect the municipality's ability to properly maintain their infrastructure to ensure consistent delivery of water, electricity and sanitation. These poor cash flows contributed to the shortfall on maintenance of assets of R46,1 million (2017-18: R44,3 million). Without the proper maintenance of infrastructure assets, the municipality will continue to suffer significant water and electricity losses – as was the case in the past two years, when it increased from R32 million to R40,7 million.

NGWATHE was mostly reliant on government grants to fund service delivery as 95% of the cash collected from their consumers was used to pay the salaries of employees and councillors of R234,4 million. With most of their own revenue being used for salaries, they were not able to prioritise the maintenance of assets to ensure the consistent provision of services such as running water and electricity. The continued shortfall for maintenance of assets of R26,5 million (2017-18: R32,4 million) may have contributed to the water and electricity losses suffered. However, the municipality had not put controls in place to measure the water and electricity losses they suffered, thus not being able to identify possible areas where losses could be minimised and revenue maximised to improve their financial health.

Additionally, the municipality did not effectively spend some of the conditional grants received as they had underspent their regional bulk infrastructure grant by R28,8 million (87%), due to delays in community engagement relating to projects to be funded by this grant. The municipality also underspent on the water services infrastructure grant by R7,5 million (37%), due to delays in the completion of feasibility studies for projects. The municipality struggled to pay their creditors timeously because of financial difficulties caused by the poor collection of amounts owed by consumers as well as poor financial management. It took more than three years for creditors to receive payment for services they had rendered. The municipality collected only R245,7 million of the R1,1 billion (22%) in outstanding debt from consumers, which had a negative impact on their ability to provide services.

The municipality's actual deficit exceeded the budgeted deficit by R178,1 million, which was indicative of inaccurate budgeting and poor spending practices. The inaccurate budgeting practices continued from the previous year when the actual deficit exceeded the budgeted surplus by R218,6 million. Eskom was also owed R1,1 billion and the water board R108,6 million. Current liabilities exceeded current assets by R1,3 billion, confirming that the municipality did not have sufficient current assets to settle their liabilities as they fell due.

SETSOTO, situated in Ficksburg in the Thabo Mofutsanyana district, had a salary bill (including the remuneration of councillors) of R200,4 million, which exceeded their cash collected from consumers of R159 million by R41,4 million. As a result, the salary bill was not sustainable without government grants. While the time it took the municipality to collect amounts owed by consumers improved slightly from 645 days to 636 days, it still took them more than 20 times longer than the required 30 days. Added to this, the municipality's financial health continued to deteriorate as the R159 million collected only represented 25% of the R630,8 million collectable from consumers. With the salaries exceeding the revenue collected from consumers, the municipality could not prioritise the maintenance of assets. The municipality spent only R3,5 million on the maintenance of infrastructure assets, which is only 0,12% of its net book value of R3 billion, resulting in a maintenance shortfall of close to R240 million. After the metro, this was the biggest shortfall of any local municipality in the province. As a result, the municipality incurred extensive water (42%) and electricity (11%) losses of R24,3 million due to leakages, burst pipes, line losses, tampering and theft – mainly because of a lack of maintenance.

CONCLUDING REMARKS

The Constitution and the Municipal Finance Management Act prescribe what should be done to create an environment that promotes good governance and accountability. Furthermore, there are other provincial departments and institutions that should strengthen governance and improve capacity. The key officials that lead and manage local government meet the minimum competency requirements, and are conversant with the applicable legislation. Despite this, a culture was prevalent in local government where internal controls were ignored. Over time, local government leadership's actions created a deliberate obstruction to the functioning of municipalities, by not enforcing consequences for repeated wrongdoings.

Local government leaders did not respond to our messages and recommendations made year after year. These were meant to assist them in creating and maintaining an environment that promotes good administration and governance by focusing on preventative controls and consequences for unwarranted behaviour. It is no surprise that there were no clean audits in the Free State; unauthorised, irregular as well as fruitless and wasteful expenditure was high; investigations were seldom done; and projects that should have benefited citizens were delayed and led to increased costs.

To improve, leadership in local government should set the correct tone from the top by implementing and adhering to good governance practices as well as enforcing a culture of ethical behaviour to strengthen systems and processes, implement preventative controls and exercise consequence management. The levels of tolerance for non-compliance by leadership should be minimised and accountability should be enhanced.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Lejweleputswa District	DM		337 180	-	337 180	8 661 382	4%	1
2	Xhariep District	DM		2 165 332	-	2 165 332	6 890 867	31%	1
3	Dihlabeng	LM		1 836 251	-	1 836 251	23 554 215	8%	2
4	Letsemeng	LM		2 050 734	-	2 050 734	10 871 415	19%	1
5	Metsimaholo	LM		1 619 077	-	1 619 077	46 075 844	4%	2
6	Mohokare	LM		2 791 419	-	2 791 419	7 103 515	39%	1
7	Ngwathe	LM		3 420 219	-	3 420 219	39 630 894	9%	2
8	Setsoto	LM		1 375 242	-	1 375 242	6 962 309	20%	2
9	Tswelopele	LM		718 487	-	718 487	9 589 949	7%	2
10	Mangaung Metro	MET		2 899 741	-	2 899 741	108 106 022	3%	2
11	Fezile Dabi District	DM		1 912 104	-	1 912 104	6 388 293	30%	2
12	Nala	LM		373 159	-	373 159	17 418 300	2%	2
13	Nketoana	LM		7 654 038	-	7 654 038	11 053 111	69%	2
14	Kopanong	LM		2 015 577	-	2 015 577	Data not readily available		2
15	Mantsopa	LM		3 054 779	-	3 054 779	6 988 450	44%	1
16	Matjhabeng	LM		6 239 389	-	6 239 389	46 921 639	13%	2
17	Phumelela	LM		6 156 187	-	6 156 187	7 319 239	84%	1
TOTAL				**46 618 916**	**-**	**46 618 916**	**363 535 442**	**13%**	**28**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM** = district municipality **LM** = local municipality

NOTES

2.4 GAUTENG

AUDIT OUTCOMES * *

JOHANNESBURG

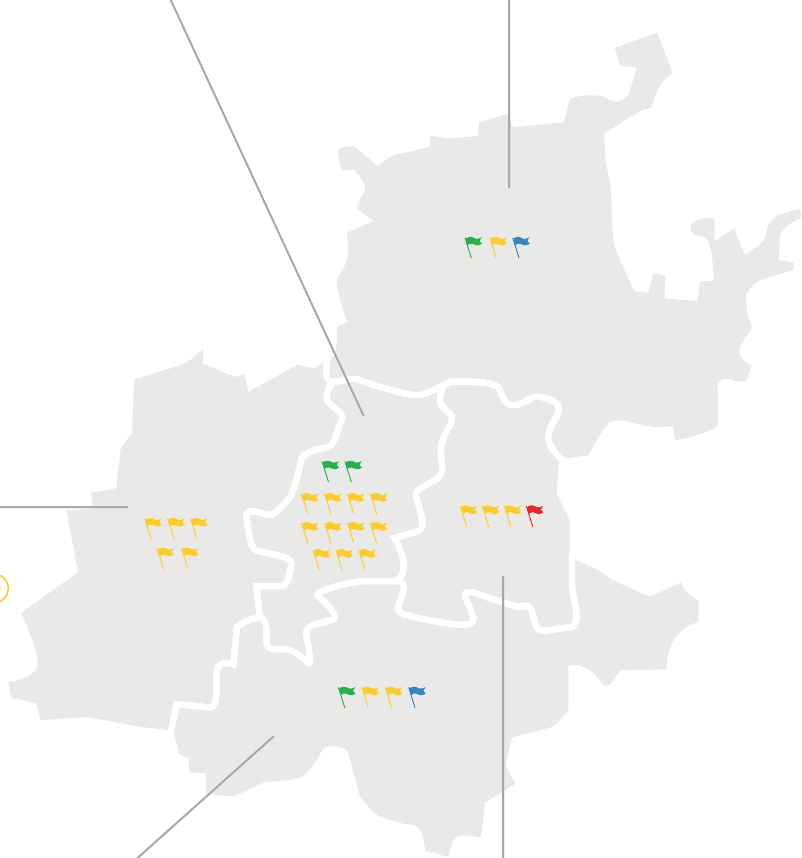
2018-19: 2 | 11 (Regressed)
2017-18: 4 | 9

- City of Johannesburg Metro
- City Power Johannesburg
- Joburg Market
- Joburg Property Company
- Joburg Theatre *
- Johannesburg City Parks
- Johannesburg Development Agency
- Johannesburg Metropolitan Bus Services
- Johannesburg Roads Agency
- Johannesburg Social Housing Company
- Johannesburg Water
- Metropolitan Trading Company
- Pikitup Johannesburg

TSHWANE

2018-19: 1 | 1 | 1 (Unchanged)
2017-18: 1 | 2

- City of Tshwane Metro
- Housing Company Tshwane *
- Tshwane Economic Development Agency *



WEST RAND

2018-19: 5 (Unchanged)
2017-18: 5

- West Rand DM
- Merafong City LM
- Mogale City LM
- Rand West LM
- West Rand Development Agency *

SEDIBENG

2018-19: 1 | 2 | 1 (Unchanged)
2017-18: 1 | 3

- Sedibeng DM
- Emfuleni LM
- Lesedi LM
- Midvaal LM

EKURHULENI

2018-19: 3 | 1 (Regressed)
2017-18: 4

- City of Ekurhuleni Metro
- Brakpan Bus Company
- East Rand Water Care Company
- Germiston Phase II Housing Company

* These represent small auditees that are excluded from this report

** The audit outcomes of municipal entities are included due to the significance thereof in the province

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PERFORMANCE SNAPSHOT

The Gauteng local government consists of 11 municipalities and 14 municipal entities. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, two audits (Emfuleni and City of Tshwane Metro) were outstanding. Although not included in the snapshot analysis, the City of Tshwane Metro is included in the narrative due to its significance in terms of size and budget.

MUNICIPALITIES

Overall audit outcomes

OVERALL SUSTAINMENT OF AUDIT OUTCOMES

0 Regressed
0 Improved

Clean audits	Financially unqualified financial statements	No findings on compliance with legislation	No findings on performance reports	Irregular expenditure
11%	100%	11%	11%	R1,7 bn*
(2017-18: 11%)	(2017-18: 100%)	(2017-18: 11%)	(2017-18: 44%)	(2017-18: R1,6 bn)

*Excluding City of Tshwane Metro's R2,9 bn (2017-18: R1,7 bn) and Emfuleni's R358 m (unaudited) (2017-18: R768 m)

MUNICIPAL ENTITIES

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

3 Regressed
0 Improved

Clean audits	Financially unqualified financial statements	No findings on compliance with legislation	No findings on performance reports	Irregular expenditure
7%	93%	7%	57%	R1,8 bn
(2017-18: 21%)	(2017-18: 100%)	(2017-18: 21%)	(2017-18: 50%)	(2017-18: R1,3 bn)

Local government finance – concerning trend needs to be addressed to restore municipal financial health

Income statement

Revenue

- **Equitable share** of **R11,7 billion** (2017-18: R10,5 billion) and **other grants** of **R9,5 billion** (2017-18: R8,9 billion)
- **Revenue** of **R79,9 billion** (2017-18: R70,7 billion) was generated from billing

Expenditure

- **Salaries and wages** was **R24,1 billion** (2017-18: R21,1 billion); in addition, R29 million spent on financial consultants at five municipalities
- **Average supplier payment period** of **247 days** (2017-18: 242 days)
- **Fruitless and wasteful expenditure** of **R209 million** (2017-18: R60 million)
- **Unauthorised expenditure** of **R798 million** (2017-18: R741 million)

Net result

- Municipalities that **ended the year in a deficit: 44%** (2017-18: 44%)
- The total **deficit of municipalities** was **R1 billion** (2017-18: R534 million)

Balance sheet

- At year-end, municipalities had **creditors** of **R14,4 billion** (2017-18: R9 billion) while **cash available** was **R8,7 billion** (2017-18: R2,3 billion)
- **More than half of the next year's budget will be spent on prior year expenditure** at **56%** (2017-18: 67%) of municipalities
- An average of **74%** (2017-18: 79%) of **municipal debt is not recoverable**

- **4 (44%)** municipalities [2017-18: 4 (44%)] **are in vulnerable financial position**

Outstanding debt	Total amounts owed (as at June 2019)	Total amounts in arrears (31 days and over)
Eskom	R3,3 billion	R758 million
Water boards	R939 million	R32 million

Good financial accounting with inadequate monitoring of preventative controls

Gauteng municipalities sustained their audit outcomes in 2018-19 with one municipality, namely Midvaal, obtaining a clean audit. Encouragingly, all Gauteng municipalities have obtained unqualified audit opinions with regard to their financial accounts for the past four years. Gauteng also remains the only province where municipalities do not have negative outcomes on their financial statements. However, with the exception of Midvaal, municipalities did not always monitor the checks and balances that were necessary to comply with relevant laws and report accurately on service delivery achievements, and therefore did not obtain clean audits.

It is commendable that municipalities in the province have improved the quality of the financial statements that they submit for auditing. This improvement was due to two municipalities, namely the City of Ekurhuleni Metro and Mogale City who joined Midvaal and Merafong City, being proactive and upskilling the finance function. These municipalities took our previous year's messages seriously and positively responded to our concerns regarding the unsustainable practice of reliance on auditors to identify errors in the financial statements, which are then corrected by municipalities. The province also used public funds efficiently by mostly using internal staff to prepare financial statements. Five municipalities spent R29 million on consultants mostly for technical work on infrastructure assets. Of these, we identified errors at only one municipality (Lesedi) in the accounting for financial assets on which the consultant assisted, as the municipality did not provide all relevant documentation to the consultant. A further R312 million in consultancy fees were paid by Emfuleni and the City of Tshwane Metro. Both these audits were still outstanding at the cut-off of this report. The improvement in the quality of financial statements is a demonstration to residents that public funds are being accounted for correctly, and an indicator of increased accountability and transparency.

While non-compliance with legislation has traditionally been the main reason for municipalities not obtaining clean outcomes, the reported performance information deteriorated to the same level as that of compliance, in that all eight municipalities that did not achieve a clean outcome had material findings on their performance reports, compared to five in the previous year. The regressions in performance reporting occurred at the City of Ekurhuleni Metro, Merafong City and West Rand District as these municipalities did not ensure that all controls necessary for performance reporting were adequately monitored. Instead, they focused only on areas raised as findings in prior years which led to similar findings when municipalities added new service delivery performance indicators or when new performance indicators were audited.

The audit outcomes as described above are a reflection of a province that is doing well in reporting on their financial accounts, with minimal reliance on consultants, but needs to pay attention to complying with relevant laws and reversing the emerging trend of not reporting accurately on service delivery. This can be done by ensuring that the necessary checks and balances, which are key preventative controls, are adequately monitored.

MUNICIPAL LEADERSHIP SHOULD PAY CLOSER ATTENTION TO ADDRESSING THE NEGATIVE TREND AT MUNICIPAL ENTITIES

We analysed 11 municipal entities of the City of Johannesburg Metro and three municipal entities of the City of Ekurhuleni Metro, while four small municipal entities are excluded from this report due to their size. The audit outcomes of three municipal entities regressed, including two City of Johannesburg Metro audits namely Joburg Property Company and Johannesburg City Parks, which regressed from clean audit outcomes to unqualified opinions with findings on compliance. This was due to inadequate monitoring by these two entities of their system of internal control, which led to new instances of non-compliance with legislation. In addition, and as explained in further detail below, the Brakpan Bus Company regressed from an unqualified opinion with findings to a disclaimed opinion with findings.

The four largest municipal entities by budget, namely City Power Johannesburg, Johannesburg Water, Johannesburg Roads Agency and Pikitup Johannesburg, are responsible for a combined R33 billion of the total municipal entity budget of R40 billion. We are encouraged that these entities maintained their audit outcomes of unqualified with findings, and recommend that they follow the example of the fifth largest entity, the Johannesburg Development Agency, which has sustained a clean audit outcome for the past three years due to disciplined monitoring of key controls.

While municipalities in the province have sustained their outcomes, the metros should pay attention to the governance of entities under their control to reverse the negative trend in some entities' audit outcomes, primarily due to non-compliance. The status of procurement should be a specific focus, as irregular expenditure incurred by municipal entities increased from R1,3 billion in the previous year to R1,8 billion. The bulk of this (R1,6 billion) was incurred by the four largest City of Johannesburg Metro entities (as listed above) together with Johannesburg Metropolitan Bus Services and one City of Ekurhuleni Metro entity, the East Rand Water Care Company. The administrative leadership of metros should ensure that best practices at municipal level, as detailed in this report, are implemented across the municipal group.

DESPITE EFFORTS MADE, IRREGULAR EXPENDITURE INCREASED

Compliance outcomes remained stagnant with the incurred irregular expenditure increasing from R3,2 billion to R4,6 billion mainly due to prior year contracts. Despite efforts made to reduce irregular expenditure from new awards, we continue to be concerned that the total irregular expenditure remains high.

All municipalities except Midvaal continued to have material compliance findings, mainly relating to procurement and contracts (in other words, supply chain management). We also identified a trend of the high utilisation of supply chain management regulation 32 where four municipalities and five municipal entities made awards to suppliers by relying on contracts awarded by other state institutions, without adhering to all regulation 32 requirements. The breakdown of the R4,6 billion irregular expenditure indicates a sharp decrease in the irregular expenditure relating to current year awards issued from R1,6 billion to R735 million. This demonstrates that the province has been making strides to reduce irregular expenditure from new awards. However, the balance of the irregular expenditure relating to non-compliance on prior year awards amounted to R3,9 billion and therefore we remain concerned about this high level of irregular expenditure. When goods and services are procured through a fair and competitive process, this is likely to lead to residents' funds being spent efficiently, resulting in more funds being available for service delivery.

Consistent with prior years, the metros due to their large budgets were responsible for most of the R4,6 billion irregular expenditure in the province. The **CITY OF TSHWANE METRO** has a history of high levels of irregular expenditure incurred due to the non-monitoring of preventative controls, which resulted in supply chain management non-compliance. Examples of this include R2,72 billion and R643 million on the smart prepaid meter and infrastructure project management services contracts, respectively. In the current year, we identified irregular expenditure of R2,9 billion, of which the majority (R2,4 billion) related to expenditure on contracts awarded in prior years. The biggest contributors to the irregular expenditure included R1,1 billion and R326 million on the Thorntree housing project and infrastructure project management services contracts, respectively. These awards were made without following proper supply chain management processes such as ensuring that extensions were validly approved and undertaking a competitive tender process. The metro also made excessive use of deviations, and while it is encouraging that the metro has disclosed these adequately in the financial statements, the irregular expenditure could have been avoided through controls such as monitoring by the contract management unit of impending contract expiry dates to avoid emergency deviations due to poor planning. The metro has taken positive steps to reduce further irregular expenditure by cancelling non-compliant contracts such as the smart prepaid meter and infrastructure project management services contracts. However, we reiterate our message that the metro should focus on controls to prevent supply chain management non-compliance, instead of merely reacting to it.

The **CITY OF JOHANNESBURG METRO**, the economic hub of South Africa stretching from Orange Farm in the south to Midrand in the north, incurred irregular expenditure of R816 million, of which R643 million related to continuing expenditure on prior year contracts. This included R334 million and R126 million on the previous year's fleet and information technology contracts, respectively, which were invalidly awarded as deviations in contravention of supply chain management regulation 36. This could have been prevented had proper planning and contract management been followed. Furthermore, irregular expenditure of R37 million was identified due to contraventions of supply chain management regulation 32 on contracts awarded during the year. The **CITY OF EKURHULENI METRO** incurred irregular expenditure of R413 million, including R385 million on a prior year chemical toilets contract that was awarded based on functionality criteria that were different from the original tender invitation. Similarly, this could have been prevented through controls such as using a compliance checklist before adjudicating awards. At **SEDIBENG DISTRICT**, supply chain management processes were disregarded, as most awards were processed by officials outside the supply chain management division, resulting in irregular expenditure of R9 million.

Based on the analysis above, we acknowledge that the province has taken steps to reduce irregular expenditure from new instances of non-compliance. However, more work needs to be done to address the trend of an overall increase in irregular expenditure. We also continue to recommend that municipalities conduct investigations into unauthorised, irregular and fruitless and wasteful expenditure with a sense of urgency, and that officials who deliberately or negligently do not comply with legislation should be held accountable for their actions. This will provide comfort that public funds are being spent properly on services that are important to the lives of citizens, and that a culture of impunity will not arise in the province.

STABILITY AT POLITICAL AND ADMINISTRATIVE LEVEL IS LINKED TO GOOD AUDIT OUTCOMES

Gauteng does not struggle to attract individuals with adequate professional skills as it remains a destination of choice for many graduates and job seekers in the country. Municipalities in the province that have both attracted and retained staff with the right skills have benefited from this continuity and managed to maintain good audit outcomes.

MIDVAAL, a local municipality located in the Sedibeng district, is named for its location halfway between Johannesburg and the Vaal. Midvaal has achieved a clean audit for the past six years as they have benefited from a high level of institutional knowledge since key management officials such as the municipal manager, chief financial officer and head of supply chain management have been at the municipality for at least five years.

Similarly, the **CITY OF EKURHULENI METRO** – in contrast to the other two metros – has experienced stability in both the political landscape and at administrative level. The city manager and head of supply chain management have been in their positions for two and five years, respectively. The metro has also actively embarked on a process of capacitating their finance unit over the past few years, which has resulted in a gradual improvement in the quality of financial statements and a reduction in compliance findings.

By contrast, municipalities characterised by instability in political or administrative leadership were unable to improve their outcomes. For example, the **CITY OF TSHWANE METRO**'s instability at council level has had an impact on the administration, as council is responsible for the city manager's appointment, and there have been two acting city managers since the resignation of the former incumbent on 31 August 2019. The instability at city manager level led to a poor control environment where internal controls were not always performed properly, resulting in poor-quality financial statements submitted for auditing and non-compliance with legislation. While it is commendable that the internal audit unit investigated instances of unauthorised, irregular and fruitless and wasteful expenditure during the financial year, a council resolution to recover R3,26 billion (including R2,72 billion on the smart prepaid meter contract) from the responsible officials and service providers had not been implemented at year-end. The instability in the council as evidenced by numerous collapses in council sittings has resulted in an inability to table investigations and effectively implement resolutions.

Similar to the City of Tshwane Metro, the **CITY OF JOHANNESBURG METRO** also experienced instability at council level which contributed to vacancies in key management positions not being filled. The position of group chief financial officer was vacant for almost two years before being filled during the year, the chief audit executive position was vacant for over two years, and the position of head of strategy was vacant for over a year. These vacancies contributed to material errors in the financial statements, evidence not provided for the reported achievement of some performance indicators, and inadequate assurance provided by the internal audit unit as they did not review management's action plans.

At **LESEDI**, located in the Sedibeng district with its seat in Heidelberg, instabilities and vacancies at senior management level, including the key positions of chief financial officer and municipal manager which are occupied by acting personnel, led to a breakdown in the system of internal control. This resulted in financial statements being submitted that were of a poor quality, resulting in material adjustments being made, as well as non-compliance with legislation. Action plans to address prior year findings were also not sufficient and in most cases not adequately monitored and implemented, which resulted in repeat findings. It is important that stability is restored to the municipality and that public funds are spent in a fair manner that ensures value for money. This will ultimately ensure that service delivery promises to citizens are met.

RAND WEST CITY is located in Randfontein approximately 40 km west of Johannesburg and was formed after the merger of the former Randfontein and Westonaria municipalities in August 2016. Post-merger, the municipality has not finalised a staff establishment that accommodates staff from both municipalities in certain positions; for example, the municipality has two human resource practitioners and asset managers who are not supported by the organisational structure and do not have job descriptions. The duplicate staff have not been allocated to positions in other areas, which has resulted in these other positions remaining vacant pending this process. This contributed to a high vacancy rate (47% at year-end) which had a negative impact on service delivery, as the municipality did not achieve three planned targets relating to the provision of infrastructure services.

The **BRAKPAN BUS COMPANY** is a municipal-owned entity of the City of Ekurhuleni Metro responsible for providing public transportation in the East Rand region. The entity was the only auditee in Gauteng that could not produce a reliable set of accounts after the completion of the audit process as it regressed from an unqualified outcome with material findings to a disclaimer with material findings. This was due to the entity not submitting documents to enable the audit of expenditure, supply chain management and some financial statement disclosure notes. The poor outcome can be attributed to instabilities at senior management level as the chief executive officer post had been vacant for five years and was only filled in October 2018, while the chief financial officer was suspended on allegations of fraud in October 2018.

We recommend that the administrative leadership in the province prioritise the retention of suitably skilled officials as this will result in a good internal control environment where the implementation of preventative controls is adequately monitored. The maintenance of stability at political leadership level will also assist in this regard.

WHAT DO THE FINANCIAL STATEMENTS SAY?

Financial sustainability is of concern, with some positive elements at some municipalities

Gauteng municipalities and their entities, primarily through the province's three metros, were responsible for R158 billion (34%) of South Africa's local government expenditure budget. This included R21 billion in capital expenditure. The current economic climate has kept municipalities' financial sustainability under pressure, as they continued to experience difficulties in collecting debt from residents. This has a negative impact on these municipalities' ability to pay suppliers timeously for basic services, which in turn leads to non-delivery or delays in municipal services. Gauteng, despite being the country's economic powerhouse, is not immune to these challenges. The expanding Gauteng population, as well as the resultant increased infrastructure development and maintenance needs, has further placed a strain on municipal finances, as there are limited funds available to allocate across various desired projects. We continue to encourage municipalities to intensify debt-collecting processes while also spending funds efficiently to ensure that they are still able to provide residents with essential services. The following is an analysis of the financial situation at various Gauteng municipalities.

The **CITY OF JOHANNESBURG METRO**, home to more than four million people, is the economic and financial centre of the country and thus attracts a number of people from various backgrounds who come to the 'City of Gold' in search of prosperity. This unfortunately brings challenges typically associated with other big cities, such as housing shortages and infrastructure backlogs, leaving the metro struggling to meet all the needs of all its citizens. The operations of the metro as the economic hub of the country have also been negatively affected by the challenging economic conditions of the country, including poverty, unemployment and poor economic growth. This has had an adverse impact on the ability of the metro to collect the revenue billed for services as more people struggle to pay, which in turn places a strain on the resources of the metro to embark on new service delivery projects. While these challenges prevail, the metro has been able to provide basic services to the majority of its citizens, has increased its cash balance, and also has long-term assets to cover its total liabilities. This stable position serves as a solid foundation to attend to the citizens' expectations as promised in the metro's integrated development plan.

The story of the metro has remained the same over the last few years as it again had errors in the financial statements, did not comply with legislation, and did not report accurately on service delivery. This was due to instability at political and administrative leadership level which resulted in the metro not monitoring controls. Such controls included the adequacy of existing asset and revenue reconciliations, more frequent asset verifications and meter readings to determine actual usage, as well as supply chain management controls as highlighted above. The metro was subsequently able to correct these errors, and therefore obtained an unqualified financial opinion with findings on compliance and performance reporting. An analysis of these financials reflects a metro that is stable, with improvements in some areas such as revenue, but with areas requiring attention as explained in further detail below.

The metro's financial health improved with a net surplus of R6,9 billion driven by a R3,3 billion increase in rates revenue arising from a 38% increase in the property valuation roll to R1,374 trillion. However, we remain concerned about the high 76% debtors' provision due to debt-collection challenges, particularly the collection of water revenue in townships and other areas with a culture of non-payment. This has resulted in the metro placing excessive reliance on external sources of funding such as loans and bonds, which is costly in the long run as the capital and interest payments exceed the rate at which the metro is investing in its repayment fund, and further increases the cost of future debt. This may create future cash-flow challenges when these borrowed funds become due, affecting future service delivery.

The **CITY OF EKURHULENI METRO** located in the east of Gauteng prides itself on being the host of the OR Tambo International Airport, the busiest airport in Africa. The metro has over a number of years demonstrated prudent financial management of funds supported by solid service delivery to its citizens. Similar to the City of Johannesburg Metro, the metro is home to more than three million people, who come from different areas looking for the better economic prospects due to the number of manufacturing facilities located in the vicinity of the metro. The metro had previously been highlighted as one of the best-performing municipalities in Gauteng, demonstrating good financial disciplines and controls, and managing to obtain a clean audit in the past. However, there are emerging trends that require attention, including the worsening collectability of debt and expenses exceeding revenue during the year.

Our high-level assessment of the metro's financial statements showed that it incurred a deficit of R791 million compared to the previous year's surplus of R1,5 billion. The metro is experiencing difficulties to recover debt from customers who took an average of 85 days to pay for services. This contributed to the metro's inability to pay suppliers within 30 days, with suppliers being paid on average after 95 days. Although the metro raised revenue of R37 billion in the financial year, it was unable to collect a large portion of this. This can be seen from the R14 billion in consumer debt that was outstanding. The situation was further aggravated by the high provision for bad debt of R9,1 billion which represented 65% of the outstanding consumer debt. This increased the metro's reliance on loans to fund capital expenditure which resulted in a R3,6 billion increase in liabilities at year-end, while the metro intends to raise an additional R3 billion of debt through a bonds issue in the 2019-20 financial year. This is not sustainable in the long run, as external funding is more expensive than own funding, and may negatively affect service delivery and the metro's ability to meet its current and future obligations. Currently, the position of the metro to pay current debt as it falls due with available liquid assets has decreased compared to prior years; however, in terms of the total asset base being sufficient to cover the total obligations, the metro's total assets still exceed total liabilities by R50 billion, despite the increase in long-term liabilities of R3 billion. This demonstrates that the metro does have some good disciplines in place, which need to be embedded in a good revenue-management and debt-collection strategy.

Both the City of Johannesburg Metro and the City of Ekurhuleni Metro have also incurred high combined losses of water and electricity purchases amounting to R4,3 billion and R2,2 billion, respectively, due to a combination of ageing infrastructure and theft. If these metros can reduce these substantial losses, they could spend these funds on adding to the existing – relatively satisfactory – service delivery experience of citizens.

The **CITY OF TSHWANE METRO**, located in the north of Gauteng, is the administrative capital of South Africa and the largest municipality in the country by land size. Among others, the metro is still confronted with problems such as unemployment, inequality, poor management of resources, project stoppages or delays, infrastructure vandalism and cable theft. The metro's inability to effectively recover debt will have a negative impact on future capital expenditure and service delivery. The metro should be more aggressive in collecting long-outstanding debt to improve its cash position, which can then be used for service delivery including capital projects. The story of the metro has been similar to that of the City of Johannesburg Metro, due to instability at political and administrative leadership level. The metro also had repeat errors in its financial statements and did not comply with all laws, receiving an unqualified financial opinion with findings on compliance. This was due to controls that were not adequately monitored, including the regular review of commitment and asset registers as well as supply chain management controls as highlighted above.

The metro generated R35 billion in revenue, comprising R18,6 billion from service charges including water and electricity sales, property rates of R7,1 billion, and grants of R6,5 billion. However, the metro's financial health remained of concern due to a number of factors, including a high salary bill of R9,2 billion which equated to 26% of revenue, and electricity and water losses of R1,5 billion and R1,1 billion, respectively. In addition, the large 62% impairment of debt meant that the metro did not receive a large amount of revenue billed, negatively affecting its ability to provide basic services. This resulted in the metro taking an average of 71 days to pay creditors as it took 67 days to collect monies owed by citizens, and forcing the metro to rely on other sources of finance including long-term loans in order to meet its obligations. The financial constraints had a negative impact on service delivery; for example, the metro did not achieve 13 of 33 targets during the year and some projects were halted or delayed. This included R381 million of assets under construction such as the upgrading of the Temba and Babelegi wastewater treatment works. The metro also has a diverse range of assets valued at R39 billion.

Unlike other municipalities in the province who utilised consultants efficiently, the metro was an exception as it spent R213 million on consultants to correct the fixed asset register and verify assets. Despite this, we still identified material findings on assets including R367 million of completed projects that were not recorded under the correct category of property, infrastructure and equipment and that were not depreciated due to the inadequate monitoring of controls such as linking the completion of projects with financial reporting. Encouragingly, the metro has been trying to take steps to improve its finances and achieved an improved R2,9 billion surplus (2017-18: R2,4 billion) through limiting expenditure increases to below that of revenue tariff adjustments. This will allow the metro to spend these funds, when they are collected, on future service delivery projects to improve the experience of citizens.

RAND WEST CITY is comprised of various urban areas and mining villages spread throughout the area. The municipality was established in 2016 after a merger of Westonaria and Randfontein municipalities. The creation of the new municipality was, in part, a result of poor financial administration in the local municipalities resulting in undesirable audit outcomes. Partly due to a decline in gold mining, the area has high levels of unemployment and poverty, and as a result residents are unable to pay for the basic services that they receive.

Our overview of the municipality's financial statements indicates that the average time it took to collect debt was 69 days while there was a high debt impairment of 69% of the total outstanding service debt of R588 million. This resulted in the municipality taking an average of 397 days to pay creditors, while negotiations with Eskom to avoid power cuts were ongoing due to arrears of R135 million at year-end. Total revenue was R1,8 billion; however, 31% of this was spent on employee-related costs due to the large number of employees arising from the merger as mentioned above, which reduced the funds available for service delivery and the maintenance of assets. The municipality appropriately accounted for its large asset base of R4,3 billion, mainly consisting of infrastructure assets and land and buildings, with the assistance of consultants who helped maintain an accurate asset register. However, assets were not well maintained which contributed to electricity and water losses of R116 million and R75 million, respectively. Encouragingly, the municipality was still able to spend R341 million on infrastructure projects during the year, including R14 million on the Westonaria alternative water supply pipeline funded by the municipal infrastructure grant and R18 million on the refurbishment of the Randfontein wastewater treatment works funded by the water services infrastructure grant.

The **BRAKPAN BUS COMPANY**'s primary mandate is not one of profit-making, as its main objective is to provide residents with a public transport service. Our assessment and observations during the current and prior audits have, however, confirmed that the entity was unable to fully deliver on this service to its residents. This could be attributed to the entity experiencing governance challenges where there was instability at chief executive officer and chief financial officer level and the board being ineffective as members did not regularly attend meetings which affected its oversight function, despite receiving large board fees. This placed a strain on the entity's finances. The entity could also not provide supporting documents to audit the financial accounts, and as a result, no audit opinion could be issued on the financial statements.

The entity's financial statements indicate that it relies on subsidies of R15 million from both the provincial department of transport and the City of Ekurhuleni Metro to supplement its own revenue of R13 million. However, even with this external support, expenses exceeded revenue by R13 million due to salary costs of R23 million which represented 83% of total revenue including subsidies. During the year, the high number of bus repairs and long repair turnaround times resulted in only 17 517 bus trips being achieved compared to a planned target of 22 100 trips. This confirms that the entity could not always deliver on services to residents. This further resulted in the provincial department of transport reducing its subsidy to the entity by R5 million. Going forward, the entity's ageing fleet will require a high level of future repairs and preventative maintenance which the entity cannot afford given its current financial position, which will further affect its ability to generate future revenue. The entity's current sources of revenue are less than its operational and planned capital expenditure – this is not sustainable and requires intervention. There are indications that functions allocated to the entity could be incorporated into the City of Ekurhuleni Metro, with services currently offered to residents continuing.

Our analysis of the financial statements including the spending on key infrastructure projects and municipal grants indicates instances of both poor and good project management. Encouragingly, the majority of grants selected for testing were spent, including the municipal infrastructure grant, water services infrastructure grant, public transport network grant and urban settlements development grant. These funds were spent in accordance with the grant framework and planned targets were achieved at 100% of projects funded by the grant, except for the urban settlements development grant where planned targets were achieved at 40% of the 10 key projects selected. This demonstrates that while grant funding is generally used adequately in the province, municipalities – and in particular the metros – need to pay greater attention to achieving the planned targets especially relating to the urban settlements development grant.

Overall the financial health of the other local municipalities as well as the districts (as described in further detail below) is also following a similar trajectory characterised by poor debt-collection rates and creditors exceeding available funding, which hampers the effective functioning of municipal operations and service delivery.

THE FINANCIAL MODEL OF DISTRICTS IS NOT SUSTAINABLE AND REQUIRES RECONSIDERATION

The financial health concerns in the province are particularly relevant at the two district municipalities, namely West Rand District and Sedibeng District. These districts' financial position is influenced by the district funding model and their allocated functions in terms of legislation including basic services such as water, electricity, wastewater and sewage disposal, and solid waste disposal. These functions can be adjusted in terms of legislation by allocating any functions vested in the local municipality to the district municipality, or vice versa. While in some provinces, some districts are responsible for basic services and generate revenue from this function, Gauteng's two district municipalities do not provide basic services and are mainly responsible for ensuring integrated development planning for the district as a whole and building the capacity of local municipalities in its area to perform their functions and exercise their powers. This is further illustrated by an analysis of the services provided by districts, and major sources of revenue and expenditure.

The main services provided by **WEST RAND DISTRICT** are emergency fire rescue and ambulance services, disaster management, and district health service coordination. Emergency services contributed only R1 million of the total revenue of R303 million, while the district did not receive any revenue for the coordination of health services. Local municipalities contributed R13 million of revenue to the district with the balance funded mainly by grants of R273 million. This included the regional service levy replacement grant of R163 million used to supplement revenue as the district does not collect own revenue from services, the fire brigade service grant of R57 million, the equitable share of R35 million as well as other small grants. Of the total revenue, 63% was spent on salary costs of R190 million which resulted in only a small portion of funds being available to render services.

West Rand District's financial situation worsened after it invested R76 million in VBS Mutual Bank which was written off as a financial loss. This was a culmination of the gradual weakening of the control environment as we had highlighted concerns in prior years about weak cash management controls, including a lack of regular bank reconciliations. The amount invested in VBS included a R43 million neighbourhood development partnership conditional grant received from the National Treasury. Service delivery was negatively affected as money meant to rejuvenate the municipality was diverted from projects funded by the mentioned grant, such as the construction of sidewalks in Merafong and Rand West City that could not be completed by year-end. As a result, the National Treasury recovered this grant money by reducing unconditional grant funding to West Rand District in the current year. This led to the financial position worsening, which resulted in the municipality being unable to meet its obligations including the payment of salaries and suppliers – it took the municipality an average of 711 days to pay creditors. A portion of the fire brigade service conditional grant meant for fire services amounting to R20 million was also used for operational expenditure and reported as unauthorised expenditure. Subsequent to the release of the findings of a forensic investigation into the VBS investment, a criminal charge was laid against the chief financial officer and the municipality has been cooperating with the Directorate for Priority Crime Investigation (Hawks). The municipal manager's employment was also terminated in January 2020 for failure to appoint a new chief financial officer timeously.

Due to the financial health concerns as illustrated above, the Gauteng provincial executive intervened at West Rand District on 22 November 2018 in terms of section 139(5)(a) of the Constitution. The intervention focused on the development of a financial recovery plan for the municipality and resulted in West Rand District being one of two municipalities (along with Emfuleni) in Gauteng under provincial intervention. To date, the intervention has had little impact as the majority of the objectives had not been implemented by the due date and remain in progress. West Rand District is still experiencing severe financial challenges and is unable to pay suppliers within 30 days.

SEDIBENG DISTRICT has its administrative seat in Vereeniging in the south of Gauteng. Similar to West Rand District, the financial health of Sedibeng District requires intervention as expenditure exceeded revenue by R49 million. Sedibeng District generated only R93 million in revenue, with the majority of revenue earned from agency licensing services provided to the provincial department of transport amounting to R66 million. The sale of aviation fuel amounted to R4 million while R10 million was billed to Emfuleni and Lesedi for information technology services by staff seconded to these municipalities. However, these local municipalities did not pay for the services due to their own financial health concerns, which resulted in Sedibeng District providing for an impairment of R53 million for total information technology services to date. As seen above, the district had minimal revenue sources and therefore relied on grants of R278 million to supplement own revenue. An excessive 75% of total revenue, which was also equal to the entire grant revenue, was spent on salary costs of R277 million leaving little money for any service delivery matters. To supplement this shortfall, the district used R110 million from licence fees collected on behalf of the provincial department of transport as well as conditional grants for own operations. As part of efforts to improve the financial situation, the district identified the refurbishment and commercialisation of an airport, namely the Vereeniging Aerodrome, as a strategic project in line with section 84(1)(h) of the Municipal Structures Act (which designates 'municipal airports serving the area of the district municipality as a whole' as a district function). If this is modelled properly and commercially viable, it could generate much-needed additional revenue for the municipality.

In its current form, the district model in Gauteng is not sustainable as the districts' operational expenses, mainly salaries, are very high due to a large staff structure relative to the limited functions they perform. These high expenses exceed the revenue they are able to generate from services and grants. We therefore recommend that districts ensure that staff are used optimally for service delivery to ensure the efficient use of limited funds. Alternatively, the funding provided to districts needs to be increased to allow them to break even and perform their functions adequately.

THE ASSURANCE PROVIDED BY ROLE PLAYERS IS STILL NOT AS EFFECTIVE AS IT SHOULD BE

The assurance provided by governance structures such as the audit committee, municipal council and municipal public accounts committee improved overall. These structures are well established and generally provided some assurance on the effectiveness of the control environment. As part of the combined assurance model, the assurance provided by the different role players had a ripple impact on the functioning of each provider.

We found that municipalities with better-functioning internal audit units such as **MIDVAAL** and the **CITY OF EKURHULENI METRO** were able to adequately support their governance structures such as audit committees, municipal public accounts committees and councils who in turn were able to provide assurance. We also identified some positives at the **CITY OF TSHWANE METRO**, where the internal audit unit reviewed all supply chain management deviations which resulted in the metro disclosing these adequately in the financial statements. Overall, it is encouraging that the majority of governance structures in the province were able to support the municipalities to some extent to maintain an acceptable control environment.

However, there is still room for improvement, especially in relation to the monitoring of preventative controls by key role players relating to performance information and supply chain management. For example, at the **CITY OF JOHANNESBURG METRO** the assurance provided was concerning as the internal audit unit did not complete their planned audits due to staff vacancies, which had a negative impact on the municipal public accounts committee who did not investigate all instances of unauthorised, irregular and fruitless and wasteful expenditure. In addition, the internal audit unit at **SEDIBENG DISTRICT** did not adequately review the financial statements and performance report prior to submission for auditing, and did not support the audit committee by monitoring their recommendations.

At **RAND WEST CITY** only some comfort was provided by most role players. The internal audit unit identified various shortcomings, including the inaccuracy of the supporting schedules to the quarterly financial and performance reports, and inadequate consequence management for non-compliance; however, internal audit recommendations were not timeously actioned. The internal audit unit was also unable to review the final financial statements and performance report as management did not provide them with information timeously. The municipal public accounts committee did not operate as planned due to instabilities in the chairperson role with most meetings being cancelled due to non-attendance of members. The last investigation report was issued in August 2018 with no evidence of consequence management being implemented. Municipal public accounts committee members have indicated that they need training on the auditing terms used by us as well as on how to deal with the investigation requirements of the municipality to enable them to effectively exercise their oversight role. At **MOGALE CITY**, located in Krugersdorp on the West Rand, similar issues were identified by the internal audit unit during the quarterly reviews but these were not addressed, which contributed to a stagnation of outcomes. The municipal public accounts committee did not fully perform its duties, as only some unauthorised, irregular and fruitless and wasteful expenditure was investigated due to the delay in the establishment of the disciplinary board which was responsible for undertaking these investigations.

Initiatives by the provincial cooperative governance department, the provincial treasury and the premier are ongoing. These initiatives include the provincial operation clean audit committee which meets on a quarterly basis to assess, monitor and support municipal action plans to address audit findings. However, these meetings are not always attended by the right level of staff in the municipality such as the chief financial officer; therefore, the desired impact of this initiative has not been realised. We encourage the provincial leadership to intensify the level of support provided, especially relating to compliance and in particular supply chain management. Although there is clearly still some work to be done by most assurance providers, we remain encouraged that the majority of governance structures have been to able provide their municipalities with support to improve the credibility of the financial and performance reports.

AUDIT PHASED IN FOR IMPLEMENTATION OF PUBLIC AUDIT ACT AMENDMENTS

While supply chain management processes have previously been the biggest concern, the City of Tshwane Metro has taken steps to prevent financial losses from procurement. However, a lack of attention to keeping existing assets safe resulted in two material irregularities reported.

The **CITY OF TSHWANE METRO** was selected for the phased-in implementation of the amended Public Audit Act based on the high levels of irregular expenditure incurred due to supply chain management non-compliance over the last few years. During the site visits of key projects on water and sanitation, two material irregularities were identified due to non-compliance which resulted in a material financial loss, as there was an inadequate system of internal control to protect assets.

The city manager, together with those charged with governance, was receptive to the amendments and cooperated in the process. The city manager took some immediate steps to start addressing the material irregularities, while further steps are in progress to fully address them. We will assess whether appropriate actions have been taken during next year's audit. (Refer to section 3 of this report for further details on the material irregularity process and the material irregularities identified.)

MUNICIPALITY LEADING BY EXAMPLE

While there are a number of areas requiring improvement at most Gauteng municipalities, **MIDVAAL** is well run and characterised by satisfactory service delivery. The municipality produced quality financial statements, which correlates with a well-run municipality where citizens enjoy services. For example, the roads are generally in a good condition and recreational facilities such as parks and community swimming pools are well maintained. The municipal culture, driven by both the political and administrative leadership, is characterised by zero tolerance for transgressions and by taking personal accountability for maintaining good financial practices and sustaining clean audit outcomes.

The financial statements are prepared by the finance department and then reviewed by both the internal audit unit and an external consultant that assists with more complicated technical items such as the taxation calculation. The system of collecting, confirming the accuracy and reporting on performance information involves review at every level and scrutiny by the strategy department before being reported on, which results in reliable information supported by proper listings. Midvaal manages its financial position well, with only 24% of the total revenue of R1,16 billion spent on salaries, which allowed for R130 million to be spent on various infrastructure projects during the year. This included R15 million on the Scelo/Highbury reservoir and pipeline construction project, and R10 million for a roads tarring project. Loan funding by the Development Bank of Southern Africa of R57 million has also been used to implement capital projects.

In sharp contrast to the rest of the province, Midvaal collected the majority of its revenue from billed services (from current debtors), due to robust debt-collection procedures and strategies where overdue accounts were immediately handed over to attorneys – this contributed to the fastest payment of creditors in the province with an average of only 10 days, which enabled the municipality to self-fund a large portion of its expenditure. The municipality has continually been emphasised as a success story and model of good financial and performance management which other municipalities in Gauteng should replicate.

CONCLUDING REMARKS

We continue to interact regularly with stakeholders to discuss our management and audit reports and highlight key areas requiring attention, as part of efforts to improve accountability. We also continued to implement the status of records review but most auditees did not adequately address concerns highlighted during these reviews. For example, at **RAND WEST CITY**, the status of records review identified areas of concern; however, management's failure to address the review's findings resulted in the stagnation of audit outcomes. We reported material misstatements in the financial statements, which could have been prevented through controls such as the review of commitment schedules, and material findings on performance reporting and compliance.

There were also positive examples arising from the status of records review implementation where auditees did action some of our recommendations, including the **CITY OF EKURHULENI METRO** where management adequately addressed risks highlighted to them on fixed assets and payables which resulted in quality financial statements submitted for auditing. The number of material compliance findings reported also substantially decreased. However, inaccurate performance reporting and non-compliance with legislation remain a concern.

As emphasised above, the audit outcomes of the province reflect a stable control environment, underpinned by the role played by the administrative leadership supported by governance and oversight structures. We again encourage the provincial cooperative governance department, the provincial treasury and the premier to intensify the level of support provided to municipalities going forward, especially in the areas of compliance with legislation and reported performance information. We will continue to monitor the impact and progress of commitments made, as they are crucial to improving the overall audit outcomes in the province. With basic internal controls firmly in place, we urge the political and administrative leadership in the province to ensure that all necessary preventative controls, as detailed above, are implemented and monitored consistently, and that consequence management is adequately implemented to deal with the stubborn trend of high irregular expenditure.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Midvaal	LM		1 050 195	-	1 050 195	18 293 054	6%	1
2	City of Ekurhuleni Metro	MET		17 044 482	-	17 044 482	445 301 584	4%	1
3	Lesedi	LM		3 525 663	-	3 525 663	15 363 798	23%	3
4	Merafong City	LM		5 696 673	-	5 696 673	13 506 756	42%	2
5	Rand West City	LM		1 964 071	-	1 964 071	75 375 879	3%	1
6	City of Tshwane Metro	MET		213 142 168	-	213 142 168	689 442 240	31%	1
7	Emfuleni	LM		98 684 684	-	98 684 684	83 462 962	118%	4
TOTAL				**341 107 936**	**-**	**341 107 936**	**1 340 746 273**	**25%**	**13**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM** = district municipality **LM** = local municipality

NOTES

2.5 KWAZULU-NATAL

AUDIT OUTCOMES

AMAJUBA
2018-19 2 2
2017-18 2 2

- Amajuba DM
- Danhausser LM
- Emadlangeni LM
- Newcastle LM

ZULULAND
2018-19 4 2
2017-18 3 2 1

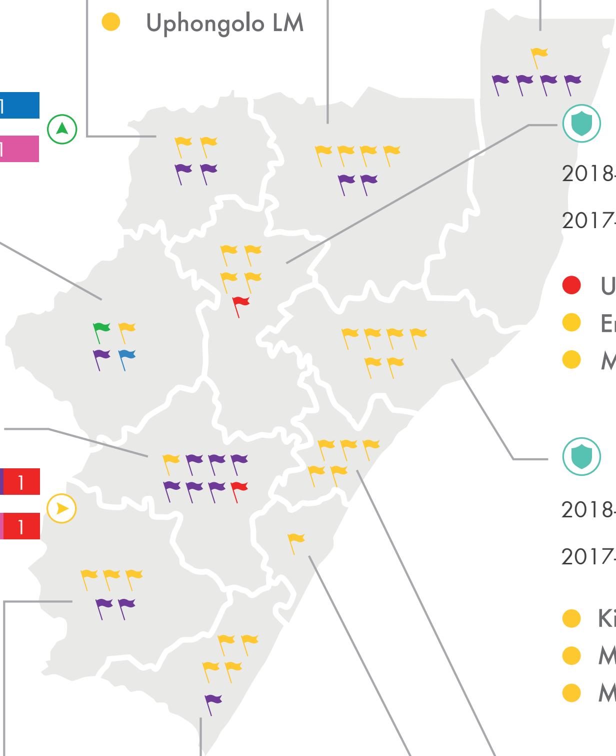
- Zululand DM
- Abaqulusi LM
- Edumbe LM
- Nongoma LM
- Ulundi LM
- Uphongolo LM

UMKHANYAKUDE
2018-19 1 4
2017-18 3 2

- Umkhanyakude DM
- Big 5 Hlabisa LM
- Jozini LM
- Mtubatuba LM
- Umhlabuyalingana LM

UTHUKELA
2018-19 1 1 1 1
2017-18 1 2 1

- Uthukela DM
- Alfred Duma LM
- Inkosi Langalibalele LM
- Okhahlamba LM



UMZINYATHI
2018-19 4 1
2017-18 4 1

- Umzinyathi DM
- Endumeni LM
- Msinga LM
- Nquthu LM
- Umvoti LM

UMGUNGUNDLOVU
2018-19 1 6 1
2017-18 3 2 2 1

- Umgungundlovu DM
- Impendle LM
- Mkhambathini LM
- Mpofana LM
- Msunduzi LM
- Richmond LM
- Umngeni LM
- Umshwathi LM

KING CETSHWAYO
2018-19 6
2017-18 5 1

- King Cetshwayo DM
- Mfolozi LM
- Mthonjaneni LM
- Nkandla LM
- Umhlatuze LM
- Umlalazi LM

ILEMBE
2018-19 5
2017-18 5

- Ilembe DM
- KwaDukuza LM
- Mandeni LM
- Maphumulo LM
- Ndwedwe LM

HARRY GWALA
2018-19 3 2
2017-18 3 2

- Harry Gwala DM
- Dr Nkosazana Dlamini Zuma LM
- Greater Kokstad LM
- Ubuhlebezwe LM
- Umzimkhulu LM

UGU
2018-19 4 1
2017-18 4 1

- Ugu DM
- Ray Nkonyeni LM
- Umdoni LM
- Umuziwabantu LM
- Umzumbe LM

eTHEKWINI METRO
2018-19 1
2017-18 1

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

The KwaZulu-Natal local government consists of 54 municipalities and three municipal entities. The audit outcomes of the municipal entities are not included in the analysis in this report. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, one audit was outstanding, namely that of Inkosi Langalibalele, which was subsequently finalised on 3 February 2020 – the municipality received an adverse opinion.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL SLIGHT IMPROVEMENT IN AUDIT OUTCOMES

7 *Regressed*

8 *Improved*

Clean audits

2%

(2017-18: 2%)

Financially unqualified financial statements

62%

(2017-18: 64%)

13% (7)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

2%

(2017-18: 4%)

Irregular expenditure

R6,5 bn

(2017-18: R3,0 bn)

Audits subsequently finalised

R17,2 m

(2017-18: R134,7 m)

No findings on performance reports

43%

(2017-18: 40%)

79% (42)

Reported achievement reliable

FINANCIAL HEALTH

Deficit

(expenditure exceeded revenue)

2018-19	27% (14)
2017-18	17% (8)

Creditor-payment period > 30 days

2018-19	90% (46)
2017-18	89% (42)

Vulnerable financial position

2018-19	15% (8)
2017-18	11% (6)

Little change in outcomes, accountability not adequately practised and enforced by leadership, and failure of key controls

The overall audit outcomes reflect a slight improvement. Seven auditees regressed while eight auditees improved. District municipality outcomes reflect two regressions (Umzinyathi and Umkhanyakude), four improvements (King Cetshwayo, Ugu, uThukela and Zululand), and four unchanged results (Amajuba, Harry Gwala, ILembe and Umgungundlovu). The worst-performing district was Umgungundlovu, with six qualified audit opinions and one disclaimed opinion. Insofar as other municipalities are concerned, Edumbe, Jozini, Mtubatuba, Umngeni, Umshwathi and Umzimkhulu regressed to qualified opinions from unqualified opinions. Richmond and Msunduzi improved from adverse opinions to qualified opinions whilst Nongoma improved from an adverse opinion to an unqualified opinion. Alfred Duma and Abaqulusi improved from qualified opinions to unqualified opinions. The eThekwini Metro retained its unqualified audit opinion with findings on compliance. The summary that follows details the underlying reasons for the good practices of a municipality doing well along with the current state of unsatisfactory municipal audit outcomes.

STRONG FOUNDATIONS DRIVING CLEAN ADMINISTRATION WITH A DEDICATED TEAM THAT CLEARLY UNDERSTANDS THE BUSINESS OF LOCAL GOVERNMENT

OKHAHLAMBA led by example for the past four years by sustaining a clean audit outcome. Situated in the foothills of the Drakensberg mountains in Bergville, the municipal area and surrounds are known for their beautiful scenery and as a wonderful holiday destination. Since the Drakensberg mountain range is a tourist attraction in the province, the municipal council and senior management together with the municipal manager were driven to attract investors and tourists to bolster own revenue. The message of commitment to clean administration was enforced at all meetings and displayed throughout the municipal premises.

The municipality's finance team was adequately resourced and understood what needed to be done. Although the positions of chief financial officer and municipal manager were vacant for part of the year, this did not weaken the control environment because of the culture of clean administration as well as the embedded system of internal control activities in areas such as records management, supervisory reviews and key account reconciliations. The financial statements were prepared in-house, which was made possible by the daily and monthly checks (reconciliations, reviews and monitoring) that were done, even when key staff members were absent. The governance structures, comprising the municipal public accounts committee and audit committee, were well apprised of the status of internal controls and records, finances as well as service delivery performance. This provided additional layers of comfort to the council. Recommendations made by these committees were appropriate and taken seriously by the municipal manager and the senior management team who understood and appreciated the importance of internal control.

Following an increase in violent armed robberies, hijackings and vehicle theft in the Bergville area, the municipality installed surveillance cameras at entry and exit points in town. This promoted the safety of citizens and tourists with fewer reported incidents of crime, highlighting this municipality's commitment to government imperatives, namely taking a wide and integrated view to support the country and not working in silos on an island.

AN OVERALL DISMAL PICTURE AT DISTRICT MUNICIPALITIES

Most district municipalities continued to struggle with basic financial and performance management processes and a lack of responsiveness to implement and monitor action plans. Weaknesses in governance structures prevented effective accountability.

Our analysis of the audit outcomes of the 10 district municipalities paints a dismal picture in that seven of them received modified audit opinions. Two of the district municipalities, namely uThukela District and Umzinyathi District, were placed under administration in terms of section 139(1)(b) of the Constitution. The district municipalities with modified opinions continued to struggle with basic financial management and governance failures and did not adequately discharge some of their legislated service delivery responsibilities such as the provision of adequate potable water supplies, management of wastewater and sewage disposal, as well as road infrastructure maintenance. Moreover, they were unable to provide administrative, technical and financial support to local municipalities, as district finance forums that were set up for these purposes were mostly poorly attended and/or non-functional.

The district development model aims to modernise district municipalities and bring coherence in the planning and implementation of government priorities through accelerated service delivery, economic development and job creation with support from the national and provincial spheres of government by using section 154 of the Constitution [because section 139(1) has not assisted to improve outcomes]. This integrated method of support will not have the desired effect unless elected political officials and administrative leaders are serious about improving the well-being and confidence of the public and communities of the districts under their helm and support local municipalities within their districts.

Situated in Ladysmith is **uTHUKELA DISTRICT**, with the mandate of providing water services to the communities situated in Alfred Duma, Okhahlamba and Inkosi Langalibalele.

The municipality is currently under administration because of its poor financial position, which rendered it unable to settle its debts as they fell due. Diligent financial management was below expectation (see financial analysis below), which affected service delivery in the district. Media reports reflected serious challenges in the provision of water services to the local municipalities within the district. For example, the residents of the Ladysmith area had been protesting over the lack of water that should be provided by the district. The annual audit identified that the district was not reliably determining the areas that required access to water. The municipality had a full-time chief financial officer and a municipal manager; however, the service of the municipal manager was terminated after year-end.

The municipality received a qualified audit opinion with numerous findings on compliance with legislation and material findings on performance information. Management did not implement controls to ensure that water meters were regularly read and consumers were accurately billed for services received. Senior management and support staff were not strongly committed to improving the outcomes.

Service delivery protests arose during the year because of water shortages and water interruptions experienced by communities. uThukela District mostly utilised water tankers through outsourced service providers to transport water to communities because of ageing infrastructure. Although there was a reduction in the cost of water tanker services from R52,82 million to R32,89 million during the year, these costs are still high. Cost-cutting measures were implemented, with the municipality resorting to using its own tankers to provide water to communities.

The use of water tankers from outsourced service providers was a common ongoing practice at district municipalities. At some municipalities infrastructure was in place to provide these services whilst at other municipalities continual payments were made to service providers without any planning for the development or refurbishment of water infrastructure.

Some of the top contributing factors to irregular expenditure at uThukela District, which was recorded at R245,56 million, arose because of the lack of preventative controls over supply chain management. The main contributors to the irregular expenditure were the continued use of expired contracts and contracts that did not have an end date. Additionally, competitive bidding processes were not always followed, awards were made to bidders whose tax matters were not in order, and declarations of interest were not always submitted by winning service providers. Compliance checklists were not reviewed to ensure that all related legislation was included in contracts; nor were these properly implemented and monitored. Some progress was made in investigating and terminating supplier contracts that were irregularly awarded; however, there were instances where no investigations were taking place.

The municipality established oversight mechanisms to promote good governance but these structures were not without their own challenges. The internal audit unit and the audit committee made appropriate recommendations, but these were not subsequently implemented by the different levels of management. Politically, the municipality was stable with a mayor and a functioning council. What was lacking was the implementation of consequence management mechanisms to foster accountability.

UNSATISFACTORY MUNICIPAL AUDIT OUTCOMES

Municipalities were unable to avoid setbacks when vacancies arose and were in a state of constant volatility due to failed preventative controls. High reliance continued to be placed on consultants without adequate assurance from internal audit units, audit committees and municipal public accounts committees. The tone at the top was not always set to influence robust systems of internal control that drove good governance and discipline.

MSUNDUZI is responsible for providing water, electricity, refuse removal and fire services (service charges) in the Pietermaritzburg area. The municipality is also responsible for charging rates on properties. It has a high own revenue base with R3,87 billion (2017-18: R3,57 billion) for service charges and property rates. The audit opinion improved from adverse in 2017-18 to qualified in the year under review. Although there was an improvement in audit outcome and management had managed to clear some of the qualifications from the previous year, the municipality continued to have challenges with the SAP accounting system for debtors and revenue. In this regard, there had been persistent billing issues because of the incorrect configuration of the SAP system, particularly on the modules for revenue and debtors, which resulted in a qualification on revenue and receivables. This was reported in the media as many consumers received incorrect billings from the municipality.

Msunduzi was also placed under administration due to poor management and governance. The administrator assisted the municipality with the filling of key vacancies, fast-tracking the finalisation of investigations, and implementing consequence management. Consultants were appointed to assist with financial reporting services at a cost of R6 million without much improvement in controls. The total salary bill of the finance department as provided by management was R134,18 million in the year under review.

The poor control environment resulting from the lack of consequence management and ineffective investigations also resulted in increased irregular expenditure. The total amount of irregular expenditure incurred was R214 million, indicating that goods or services had not been procured through a fair, competitive and transparent process due to a lack of preventative controls in awards made to suppliers. Despite the high irregular expenditure, there was no indication that goods or services were not received.

The municipality received and spent the full R42,76 million of the water services infrastructure grant. However, there was still a backlog in the provision of water and sanitation services to various areas due to insufficient funding. The findings reported correlate with the many protest actions that took place in the year with residents complaining about the constant water shortages and ageing infrastructure.

Road infrastructure plans for renewal and routine maintenance projects were not developed and the road infrastructure renewal budget of R3,22 million fell short by R31,39 million. This was due to poor planning and budgeting. Additionally, the systems and processes that enabled reliable reporting of the achievement against the service delivery indicator of refuse collection were not adequately designed, resulting in insufficient audit evidence. The poor budgeting had an impact on citizens as many residents complained about potholes and the poor condition of roads as well as refuse not being collected.

Insufficient budgets were cited as one of the main reasons for the municipality having a backlog of service delivery initiatives, yet R3,21 billion of the R3,67 billion consumer debt was declared doubtful and not collected by the municipality. If stringent practices were in place to collect the debt owed to the municipality, there would have been sufficient cash to address the backlog in water and sanitation services and infrastructure as well as routine road maintenance.

Although the municipality had a municipal public accounts committee, internal audit unit and audit committee, they did not provide the required level of assurance to significantly improve governance. The internal audit unit was often inadequately staffed and the mayor and municipal council were slow to respond to action plans, as there was a lack of commitment by these structures. It is of concern that R57,48 million was paid to councillors and internal audit committees, yet value for money from these structures was not evident as poor audit outcomes persisted. The municipal manager was not always keen to seek support and assistance from the provincial department of cooperative governance and traditional affairs and the provincial treasury as the oversight of municipal affairs was not delegated to the province, but instead vested in the National Treasury.

The audit opinion of **NEWCASTLE** remained unchanged as unqualified with findings. The positions of municipal manager and chief financial officer were vacant at year-end and filled with acting officials. The chief financial officer position was subsequently filled after year-end, indicating that the mayor made an effort to implement controls to create stability within the municipality. The financial statements were prepared by the municipality and contained material misstatements due to the lack of appropriate management reviews. Consultants were also sourced at R15,72 million for other financial reporting purposes. The total salary bill of the finance department as provided by management was R59,30 million. The internal audit unit and audit committee fulfilled their responsibilities, as internal audit findings were raised and follow-up audits were performed throughout the year. The audit committee tracked the implementation of internal audit recommendations and reported progress to the council. However, management was slow in implementing these recommendations. The municipality provides water and electricity to Newcastle and Emadadeni residents. The municipality's non-payment to Eskom and the possibility of blackouts in the area as a result of this led to community strikes.

Situated in Ladysmith, **ALFRED DUMA** was formed on 3 August 2016 after the demarcation of municipal boundaries, which resulted in municipalities being disestablished, and their former areas of jurisdiction merging under new municipalities. The former Emnambithi/Ladysmith and Indaka municipalities were part of the municipalities that merged to form Alfred Duma. The mandate of this municipality is to provide basic services (electricity, refuse and charging of property rates). The municipality received an unqualified audit opinion, with findings on compliance with legislation, which was an improvement on the qualified audit opinion received in the preceding two years.

The improvement in the audit outcome was attributed to management being proactive in responding to findings raised in the previous and current year. The municipality's finance team was sufficiently resourced and skilled and financial statements were prepared in-house with no reliance on consultants. Compliance findings were again reported as management did not prevent unauthorised and irregular expenditure as well as ensure compliance with supply chain management prescripts. Of concern was the compliance finding relating to ineffective monitoring controls over the performance of contractors, which delayed the completion of certain projects. One such project was the construction of the Colenso tarred road with a project value of R13,61 million which was not managed well by the municipality. Non-monitoring of the performance of the project led to delays in its completion. The project was initially planned to be completed in December 2018 but was still in progress although the completion date was amended to 31 August 2019. Reports of service delivery protests were received during the year. These arose as a result of management not achieving on some of the road and electrification projects set out in the annual performance report. One of these projects was the electrification of the 178 households at Uitval in Ward 35. The project was delayed as a result of the late approval of designs by Eskom.

The internal audit unit, audit committee, municipal council and municipal public accounts committee were fully operational and resourced. Recommendations made by these structures were appropriate to ensure that a sound internal control environment was fostered, and the leadership and management teams understood the importance of controls and their responsibilities in this regard.

The audit outcome of **ABAQULUSI** improved from a qualified opinion to an unqualified opinion with findings. This was due to the commitment of the finance team, support from the provincial department of cooperative governance and traditional affairs and the National Treasury, and the use of consultants to assist in preparing the financial statements. However, the municipality's leadership was unstable due to the suspension of the municipal manager and the resignation of the mayor. Stability had been a challenge for this municipality for a number of years. One of the reasons for this was the closely contested elections where the ruling party usually had a majority of only one seat. In prior years the municipality had no municipal manager for the entire five-year term of council. The municipality placed undue reliance on the chief financial officer, which was not a good practice as it could hamper operations should this official leave.

The internal audit unit completed many audits throughout the year but recommendations were not implemented in a timely manner by management, resulting in repeated deficiencies. The municipal public accounts committee held meetings and reviewed information but not comprehensively enough to provide assurance on the credibility and reliability of financial and performance information. The committee was unable to fulfil its duties effectively due to political instability within the council which resulted in the appointment of an administrator in March 2019.

The audit outcomes of **NONGOMA** improved from an adverse opinion to an unqualified opinion with findings. In the previous year the municipality lost key finance officials and therefore placed heavy reliance on consultants to prepare the financial statements, but they prepared poor-quality financial statements. The municipality has since taken legal action against the consultant to recover the costs incurred. The improvement in the audit outcome was attributed to the dedicated commitment displayed by management and the mayor. The municipality also engaged a new consultant to prepare the financial statements due to a lack of skills in the finance department. An amount of R1,1 million was spent on consultants for financial reporting.

Nongoma is predominantly a rural municipality. The municipality generated revenue from refuse removal of R1,88 million. However, management failed to provide evidence of the number of households where refuse was collected, despite the revenue that was received for this service.

Some findings and recommendations by the internal audit unit and audit committee on the financial statements were not implemented in time by management, with the result that material misstatements were corrected during the audit process.

The audit outcome of **eDUMBE** regressed from unqualified to qualified. The position of the chief financial officer was vacant for seven months during the year, which contributed to the regression in audit outcomes. The municipality engaged consultants to assist in the preparation of the financial statements due to vacancies and a lack of financial reporting skills in the finance department. An amount of R2 million was spent on consultants while finance employees were paid total salaries amounting to R5,79 million according to management. Although consultants were used, material misstatements were identified in the financial statements due to a lack of management review of the work performed by consultants.

The internal audit unit did not perform its functions adequately as there were vacancies in the unit. This included the head of internal audit who resigned during the year, leaving the unit with only one staff member. This affected the audit committee's ability to provide guidance and direction to the unit. The position of head of internal audit had been vacant for more than four months. Although the municipality established a municipal public accounts committee, the committee did not provide the required level of assurance to improve governance and have a positive impact on the audit outcome. The mayor and municipal council did not adequately monitor the implementation of the committed action plans, nor did they ensure that the senior managerial vacancies were timeously filled. In addition, preventative controls over financial misstatements failed when the post of chief financial officer became vacant. This is testimony to the fact that basic reconciliation processes and routines were not embedded in the municipality.

AUDIT PHASED IN FOR IMPLEMENTATION OF PUBLIC AUDIT ACT AMENDMENTS

The eThekwini Metro was selected for the implementation of the material irregularity process in 2018-19. No material irregularity was identified during the audit. (Refer to section 3 of this report for further details on the material irregularity process.)

The metro disclosed the highest amount of irregular expenditure in the province at R2,34 billion. In this regard, a panel of service providers was appointed to construct washing facilities and toilets for informal settlements and schools within the greater Durban area. We could not confirm that proper supply chain management processes were followed for establishing this panel and the subsequent awarding of contracts to suppliers on this panel. Sufficient and appropriate audit evidence was also not provided to establish whether the performance of some of the contractors on the panel was monitored on a monthly basis. The total value of irregular expenditure arising from awards to suppliers on the panel was R424 million. Another instance of irregular expenditure amounting to R816 million arose as a result of the appointment of a service provider for the development of an information technology management system.

Although investigations into irregular expenditure of the previous year were taking place, these were not conducted properly or not completed within a reasonable time in some instances. Additionally, where investigations had been completed, effective disciplinary steps (based on recommendations arising from these investigations) were not always taken against officials.

WHAT DO THE FINANCIAL STATEMENTS SAY?

The cash balance of **OKHAHLAMBA** (unqualified with no findings) was recorded at R26,66 million at year-end. Fixed assets of R50,66 million were purchased during the year (26% of cash inflows), while employee costs amounted to R87,53 million (44% of cash inflows). Approximately R32,39 million (61%) of the consumer debtors' book of R53,49 million had been impaired due to the possibility of non-payment. If these funds had been collected, it could have further contributed to local economic development and job creation in the area. However, the municipality tried to collect its current as well as older debts as not all debts in excess of 150 days were impaired. The municipality relied on grants to fund its operations, as an analysis of the employee costs revealed that these costs accounted for R87,53 million (71%) of the operational grants of R123,24 million received. Internal revenue (service charges and property rates) represented only R32,05 million (15%) of the total generated revenue of R214,18 million. Current assets exceeded current liabilities by R7 million; therefore, the municipality was able to discharge its current obligations, with an average of 49 days taken to pay creditors.

Persistent challenges with debt collection at **ILEMBE DISTRICT** (unqualified with findings) increased the debt impairment provision to R250,27 million, representing 71% of the debtors' book of R350,66 million. Additionally, the municipality's finances remained under immense stress with the reported surplus dwindling by R122,94 million (40%) from R309,54 million in 2017-18 to R186,60 million in 2018-19. Moreover, obligations of R78,56 million to creditors were not paid within 30 days due to low debt-collection levels. Conditional grant funding of R175,95 million was not fully spent, with planned projects for the provision of water services not materialising as anticipated. These funds were available and invested at year-end. The municipality generated own revenue of R197,77 million and received an equitable share allocation of R468,60 million. The municipality was fully dependent on its equitable share allocation to pay for operational expenditure as these costs (employee cost, councillor remuneration, contracted services and bulk purchases) of R480,68 million exceeded the equitable share allocation. Expenditure on repairs and maintenance of infrastructure decreased significantly to R24,16 million (2017-18: R55,15 million). Water losses were also reported at R92,97 million, increasing by 130% since 2017-18. The reported water losses of 61,74% depicted a dire situation arising from leaks in ageing infrastructure, the curbing of expenditure on infrastructure repairs and maintenance, as well as the failure to contain reservoir overflows and pipe connection leaks.

The poor state of **uTHUKELA DISTRICT** (qualified) was evidence of weak financial management (such as credit-control and debt-collection policies not being vigorously enforced), inadequate asset management as well as lapses in essential governance and oversight by administrative and political leadership. This was demonstrated by the excessive creditor-payment days and poor collection of municipal debt. More than 70% of the total municipal debt was impaired with the possibility that these funds might not be received by the municipality. An analysis of the provision for impairment of consumer debtors revealed that R729,68 million of the R793,63 million (92%) related to old debt outstanding in excess of 121 days. This affected the municipality's ability to adequately discharge its obligations as evidenced by the fact that it took longer than 488 days to pay creditors. In addition, outstanding debt related to water and sanitation amounted to R208,25 million at year-end.

The municipality incurred water losses of R246,15 million (56%) due to water services not being monitored, ageing infrastructure and suspected fraudulent sales of water to privileged members of the community. The water services infrastructure grant was also not spent as intended. The delays on water and sanitation projects were due to contractors not being paid on time as a result of cash-flow constraints. There were also delays in the completion of the projects, which affected water supply. uThukela District was heavily reliant on grants to fund its operations as internally generated revenue from the sale of water of R221,15 million was not adequate to cover the total employee and councillor costs of R299,28 million. We were unable to adequately rely on certain amounts in the financial statements for our analysis as the municipality was qualified on consumer debtors as well as on water losses.

MSUNDUZI (qualified) billed R3,87 billion to consumers for services, of which it received R3,48 billion in the current year, resulting in an approximate collection rate of 90% of current revenue billed. However, the municipality still had challenges in collecting old debt. Although the debt-collection period of 56 days was favourable, outstanding old debtors were not paying their accounts timeously. This led to the municipality reflecting a R3,21 billion (88%) impairment loss on the outstanding debt of R3,67 billion as being uncollectable. Subsequent to year-end, the municipality appointed 24 debt collectors to a panel to help with debt recovery. The municipality's own revenue of R4,22 billion represented 81% of the total revenue. Payroll expenditure of R1,35 billion represented 26% of the total revenue and constituted 24% of the total expenditure. This indicated that the municipality had the ability to be self-sufficient.

Although the municipality received high amounts from service charges and government grants, trade creditors were very high in relation to cash reserves, indicating that the municipality would not be able to meet its existing obligations with the funds available. This was evident from the amounts owing to the Development Bank of Southern Africa, Eskom and Umgeni Water at year-end of R480 million, R209 million and R77 million, respectively. The municipality spent R477,37 million (80%) of its capital budget, which resulted in an underspending of R118,31 million (20%). The water losses increased by 13% to R157,2 million and the electricity losses decreased slightly by 3% to R248,22 million. Progressive deterioration, illegal water connections, ageing and increasing levels of fragility in the bulk water infrastructure contributed to water losses. We were unable to rely on certain amounts in the financial statements for the analysis, as the municipality was qualified on consumer debtors as well as on revenue.

NEWCASTLE (unqualified with findings) had been facing going concern problems since it spent R400 million in upgrading an existing municipal building which had been occupied since July 2016. This upgrade depleted much of its cash reserves. Additional loans were secured to finance the completion of the building. Most of the infrastructure grants were spent on service delivery infrastructure during the year. We tested certain key infrastructure projects funded by these grants and no material findings were noted in this regard. Challenges were experienced especially with the debt due to Eskom and uThukela Water because the municipality repeatedly failed to honour payments. Amounts due to Eskom and uThukela Water stood at R230,1 million and R51,6 million, respectively.

The municipality collected R1,10 billion (85%) of the total own revenue of R1,28 billion billed during the year. However, challenges with the collection of some debts were experienced, with the debt-impairment provision of R933,90 million representing 61% of the debtors' book balance of R1,52 billion at year-end. This presented a bleak financial outlook for the municipality. Nevertheless, the municipality would be able to sustain its operations with own revenue as the employee cost, councillors' salaries as well as bulk purchases and contracted services amounted to R1,23 billion compared to own revenue of R1,28 billion. The municipality also continued to report a high deficit of R310,46 million, with its cash flow remaining under pressure. Water losses and electricity losses amounted to R45,10 million and R18,75 million, respectively, due to water services not being monitored, ageing infrastructure and illegal connections.

The financial viability of **ALFRED DUMA** (unqualified with findings) remained stable during the year as evidenced by healthy cash reserves, a net asset position and the accumulated surplus reported. The municipality did not rely on long-term debt as most funding was secured through government grants. Debts were not collected in time, with a high bad debt provision of R189,48 million (54%) of the gross debtors' balance (revenue from service charges and property rates) of R348,44 million reported. This was evidenced by the 132 days on average it took to collect debt. The collection of old debts, mainly arising from the billing of consumers in poor communities who could not afford to pay for the services rendered to them, remained a challenge. In total, 82% (R47,3 million of the R57,6 million revenue from exchange transactions) of the impairment provision related to debt outstanding in excess of 120 days.

Our analysis of the municipality's own revenue showed that it was collecting most of the current year billings. The municipality's employee costs of R318,81 million accounted for 60% of the internal revenue generated. The municipality was not solely reliant on government grants to fund its operations and was able to operate on the internally generated revenue. No significant deficiencies were identified in respect of conditional grants and projects funded by these grants for road infrastructure, as grants were used for their intended purpose. The municipality was able to discharge its current obligations and took an average of 57 days to pay creditors. Debt due to Eskom and the Development Bank of Southern Africa stood at R27,21 million and R2,72 million, respectively.

ABAQULUSI (unqualified with findings) entered into an agreement with Zululand District in 2003 according to which the provision of water services in the Vryheid and Paulpietersburg areas was delegated to the municipality. The lack of funding for water infrastructure was felt in all communities across the municipality with the ageing assets no longer coping with demand and constant breakages occurring. This was evidenced by the high asset maintenance costs, the non-achievement of the targets set for the replacement of infrastructure assets as well as the high disclosed water losses of R15,9 million (60%).

The municipality was involved in a legal dispute with a landowner over the compensation for property that was expropriated for a low-cost municipal housing development on 12 June 2006. After a protracted legal process, the court settlement agreement ruled that the municipality had to pay R25,1 million plus interest to the landowner from 2006. The repayment of this debt, the low levels of debt collection as well as reported deficits meant that the municipality had insufficient cash reserves to discharge its responsibilities. Furthermore, the municipality did not obtain any grant funding and support from the district for water services provided on its behalf which could result in further cash-flow constraints.

The impairment provision of R82 million represented 58% of the debtors' balance of R143,6 million at year-end. In addition, the debt-collection period of 137 days exceeded the 90-day norm. There was also a lack of funds available to settle creditors, as it took more than 129 days to pay creditors. Grant funding of R182,8 million represented 32% of the total revenue of R565 million. Salaries and wages of R159 million represented 122% of the equitable share allocated to the municipality. This placed significant strain on the municipality's finances as it depended on the internally generated revenue to fund the difference in the salary bill as well as its operational costs. The pressure on the municipality's finances was further worsened by significant water losses of R15,9 million (60%) due to an ageing infrastructure network. Furthermore, illegal electricity connections resulted in electricity losses of R30,7 million (19%), placing a further strain on finances.

Salaries and wages for **NONGOMA** (unqualified with findings) represented 79% (R107,8 million) of the equitable share allocated to the municipality. A substantial higher salary cost of R107,8 million was incurred to generate only R30,8 million of internal revenue. Almost 60% of the salary costs related to the technical divisions responsible for service delivery. In this regard, the biggest amounts were represented by the community services and refuse collection divisions. This did not reflect the municipality as being economically sustainable as it was highly dependent on the equitable share allocation received. Municipal infrastructure grant funding of R31,2 million was allocated and fully spent during the year. This grant funding represented 29% of the total salary cost, indicating that a limited budget was dedicated to infrastructure development. The municipality still had challenges in collecting older debt from some consumers as there were high levels of unemployment. This resulted in R16,9 million (28%) of the total debtors' book value of R59,9 million being declared as uncollectable, with the municipality taking an average of 421 days to collect debts.

eDUMBE (qualified) is located in one of the poorest areas within the Zululand district. Only 23% of the municipality's population lives in an urban area while 77% lives in rural areas. This factor had severe implications for actual service delivery, as most settlements were unplanned and lacked the necessary access to basic services such as electricity, refuse removal and roads. The municipality's cash receipts from customers of R65,6 million represented a 121% collection rate of the R54 million in services billed. The over-collection resulted from the recovery of some of the old debt. Overall, however, the municipality was struggling to collect old debt as evidenced by the fact that it took on average 222 days to collect debts. High levels of unemployment, together with poverty affecting the district, contributed to a R109 million (79%) impairment loss on the consumer debtors' balance of R137 million.

The municipality was dependent on grant funding to sustain its operations as the analysis of employee costs revealed that the total amount of salaries and wages of R54,8 million represented 70% of the operational grant funding received, whereas own revenue of R60 million represented 32% of the total revenue generated. The average of 61 days it took to pay creditors exceeded the 30-day norm. The municipality was able to settle its historical debt with Eskom, leaving the amount outstanding at year-end at R5 million. Electricity losses of R8,2 million (38%) were incurred due to illegal connections as well as ageing infrastructure. Even though the municipality was faced with many challenges, positives may be drawn from the fact that it managed to spend R40,56 million (95%) of the capital budget. Of this amount, R35,74 million (88%) was spent on the construction of community and infrastructure projects. These projects resulted in an additional 328 households being connected to electricity.

CONCLUDING REMARKS

The messages reported above signify to a large extent that local government in the province is not fulfilling its promises to society. Legislation coupled with policies and procedures is in place to guide local government, but local government persistently fails to implement these in the intended manner to enforce compliance. More focus must be placed on exercising political oversight and addressing the aspirations of citizens. Municipal managers and senior management also do not devote sufficient energy to areas that matter such as key controls, risk management and credible reporting in prime areas such as reconciliations, supervisory reviews, action plan monitoring and adherence as well as record keeping, which form the foundation for sound levels of accountability. Consequently, there is often a blatant disregard for the legislation that governs good administration, without punitive measures being actioned against errant officials. Moreover, consultants continue to be appointed in many instances while officials are in positions to execute these functions. This promotes indolence among officials as well as a wastage of funds.

The very fabric of local government in the province depends on the political willpower and drive to influence and forge speedy and sustainable change that supports government imperatives such as access to basic services and the district development model. The municipal managers, with their management teams, must set an ethical tone to solidify systems and processes as well as preventative controls, which should operate on autopilot and set accountability in overdrive. The levels of tolerance for non-compliance need to be minimised, with transparent reporting to councils and the public. The importance of implementing the recommendations of audit committees cannot be overemphasised, nor can the need for assurance providers (municipal public accounts committees and audit committees) to understand the business chemistry of local government beyond the financial statements. This is important to support cohesive and better-governed municipalities.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Okhahlamba	LM		3 135 114	-	3 135 114	9 338 352	34%	3
2	Ilembe District	DM		893 139	-	893 139	40 898 356	2%	1
3	King Cetshwayo District	DM		55 200	-	55 200	16 661 722	0%	1
4	Abaqulusi	LM		546 200	-	546 200	4 254 563	13%	1
5	Dr Nkosazana Dlamini Zuma	LM		888 231	-	888 231	9 034 815	10%	4
6	Endumeni	LM		1 772 740	-	1 772 740	10 204 916	17%	1
7	Greater Kokstad	LM		1 211 606	-	1 211 606	9 647 630	13%	1
8	Maphumulo	LM		2 442 236	-	2 442 236	6 300 551	39%	2
9	Mfolozi	LM		2 741 477	-	2 741 477	9 016 405	30%	1
10	Msinga	LM		2 644 905	-	2 644 905	5 460 010	48%	1
11	Mthonjaneni	LM		2 199 651	-	2 199 651	4 927 447	45%	1
12	Ndwedwe	LM		3 892 799	-	3 892 799	10 598 499	37%	3
13	Newcastle	LM		15 727 573	-	15 727 573	59 297 544	27%	5
14	Nkandla	LM		3 000 827	-	3 000 827	6 923 153	43%	1
15	Nongoma	LM		1 123 404	-	1 123 404	9 873 573	11%	1
16	Nquthu	LM		692 213	-	692 213	7 778 879	9%	1
17	Ray Nkonyeni	LM		7 218 742	-	7 218 742	34 508 049	21%	5
18	uMhlabuyalingana	LM		3 381 409	-	3 381 409	8 758 919	39%	1
19	uMlalazi	LM		752 631	-	752 631	15 651 768	5%	1
20	Umvoti	LM		276 000	-	276 000	7 637 700	4%	1
21	Umzumbe	LM		2 149 773	-	2 149 773	7 519 496	29%	2
22	uPhongolo	LM		2 217 603	-	2 217 603	6 661 332	33%	2
23	Amajuba District	DM		1 250 000	-	1 250 000	9 136 948	14%	3
24	Ugu District	DM		-	1 231 880	1 231 880	59 497 867	2%	1
25	Umgungundlovu District	DM		1 978 687	-	1 978 687	46 733 909	4%	3

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM** = district municipality **LM** = local municipality

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
26	uMkhanyakude District	DM		7 441 379	-	7 441 379	24 663 661	30%	1
27	uThukela District	DM		8 221 601	-	8 221 601	38 509 080	21%	4
28	Big 5 Hlabisa	LM		1 157 587	-	1 157 587	6 947 575	17%	1
29	eDumbe	LM		1 996 164	-	1 996 164	5 790 491	34%	2
30	Jozini	LM		217 638	-	217 638	9 645 896	2%	1
31	Msunduzi	LM		6 013 630	-	6 013 630	134 179 882	4%	2
32	Mtubatuba	LM		2 427 594	-	2 427 594	13 493 289	18%	1
33	Richmond	LM		2 100 000	-	2 100 000	5 451 277	39%	2
34	uMzinyathi District	DM		1 298 020	-	1 298 020	4 959 666	26%	2
35	Inkosi Langalibalele	LM		992 137	-	992 137	21 433 640	5%	1
TOTAL				**94 057 910**	**1 231 880**	**95 289 790**	**681 396 859**	**14%**	**64**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

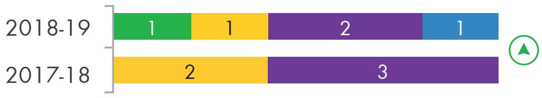
MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

NOTES

2.6 LIMPOPO

AUDIT OUTCOMES

CAPRICORN

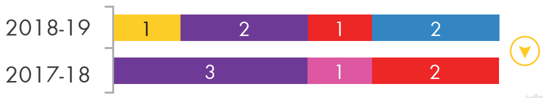


- Capricorn DM
- Blouberg LM
- Lepelle-Nkumpi LM
- Molemole LM
- Polokwane LM

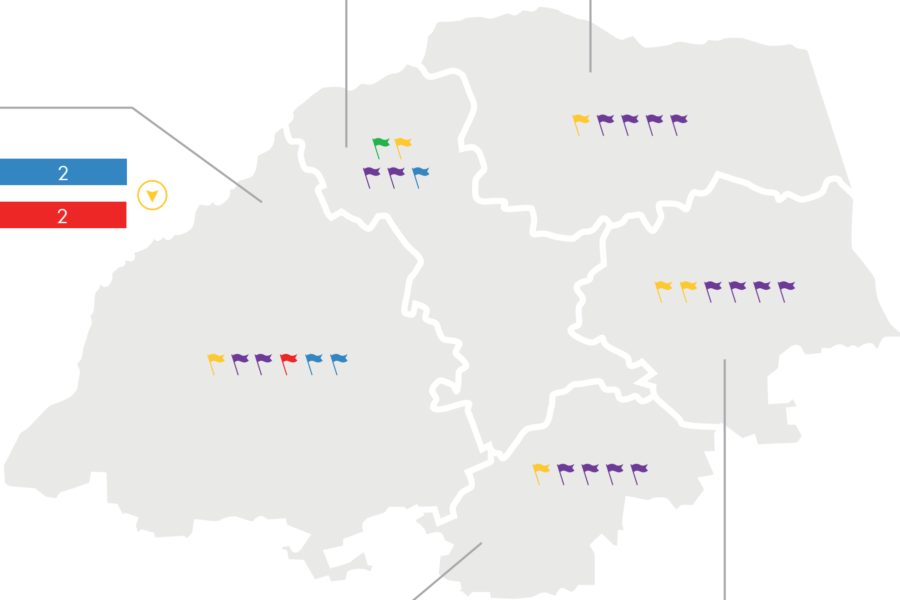
VHEMBE

- Vhembe DM
- Collins Chabane LM
- Makhado LM
- Musina LM
- Thulamela LM

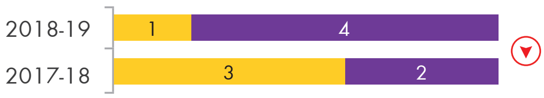
WATERBERG



- Waterberg DM
- Bela-Bela LM
- Lephalale LM
- Modimolle-Mookgophong LM
- Mogalakwena LM
- Thabazimbi LM



SEKHUKHUNE



- Sekhukhune DM
- Elias Motsoaledi LM
- Ephraim Mogale LM
- Fetakgomo Tubatse LM
- Makhudutamaga LM

MOPANI

- Mopani DM
- Ba-Phalaborwa LM
- Greater Giyani LM
- Greater Letaba LM
- Greater Tzaneen LM
- Maruleng LM

Metropolitan municipality | District | **DM** District municipality | **LM** Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PERFORMANCE SNAPSHOT

The Limpopo local government consists of 27 municipalities and four municipal entities. The audit outcomes of the municipal entities are not included in the analysis in this report, as they have been classified as small auditees. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, three audits were outstanding, namely those of Polokwane, Mogalakwena and Thabazimbi.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL IMPROVEMENT IN AUDIT OUTCOMES

3 Regressed
6 Improved

Clean audits

4%
(2017-18: 0%)

Financially unqualified financial statements

29%
(2017-18: 33%)

4% (1)
Municipalities submitted financial statements without material misstatements

Cost of using consultants to assist in financial statement preparation

R249 m
(2017-18: R180 m)

Consultant costs include **R122 m** (2017-18: R142 m) for audits completed by 31 January 2020 and **R127 m** (2017-18: R38 m) relating to outstanding audits

No findings on compliance with legislation

4%
(2017-18: 0%)

Irregular expenditure

R1,5 bn
(2017-18: R677 m)

Outstanding audits or audits subsequently finalised

R594 m
(2017-18: R466 m)

No findings on performance reports

25%
(2017-18: 8%)

33% (8)
Reported achievement reliable

FINANCIAL HEALTH

Deficit (expenditure exceeded revenue)	Creditor-payment period > 30 days	Vulnerable financial position	Distribution losses
2018-19 22% (5)	2018-19 96% (22)	2018-19 13% (3)	Water: R341 m
2017-18 50% (10)	2017-18 86% (17)	2017-18 17% (4)	(2017-18: R227 m)

Millions spent to improve audit outcomes – yet no consequences for poor performance

Overall, Limpopo improved on its audit outcomes. A total of six municipalities improved (Capricorn District, Waterberg District, Makhudutamaga, Vhembe District, Mopani District and Collins Chabane) while three regressed (Sekhukhune District, Elias Motsoaledi and Ephraim Mogale). While efforts to eliminate disclaimers in the province are commendable, there are still a significant number of municipalities that were qualified on the financial statements, with the result that no district stands out as a good example for the others. In all the districts, the majority of municipalities received a qualified audit opinion as they were still struggling with the implementation of basics for financial reporting, with findings on compliance and performance management.

Modimolle-Mookgophong, situated in Modimolle, was disclaimed for the third consecutive year. The provincial department of cooperative governance, human settlement and traditional affairs intervened through section 139(1)(b) of the Constitution at Modimolle-Mookgophong with the assistance of the National Treasury and appointed an administrator at the municipality in June 2018. The municipality was in a financial crisis as a result of poor internal controls which placed pressure on the municipality's liquidity ratio and financial sustainability. The intervention team assisted the municipality with the development of financial, infrastructure development, community service and governance strategies. The impact of this intervention will be assessed in the 2019-20 financial year.

Capricorn District in Polokwane is commended for receiving an unqualified opinion with no findings – what we also call a 'clean' audit. This is a highlight for the province as they last received a clean audit in the 2011-12 financial year by Waterberg District. The improvement is attributed to an improved internal control environment and the introduction and effective implementation of the necessary discipline to perform reconciliations and proper reviews of processes during the financial year. Stability in the positions of chief financial officer and deputy chief financial officer as well as the involvement of the mayor in the audit process further contributed to the improved outcome.

At the cut-off of this report, the province had three audits that were outstanding, namely those of Polokwane, Mogalakwena and Thabazimbi. Polokwane was late as the submitted financial statements did not agree to the underlying accounting records. The municipality was required to restate the balances in the financial statements which resulted in the delay. The phased-in approach of the Public Audit Act was implemented at Mogalakwena which contributed to the audit being finalised late. Thabazimbi had been disclaimed for a number of years, which resulted in a number of adjustments to its prior balances which required additional audit work.

In analysing the audit outcomes for 2018-19, we draw attention to the following issues that need to be considered to continue improving the province's outcomes.

AUDIT OUTCOMES – DO CONSULTANTS DRIVE IMPROVEMENTS?

Although the improvement in overall audit outcomes is encouraging, the sustainability of these improvements is concerning as they are mostly consultant-driven. Despite having spent R249 million on consultants for financial reporting purposes, the number of qualified municipalities remained high. Of this, R127 million was spent by municipalities whose audits had not been finalised by the cut-off date of this report. Services provided by these consultants ranged from preparing financial statements, preparing and maintaining fixed asset registers, and rendering value-added tax services.

Although the municipalities used consultants, material misstatements were again identified in the areas of their responsibility. In most instances, consultants were appointed annually for the same services as in the previous year, which is a clear indication of the high reliance on these consultants. Skills transfer was not prioritised, with some officials becoming complacent when consultants were hired and therefore not performing the jobs they were appointed to do. Only nine municipalities had vacancies at chief financial officer level, while four were without municipal managers at year-end. Yet consultants were appointed to all municipalities (with the exception of Makhudutamaga) to provide services although there were officials to perform those duties, either permanently or in an acting capacity. In addition to the amounts paid to consultants, the total salary cost of the finance divisions amounted to R463 million, of which R112 million relates to outstanding audits. This raises a question regarding the municipalities' financial sustainability given the duplicate cost exposure where funds could have been directed to service delivery. The province relies heavily on consultants yet there are no controls to ensure that the municipalities receive a return on their investment. The following serve as examples:

ELIAS MOTSOALEDI situated in Groblersdal regressed from an unqualified opinion with findings to a qualified opinion. The municipality appointed the same consultants as in the previous year to prepare the financial statements and assist in addressing the challenges relating to asset management at a total cost of R11 million. However, the municipality was again qualified on assets. The municipality did not maintain regular asset management disciplines upon handover of the function by the consultants for capturing the asset transactions in the asset register. Furthermore, the assets of the municipality were not correctly depreciated and calculated in terms of the accounting standards. Not maintaining regular asset management disciplines increases the risk of critical service delivery assets not being maintained or safeguarded against theft, which has an impact on the ability of the municipality to effectively and efficiently deliver services to citizens. Consultants were appointed to assist with the asset management function despite the municipality having officials in the asset management unit, indicating that officials did not perform the functions and responsibilities for which they were appointed or lacked the prerequisite skills. Although the use of consultants in areas where there were officials duplicated the existing costs incurred, leadership did not take any action against the officials in the asset management unit or implement initiatives to upskill and develop them.

MOPANI DISTRICT, which is situated in Giyani, improved from an adverse to a qualified opinion. The municipality spent R34 million on consultants for preparing financial statements, updating the asset register and assisting with value-added tax services, while the finance costs amounted to R20 million. Although the municipality's audit opinion improved, all the areas for which consultants were appointed were included as qualifications in the audit report. Consultants were not able to get these areas right because of inefficiencies on the part of the municipality, such as a failure to record some assets in the asset register (illustrating inadequate record keeping throughout the year) and a lack of reconciliations between the value-added tax suspense accounts and the main value-added tax control account. Furthermore, there was a lack of ownership by municipal officials in areas where consultants were appointed, as the officials could not provide information or explanations when audit findings were raised.

At **BA-PHALABORWA**, **GREATER GIYANI** and **ELIAS MOTSOALEDI**, these experts did not produce the required quality of services for which they were paid. Glaring errors were identified during the audit process, such as a failure to meet basic accounting disclosure requirements and reconcile cash flow statements, which resulted in qualified audit opinions. Overall, the municipalities appointed consultants without performing a needs assessment or gap analysis, while requirements regarding the transfer of skills were not included in the terms of reference. The lack of skills transfer was exacerbated by the municipal leadership's failure to identify employees to whom such skills had to be transferred, as well as a lack of monitoring of the consultants' performance.

CONCERNS OVER THE GROWING TREND OF WATER SHORTAGES IN THE PROVINCE

The Department of Water and Sanitation, Lepelle Northern Water and Magalies Water provide water to the water authorities (at district or local municipal level) in the province. The water authorities are then responsible for the distribution of water to residents. During our audit, we noted with great concern that the poor management of water distribution had resulted in significant water losses due to water leakages as well as deteriorating water infrastructure, unauthorised consumption due to re-routing of water from the water stream, illegal tampering with water meters and inadequate systems to verify water purchased, amongst others. The province reported water losses amounting to R341 million – an increase of R114 million compared to the previous year – which represented a substantial amount of revenue lost by municipalities that were already struggling financially. The escalation in water losses is an indication of leadership's lack of concern or inadequate action to decisively address this basic human right due to poor management of water distribution, notwithstanding the grants provided by national government to restore and upgrade the infrastructure.

Residents of **SEKHUKHUNE DISTRICT** in Groblersdal protested for three weeks in February 2020, blocking all main roads leading to Groblersdal and Marble Hall, for allegedly not having access to potable water for six months. The protest action was only called off after the water and sanitation minister promised the community that a water relief project worth R143 million would be implemented immediately. The implementation of the project will be followed up in the next financial year.

VHEMBE DISTRICT in Thohoyandou purchases raw water through raw water schemes and boreholes from the Department of Water and Sanitation. The water is processed and distributed directly to customers by the district municipality, except for residents of Musina. The district recorded water losses of R204 million, which translates into an estimated 21 million kilolitres of water. Although water could be measured correctly at the water treatment works outlets, the district could not accurately determine the water losses. This means that their water losses include water provided to citizens living in the local villages due to a lack of the necessary infrastructure to bill for the usage of water, a lack of record keeping for free basic water supply to indigents, and water leakages caused by a lack of maintenance and ageing water infrastructure. The district municipality has a long-outstanding debt to the Department of Water and Sanitation for raw water, which is under dispute. Discussions are in progress to determine the correct amount. The liability of the district to the department is exacerbated because Musina, which sells water on behalf of the district, failed to pay over the money received from customers to the district. The above challenges resulted in the qualification of liabilities in the financial statements of the district municipality.

MOPANI DISTRICT is a water services authority responsible for ensuring the sustainability of water supply and sanitation for the district. The district purchases raw water from the Department of Water and Sanitation and purified water from Lepelle Northern Water. The district municipality experienced challenges in providing water services and therefore an initiative was launched to alleviate the problem through the Nandoni water project. The project was built to draw water from Nandoni Dam in Venda to Giyani. Due to the drought and ageing infrastructure, the water and sanitation minister conducted a site visit on 12 August 2014 which led to a ministerial directive to appoint Lepelle Northern Water as an implementing agent to speed up the water service delivery in the district. However, the project is taking longer than anticipated while the communities in Giyani still do not have access to water.

The district as the water services authority has entered into agreements with its local municipalities (Ba-Phalaborwa, Greater Giyani, Greater Letaba, Greater Tzaneen and Maruleng) to provide water services to citizens. This model puts a strain on the district's finances as local municipalities are not paying what is due to the district. Furthermore, the district municipality recorded water distribution losses of R41 million, which was a qualification area in the audit report, as the district did not have systems to validate the water losses due to a lack of information to support the recorded loss.

The following are examples of the impact of these losses:

- Loss of revenue because water losses represent revenue that was not billed.
- Inadequate delivery of water services to communities.
- Redundant water infrastructure assets (such as boreholes and reservoirs) as water does not reach all parts of the district where these infrastructure assets have been constructed or completed.
- The lack of water service delivery results in service delivery protests and community unrest. During many of these protests, members of the community vandalised the district's water infrastructure assets, which in turn resulted in increased repair and maintenance costs.

Leadership must ensure that municipalities have adequate water infrastructure in place, and more importantly, that it is maintained on a regular basis. The loss of funds emanating from water losses has a direct impact on the municipalities' ability to render basic services to the citizens of the province.

VBS – THE CONTINUING IMPACT ON SERVICE DELIVERY

As reported in the previous general report, eight municipalities in the province had invested funds with VBS Mutual Bank and incurred losses on the balance of the investment amounting to R1,2 billion.

FETAKGOMO-TUBATSE situated in Burgersfort invested funds with VBS and incurred losses on the balance of the investment amounting to R243 million. This put strain on the municipality's ability to deliver services to communities. The basic service delivery and infrastructure development and the local economic development objectives of the municipality were not fully met due to the lack of funds.

VHEMBE DISTRICT incurred a loss of R369 million of own revenue invested. The adverse impact on the district's ability to deliver services continued in the 2018-19 financial year as the district was unable to pay for repairs and maintenance of water pipes and boreholes due to the lack of funds, which resulted in water interruptions for citizens and escalated water losses.

MAKHADO, situated in the town of Makhado, lost R63 million of the equitable share invested. The municipality could not fill critical positions to address service delivery objectives due to a lack of funds, which prevented timely attention to service delivery requests.

The investigation instituted by the provincial treasury to determine the root cause that led to these investments was finalised and each municipality was provided with their own report. At all the municipalities that invested money with VBS, the officials that were responsible for making these investments were suspended. At Lepelle Nkumpi, Vhembe, Makhado, Collins Chabane, Elias Motsoaledi and Fetakgomo-Tubatse, the chief financial officers were suspended and subsequently resigned, while Greater Giyani dismissed their chief financial officer. The municipal managers at Lepelle Nkumpi and Greater Giyani resigned and the term of the then acting municipal manager for Makhado ended while he was on suspension, with the council taking a decision not to renew his contract. At Collins Chabane, the municipal manager approached the court for a ruling on the council's decision to place him on suspension as a result of investing money with VBS. The court ruled in favour of the municipal manager but the municipality is currently appealing the court decision. At Fetakgomo-Tubatse and Elias Motsoaledi, the municipal managers are still challenging the matter in court. The outcomes of both cases were still pending at the date of this report.

The municipal manager of Vhembe District was found guilty of financial misconduct and he subsequently resigned after council approved a settlement agreement of almost R1 million. When the district municipality was summoned to appear before the Standing Committee on Public Accounts in September 2019, the committee found that such a decision to pay a settlement agreement demonstrated a lack of leadership in the municipality and asked law-enforcement agencies to investigate the matter, which we will follow up in the next audit.

The mayors implicated in the investments were recalled by the ruling party. The investigation report has been handed over to the Directorate for Priority Crime Investigation (Hawks) for further action. The investigations were still in progress at the date of this report and will be followed up in the next audit.

In the hope of recovering from the big VBS loss, municipalities are implementing cost-containment measures and have introduced recovery plans. Despite these efforts, municipalities affected by losses in VBS took an average of 129 days to pay their creditors.

IS IT BECOMING A TREND TO USE CONDITIONAL GRANTS FOR UNINTENDED PURPOSES?

The major grants that were made available to all municipalities analysed in this report are as follows:

- Municipal infrastructure grant: R2,8 billion
- Regional bulk infrastructure grant: R265 million
- Water services infrastructure grant: R508 million

Mopani District, Musina and Fetakgomo-Tubatse did not spend conditional grants for their intended purpose in terms of the Division of Revenue Act framework, which resulted in irregular expenditure. Mopani District and Fetakgomo-Tubatse were also qualified on the completeness of their irregular expenditure.

MOPANI DISTRICT received a water services infrastructure grant for drought relief amounting to R85 million in March 2019. The conditions of the grant stipulated that it be used for setting, drilling, testing, equipping and electrifying boreholes in drought-stricken areas. As at 30 June 2019, R57 million had been spent. However, shortcomings in the utilisation of the grant included duplicate payments, payments made without evidence that work had been done, and money paid for water provided through water tankers instead of being used for the intended purpose of the grant. Due to poor project management and inadequate planning and monitoring by the political and administrative leadership, communities in the district were left without water and the municipality had no alternative but to use water tankers to transport water to affected areas in order to alleviate the crisis. Water service delivery remains a concern as there are still communities in the district that do not have access to running water. The Special Investigating Unit has received a directive from the President to investigate previous water infrastructure grants as part of drought-relief programmes due to identified irregularities. The investigations are still in progress.

At **MUSINA**, which is situated in the town of Musina, the unspent municipal infrastructure grant of R3 million was not cash-backed, with the result that we were unable to determine whether the grant was used for its intended purpose.

At **FETAKGOMO-TUBATSE**, the municipality received funding from the integrated national electrification programme grant to electrify 25 villages; however, certain villages were not electrified as per the agreement with the contractor. A disagreement on the performance of the contractor resulted in the municipality withholding payments to the service provider. The electrical contractor then took the municipality to court for unpaid bills amounting to R41 million dating back to 2017. The municipality lost the case and, through the attachment of their assets by the sheriff of the court, was forced to pay R41 million of unpaid bills to the same contractor for the work done and could not provide supporting documents for the total amount claimed to substantiate the work done.

In contrast to the above, **THULAMELA** in Thohoyandou spent their municipal infrastructure grant amounting to R113 million for its intended purpose. The municipality demonstrated that principles of proper planning and monitoring by project managers lie at the heart of spending conditional grants for its intended purposes. One example is the construction of the 8,5 km Thohoyandou N service road. The project is in progress and on track, with a planned completion date of November 2020. Once completed, the community will benefit as using a tarred road is much safer than a gravel road.

EFFECTIVE AUDIT COMMITTEES, INTERNAL AUDIT UNITS AND OVERSIGHT STRUCTURES ARE THE KEYS TO SUCCESS

Audit committees are functioning in most municipalities in the province. These committees comprise at least one chartered accountant and a qualified legal person, in some cases advocates. The audit committee at **CAPRICORN DISTRICT** played a role in the improvement of audit outcomes. A new committee chairperson was appointed during the year under review. The committee reviewed the interim financial statements and raised valid issues that management addressed prior to submitting the financial statements for auditing. There was cooperation between committee members and management throughout the year, which contributed to the improvement in audit outcomes. There was also ongoing communication with the council.

At **WATERBERG DISTRICT** in Modimolle, the audit committee engaged with the provincial treasury and the provincial cooperative governance, human settlements and traditional affairs department, which is a good practice to be shared with other committees.

During the audits, external auditors often raise the same findings as those raised earlier during the year by the internal auditors. Internal audit units are generally inadequately staffed and the mayors and councils are slow to respond to action plans and recommendations due to a lack of commitment. If internal audit recommendations are fully implemented, audit outcomes can improve. At Bela Bela, Fetakgomo-Tubatse, Musina, Lepelle Nkumpi, Makhado, Maruleng and Thulamela, internal audit recommendations were not implemented by management and these municipalities' outcomes remained stagnant when compared to the previous year. Of concern is that the municipalities paid a total of R74 million to internal audit staff and R21 million to audit committees.

At **CAPRICORN DISTRICT**, the internal audit function performed audits as part of their annual plan. These audits identified internal control deficiencies and recommendations were made to management for appropriate corrective action. The implementation of the internal audit recommendations is an ongoing process. The internal audit unit was actively involved in the external audit process and reviewed the quality of the information submitted to the auditors and management responses to audit findings.

Strong oversight intervention has a positive impact. In the previous year, the Standing Committee on Public Accounts called the mayors and accounting officers of five struggling municipalities in the province to appear before them. Municipalities had to give reasons for the state of their municipalities and present turnaround plans to improve audit outcomes. At **VHEMBE** and **MOPANI** district municipalities, the recommendations made by the committee had been taken very seriously and cooperation by management had improved, which led to qualified opinions after five years of disclaimed/adverse opinions.

Nine municipal public accounts committees did not investigate irregular, unauthorised and/or fruitless and wasteful expenditure. At **MODIMOLLE-MOOKGOPHONG**, none of this expenditure was investigated. The three main political parties in the council could not reach consensus on the process that needed to be followed in conducting an investigation into such unwanted expenditure. In some instances, the expenditure was condoned without any consideration of the circumstances under which it had been incurred. At **VHEMBE DISTRICT**, the municipal public accounts committee recommended to council that irregular as well as fruitless and wasteful expenditure relating to prior years be condoned without being properly investigated. Such actions make the oversight of these committees questionable.

At **BELA BELA**, some of the reasons captured in the oversight reports of the municipal public accounts committee in relation to the write-off of the irregular expenditure were not adequate. The investigations did not identify the cause of the irregular expenditure and determine whether any officials were responsible and whether the amounts could be recovered. Without proper investigation, there are no consequences for transgressors and unwanted expenditure will continue to the detriment of service delivery and creating a better life for all. As far as the audit outcomes are concerned, there was no improvement at the municipality and no collective effort by the political leadership to address outcomes and service delivery issues (for example, the roads in town are in a very poor condition), despite the town being a popular tourist destination. The perception is that leadership simply does not care.

Municipal public accounts committees were not adequately capacitated and there was still uncertainty as to their roles. The committees were unfortunately extremely politicised, which negatively affected their objectivity and ultimately the accountability cycle. We have a good working relationship with most of the municipal public accounts committees in the province and are invited to brief members on audit outcomes to help them in their oversight role; however, we have not been invited by any such committee in the Waterberg district.

As per the premier's instruction, mayors chaired audit steering committee meetings and this was enforced by the member of the executive council for cooperative governance, human settlements and traditional affairs. At **VHEMBE DISTRICT**, the mayor attended and chaired audit steering committee meetings to ensure that management complied with the requests for information and attended to the findings raised by the auditors. This involvement is necessary and once it becomes common practice, will lead to further improvement and sustainability of outcomes.

INTERNAL CONTROL WEAKNESSES EXPOSE PUBLIC FUNDS TO ABUSE

> There is a general lack of proactive controls to prevent losses or undesirable events from occurring, with no adequate segregation of duties, daily and monthly reconciliations, proper authorisation of transactions, or adequate supporting documentation. The following serve as examples:

At **COLLINS CHABANE**, situated in Malamulele, a payment of R900 000 was made to an incorrect supplier. This was as a result of the inadequate review of payment documents before payments were processed on the system, as the responsible official did not review the correctness of the payment voucher (such as verifying the supplier name, banking details, and services provided). The municipality only managed to recover a portion of the loss, and the outstanding amount of R674 625 resulted in fruitless and wasteful expenditure.

At **VHEMBE DISTRICT**, bank reconciliations were not performed regularly (for example, reconciling items dating back to the 2017-18 financial year were only cleared in August 2019). In addition, the municipality did not have proactive controls in place to ensure that invoices were only paid once. During the year, the municipality processed payment for the same invoice twice, amounting to R1 112 748. This was because payments were processed without reconciling them to supporting documentation or because supporting documentation was not stamped as 'paid' after making payment the first time.

A proactive approach, aimed at identifying risks and requiring assurance from the political and administrative leadership that these risks are being mitigated through preventative controls, will have a positive impact on the control environment of municipalities. We acknowledge that it takes time to institutionalise good preventative controls, especially in large and complex environments. The political and administrative leadership will need to build their institutions towards accomplishing this in a deliberate manner.

UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE – THE ENEMIES OF SERVICE DELIVERY AND FINANCIAL HEALTH

There were significant increases in unwanted expenditure:

- Unauthorised expenditure increased from R1,4 billion to R1,6 billion
- Irregular expenditure increased from R677 million to R1,5 billion
- Fruitless and wasteful expenditure increased from R65 million to R217 million

All of the unauthorised expenditure incurred was as a result of overspending on approved budgets.

Non-compliance with supply chain management prescripts led to R1,5 billion in irregular expenditure. Mopani District, Fetakgomo-Tubatse, Lephalale, Collins Chabane and Vhembe District were responsible for R965 million of this amount. It should be noted that this amount will increase, as some municipalities were qualified on the amounts disclosed as irregular expenditure in their financial statements, while the three municipalities of which the audits were outstanding disclosed R594 million in their financial statements. We identified unfair or uncompetitive procurement processes at 96% of the municipalities; and R8 million in awards to employees and/or councillors. At Sekhukhune District, an award amounting to R7 million was made to a driver in the employ of the district, with the employee failing to declare such employment.

Councils are dependent on recommendations from the municipal public accounts committees after an investigation into unwanted expenditure. In some cases, councillors have a vested interest in the supply chain-related irregular expenditure, which results in their failure to deal decisively with this. For example, a family member of a ward councillor was awarded a contract worth R5 million for printing services at Elias Motsoaledi.

Fruitless and wasteful expenditure incurred amounted to R217 million, mainly due to interest and penalties on the late payment of invoices. Poor debt-collection practices result in municipalities having challenges in maintaining a healthy cash-flow position, which leaves them with no alternative but to delay payments to creditors.

THE FINANCIAL SUSTAINABILITY OF THE PROVINCE

The finances of the province did not significantly change when compared to the previous year. A deficit was realised at Greater Giyani in the previous year, but there has been an improvement in the management of finances, especially cost containment, in the current year. Cost-containment measures put in place by the accounting officer for subsistence and travel costs have seen the municipality save over R2 million. This was one of the measures taken to recover from the impact of the VBS investment loss of R159 million.

Overall, the payment period pattern of the province exceeded the required 30 days. The average payment period was 187 days. This put a significant strain on service providers, especially upcoming businesses. Poor debt collection and revenue management were at the root of financial health challenges. Debt-collection strategies need to be improved in order to continue providing services. In addition, amounts owed to Eskom and water boards remained high in the 2018-19 financial year at R1 billion and R2 billion, respectively. These balances increased significantly compared to the previous year.

WHAT DO THE FINANCIAL STATEMENTS SAY?

The financial statements of the municipalities in the province generally correlate with the socio-economic climate within their respective areas as well as our assessment of their financial discipline. Below is a financial statement analysis of three varied municipalities to provide valuable insights into some of the challenges that municipalities currently face.

At **BA-PHALABORWA** (qualified audit opinion), revenue of R579 million was recorded, of which R52 million was made up of conditional grants. The equitable share amounted to R132 million and the municipality managed to collect R232 million from town residents, mines, shopping malls and the government sector. However, municipal collections were not sufficient to cover the costs incurred in the year. In total, 26% of the municipality's operational expenditure (R142 million) was incurred on employee-related costs. The municipality is highly dependent on the equitable share to fully cover their expenses, which poses a significant threat to their sustainability if debt-collection processes are not improved.

An amount of R121 million, which mostly relates to debts in the townships, was provided for as uncollectable due to the socio-economic conditions within the municipality. Overall, the municipality provided for 88% of their debtors' balance as uncollectable. The lack of collection had a direct impact on the period it took the municipality to pay suppliers, which was on average 636 days. As at 30 June 2019, the municipality had creditors amounting to R333 million and cash of only R36 million. This amount in cash cannot service the current liabilities of the municipality, meaning that the next year's budget will already be used to finance most of this liability.

The municipality is one of the water services providers for Mopani District. The municipality bills customers and collects money on behalf of the district. Of their current creditors, R256 million was due to the district for water-related services. This balance increased year on year as the municipality did not pay the district back. When consumers paid for services rendered by the municipality, these funds were instead used to finance the municipality's day-to-day operations.

The municipality received a municipal infrastructure grant of R46 million, of which R42 million was used. We tested two projects for which the grant was utilised, namely the Tshelang Gape to R71 street upgrade from gravel to tar as well the upgrading of the Benfarm road. The Tshelang Gape project had not been completed by the planned date due to community protests, which resulted in unspent conditional grant funding of R4 million. The Benfarm road was completed as planned.

BELA BELA (qualified audit opinion) is one of the smaller municipalities in the province, with total revenue of R450 million. Of the total revenue, R90 million was made up of conditional grants for which conditions were met. Although the municipality is situated in a tourism area in the province, they struggled to collect debts due to them with 87% being considered irrecoverable. This is mainly attributable to game and agricultural farms not paying their property rates. The municipality managed to collect only R22 million in the year. Although the municipality received R82 million in equitable share, this grant together with collections did not cover employee-related costs amounting to R131 million. Debt-collection strategies need to be implemented for the municipality to recover what is due to them and to improve on service delivery.

The municipality reported a net current liability position as their current liabilities (R172 million) exceeded their current assets (R45 million) – a similar situation was also reported in the previous year. Similar to Ba-Phalaborwa, Bela Bela's creditors of R74 million far exceeded the amount of cash available at year-end of R18 million. The municipality deferred the payment of creditors and prioritised the payment of key expenses such as salaries to stay afloat.

Since it is a popular tourist destination, the maintenance of infrastructure should be one of the key focus areas of the municipality; however, this was not the case. The municipality spent R7 million on repairs and maintenance while water and electricity losses amounted to R4 million and R17 million, respectively. The rate at which construction of infrastructure is completed is also very concerning as only R36 million worth of assets was completed and available for use, despite the municipality receiving R84 million for municipal and water services infrastructure. The total balance of projects that were still in progress amounted to R108 million. The municipality had R11 million in unspent conditional grants at year-end.

CAPRICORN DISTRICT (clean audit outcome) is a water services authority and has entered into agreements with three of its local municipalities (Lepelle Nkumpi, Blouberg and Molemole) to be water services providers. Polokwane is also a water services authority, and therefore operates independently.

The district recognised revenue amounting to R979 million, of which R311 million consisted of conditional grants. An equitable share of R548 million was received in the year, which was sufficient to cover operating expenses even if none of the revenue was collected. Due to the arrangement as described above, the district does not collect as much revenue as they should because the local municipalities collecting money from debtors fail to pay such money over to the district. This resulted in 83% of their debts being considered as irrecoverable with a debt-collection period of 308 days.

The municipality received municipal infrastructure grant and water services infrastructure grant funding of R226 million and R78 million, respectively; in turn recognising assets amounting to R214 million as available for use by citizens. The pace at which projects are moving is extremely concerning. The district had projects amounting to R552 million that were still in progress at year-end, with R529 million of the balance being for projects that had to be carried over from the 2017-18 financial year. Stringent monitoring processes should be put in place to ensure that projects are completed within planned timelines to improve service delivery. Water losses amounting to R19 million were incurred due to ageing infrastructure, which was not repaired or maintained on a regular basis. The district did not have unspent conditional grants at year-end and demonstrated sound financial discipline as the grants were spent for their intended purposes.

CONCLUDING REMARKS

Limpopo is known for its rich resources and unique tourist attractions. There is a lot of potential for investment and positioning the province as a destination of choice. Sadly, processes in place to prevent and detect errors still need to be institutionalised and consequence management needs to improve. The in-year status of records reviews that we perform and engage on with accounting officers provide an early warning system to alert accounting officers to matters that they can proactively deal with to prevent undesirable audit outcomes. Preventative controls promote transparency, strengthen accountability and are predictable with known expected outcomes. For a regime of preventative controls to exist, a strong tone at the top and an ethical culture must form the concrete foundation on which such discipline is built. There will be no need to debate 'consequence management' – consequences will be part of the outcome. The administrative leadership, as well as the audit committees, needs to ensure that findings raised in the areas where consultants are utilised, are addressed to better manage the performance of these consultants.

Capricorn District should inspire confidence in other municipalities to prove that where internal control systems are implemented, key vacancies are filled and there is stability at management level, a clean audit outcome is within reach. Continued effort will ensure that the clean audit status is sustained.

The biggest responsibility lies with the leadership in the province. Mayors and councillors, municipal managers, senior managers and the provincial leadership need to take charge and develop the huge potential of Limpopo. Leadership must strive to ensure that services are delivered, that money is spent wisely and responsibly, and that each and every cent can be accounted for.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Capricorn District	DM		5 041 291	-	5 041 291	21 623 000	23%	2
2	Waterberg District	DM		60 720	-	60 720	7 979 361	1%	1
3	Greater Letaba	LM		710 809	-	710 809	21 136 096	3%	1
4	Maruleng	LM		2 951 410	-	2 951 410	4 935 373	60%	3
5	Molemole	LM		794 225	-	794 225	5 281 154	15%	3
6	Thulamela	LM		2 702 138	-	2 702 138	20 928 000	13%	2
7	Mopani District	DM		34 071 251	-	34 071 251	19 788 531	172%	3
8	Sekhukhune District	DM		354 131	-	354 131	16 553 989	2%	2
9	Vhembe District	DM		6 348 021	-	6 348 021	26 694 836	24%	2
10	Ba-Phalaborwa	LM		3 509 295	-	3 509 295	20 796 202	17%	4
11	Bela-Bela	LM		10 085 187	-	10 085 187	11 729 114	86%	3
12	Blouberg	LM		5 655 301	-	5 655 301	13 529 435	42%	2
13	Collins Chabane	LM		2 797 254	-	2 797 254	11 086 299	25%	2
14	Elias Motsoaledi	LM		11 229 046	-	11 229 046	20 134 319	56%	4
15	Ephraim Mogale	LM		3 857 531	-	3 857 531	11 541 769	33%	1
16	Fetakgomo-Tubatse	LM		5 802 866	-	5 802 866	14 963 425	39%	4
17	Greater Giyani	LM		6 306 520	-	6 306 520	15 065 486	42%	2
18	Greater Tzaneen	LM		3 745 545	-	3 745 545	20 171 134	19%	3
19	Lepelle Nkumpi	LM		386 541	-	386 541	7 264 569	5%	1
20	Lephalale	LM		1 473 734	-	1 473 734	10 628 520	14%	2
21	Makhado	LM		4 876 192	-	4 876 192	28 863 904	17%	2
22	Musina	LM		8 425 812	-	8 425 812	8 839 685	95%	2
23	Modimolle-Mookgophong	LM		1 099 604	-	1 099 604	11 600 586	9%	2
24	Mogalakwena	LM		54 089 284	-	54 089 284	42 366 957	128%	4
25	Polokwane	LM		69 647 908	-	69 647 908	48 323 754	144%	3
26	Thabazimbi	LM		3 568 798	-	3 568 798	21 285 000	17%	2
TOTAL				**249 590 414**	**-**	**249 590 414**	**463 110 498**	**54%**	**62**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

2.7 MPUMALANGA

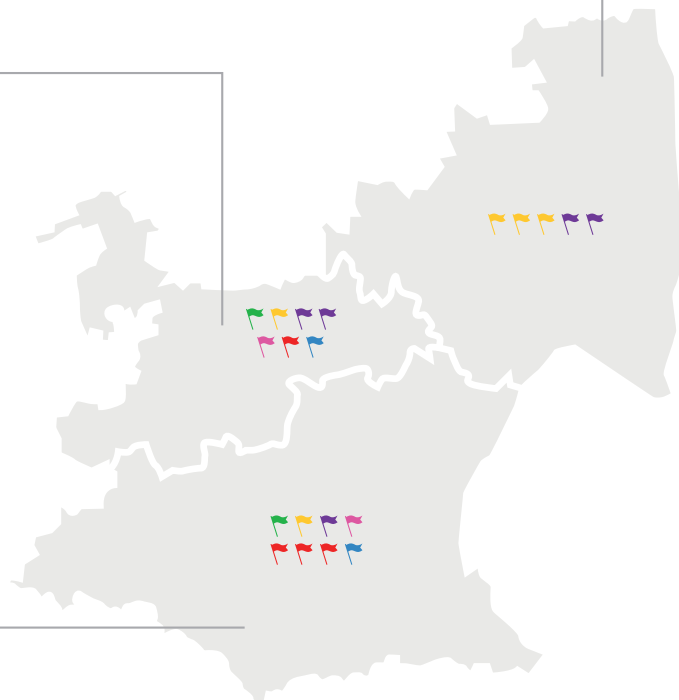
AUDIT OUTCOMES

EHLANZENI

- Ehlanzeni DM
- Bushbuckridge LM
- City of Mbombela LM
- Nkomazi LM
- Thaba Chweu LM

NKANGALA

- Nkangala DM
- Dr JS Moroka LM
- Emakhazeni LM
- Emalahleni LM
- Steve Tshwete LM
- Thembisile Hani LM
- Victor Khanye LM



GERT SIBANDE

- Gert Sibande DM
- Chief Albert Luthuli LM
- Dipaleseng LM
- Dr Pixley Ka Isaka Seme LM
- Govan Mbeki LM
- Lekwa LM
- Mkhondo LM
- Msukaligwa LM

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PERFORMANCE SNAPSHOT

The Mpumalanga local government is divided into three districts, which host 17 municipalities and two municipal entities. The two municipal entities (City of Mbombela Development Agency and Thaba Chweu Local Economic Development Agency) have been excluded from this analysis as they are classified as small auditees. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, the audits of two municipalities, namely Govan Mbeki and Dr JS Moroka, were outstanding.

The total population serviced by Mpumalanga municipalities is approximately 4 335 964. The total budget allocation for 2018-19 was R20,3 billion (2017-18: R18,9 billion) including equitable share, grants and own revenue.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

6 Regressed

2 Improved

Clean audits

11%

(2017-18: 6%)

Financially unqualified financial statements

39%

(2017-18: 44%)

17% (3)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

11%

(2017-18: 6%)

Irregular expenditure

R1 094 m

(2017-18: R1 112 m)

Outstanding audits or audits subsequently finalised

R358 m

(2017-18: R336 m)

No findings on performance reports

39%

(2017-18: 44%)

39% (7)

Reported achievement reliable

FINANCIAL HEALTH

Deficit
(expenditure exceeded revenue)

2018-19	42% (5)
2017-18	42% (5)

Creditor-payment period > 30 days

2018-19	92% (11)
2017-18	75% (9)

Vulnerable financial position

2018-19	39% (7)
2017-18	33% (6)

% of debtors' balance provided for

2018-19	61% (R7,27 bn)
2017-18	65% (R5,91 bn)

% of gross debtors' balance impaired

2018-19	13% (R1,53 bn)
2017-18	17% (R1,58 bn)

Distribution losses

Electricity: R724 m (2017-18: R1,1 bn)

Water: R394 m (2017-18: R304 m)

Deteriorating accountability and financial management coupled with weakened oversight at centre of significant regressions in audit outcomes

ANALYSIS OF AUDIT OUTCOMES

INTERNAL CONTROLS AS A BASE FOR FINANCIAL AND PERFORMANCE REPORTING AS WELL AS COMPLIANCE WITH KEY LEGISLATION

Internal controls are the preventative mechanisms, rules and procedures implemented by a municipality to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud and error. Besides complying with laws and regulations, and protecting the municipality's assets from theft or preventing fraudulent activities, preventative controls can help increase operational efficiency by improving the accuracy and timeliness of financial reporting.

These mechanisms, rules and procedures include separation of duties – separating the preparer, reviewer and approver roles; access controls – limiting access to certain information and assets to specific individuals; physical verification – checking whether what is recorded in the books actually exists; documentation standardisation and management – ensuring that each transaction is supported by valid documents; regular reporting – updating the ledger and trial balances on a daily or weekly basis to provide regular insight into the state of the system, allowing management to discover and investigate discrepancies; periodic reconciliations – to ensure that balances on the accounting system match up with balances in accounts held by other entities, including banks, suppliers and credit customers; and approval authority – requiring specific managers to authorise certain types of transactions to add a layer of responsibility to accounting records by proving that transactions have been seen, analysed and approved by appropriate authorities.

The auditor's opinion that accompanies financial statements is based on the review of the above internal control procedures. The audit outcomes clearly indicate that these internal controls did not work effectively at almost any of the municipalities in the province. The overall audit outcomes show a net regression of four municipalities, which is made up of two improvements and six regressions.

BREAKDOWN IN INTERNAL CONTROLS

The worst-performing district was **GERT SIBANDE DISTRICT**, where despite the district municipality sustaining their clean audit status, three of the local municipalities in the district regressed, namely Dr Pixley Ka Isaka Seme (Pixley), Dipaleseng and Lekwa. As part of their responsibility to local municipalities within their jurisdiction, the district municipality provided financial reporting support as well as platforms for their local municipalities to learn best practices. However, the extent of breakdown in the internal controls mentioned earlier did not make it possible for the resources to effectively improve audit outcomes.

DIPALESENG is one of the municipalities that received a resource from Gert Sibande District to assist the finance unit; however, this resource did not have an impact due to the ineffectiveness of internal controls at this municipality. The finance department had a vacancy rate of 31%, which affected their ability to perform daily and monthly preventative internal controls. The municipality used consultants to augment the skills in the finance department with respect to the preparation of the asset register and value-added tax reconciliations. As an example, management did not update and review the ledger and trial balances on a daily or weekly basis to allow them to identify that part of the revenue they recognised in the 2018-19 financial year relating to the previous year and on which they were charging property rates.

As at 30 June 2019, the municipality had a balance of R393 million in infrastructure assets, but was unable to properly account for additions made during the year as projects that were still being constructed were not categorised as work-in-progress – as they should have been in terms of the accounting framework applicable to local government. Furthermore, management did not spend anything to maintain this infrastructure to ensure that service delivery capacity was sustained. This contributed to electricity and water distribution losses of R7,4 million and R10,5 million, respectively.

The internal audit unit was composed of only the internal audit manager and one intern, with the result that they did not perform crucial activities. Due to the limited capacity, the internal audit unit could not review the financial statements and performance reports before they were submitted for auditing. The audit committee did not fulfil most of their responsibilities and did not advise the council or accounting officer on internal financial control deficiencies.

LEKWA, situated in Standerton, has been struggling to have a full staff complement for a number of years. The overall vacancy rate was 52% and the senior manager vacancy rate was 67%. The vacancy rate in the finance department was 33%, and even more serious was the position of chief financial officer that had been vacant for a while. The municipality used consultants to augment the staff but daily and monthly preventative controls were not implemented due to the high vacancy rate. Periodic reconciliations to ensure that the bank balances on the accounting system matched up with balances in accounts held by the bank were not performed. This resulted in reconciling items that management could not explain or support at year-end because they also did not manage their documents properly. Some infrastructure assets could not be physically verified during the audit to determine whether that what was recorded on the accounting system actually existed, and vice versa.

Management did not update and review the ledger and trial balances on a daily or weekly basis to allow them to identify that some of the completed projects were still recorded as work-in-progress. This also spoke to the weaknesses around the construction of these infrastructure assets as a result of poor project management, including delays in the project timelines and poor quality of work. As at 30 June 2019, the municipality had a balance of R741 million in infrastructure but management did not spend anything to maintain this infrastructure to ensure that service delivery capacity was sustained. This contributed to electricity and water distribution losses of R112 million and R63 million, respectively.

The improvement of **NKANGALA DISTRICT** from unqualified with findings to a clean audit outcome was overshadowed by the regressions in their two local municipalities, Victor Khanye and Emakhazeni.

At **VICTOR KHANYE**, there was a complete breakdown in major aspects of the internal control principles mentioned at the start of this section. The accounting system did not work for half of the year, with the result that the municipality transacted through the bank without recording the transactions on the accounting system. This meant that regular reporting and periodic reconciliations could not be done. The result was unreconciled differences between the accounting system and the balance as confirmed by the bank, which management could not explain. This is an indication of a lack of due care as stringent controls should have been put in place to prevent this situation, or manage it better to limit the risk of financial loss. Management also could not provide sufficient and proper evidence to support the majority of line items in the financial statements because they did not have effective documentation management controls.

At **EMAKHAZENI**, the internal controls had completely broken down. The municipality relied on consultants to do bank reconciliations, assist with the management of the asset register and also prepare financial statements, despite having individuals employed in the finance unit to do so. No adequate reconciliations were performed during the year, which resulted in unexplained differences between the financial statements and the municipality's accounting records (the revenue and amounts owed to the municipality). The municipality struggled with revenue billing: some invoices were billed to customers using incorrect tariffs and revenue sold by third parties on behalf of the municipality was not recorded in the municipality's books. In some instances, assets identified by the audit team as belonging to the municipality were not recorded in the municipality's accounting records. Due to the poor management of infrastructure assets, the municipality was unable to monitor and record electricity and water distribution losses.

While it did not have any municipality with a clean status, **EHLANZENI DISTRICT** had better audit outcomes compared to the other two districts. However, the preventative internal controls at the municipalities within this district were still not embedded in the day-to-day operations. This was evident from the material adjustments made to the financial statements during the audit of Bushbuckridge, Thaba Chweu and Nkomazi as well as the regression of the City of Mbombela (Mbombela).

At **BUSHBUCKRIDGE**, there was insufficient capacity to monitor daily and monthly controls. Management also did not utilise the internal audit unit effectively as they were not implementing their recommendations. The findings raised with management during the audit showed a correlation with the internal audit findings. Management did not view internal audit as a means to improve internal controls during the year and ultimately improve the accuracy of reporting. While management was able to correct accounting errors raised during the audit relating to infrastructure, we raised concerns on project planning and management controls as well as the maintenance of infrastructure assets on the municipality's balance sheet. For example, the project to reticulate 3 251 households at Rolle was delayed as the required approvals of the feasibility studies from the Department of Water and Sanitation were not obtained timeously. This resulted in delays in the completion of the project planned for 30 June 2019 but still in progress at the time the audit was completed.

Preventative maintenance was limited since the amount spent on the maintenance of infrastructure assets was far below the range of 4% – 8% set in the infrastructure maintenance budgeting guidelines contained in the national infrastructure maintenance strategy − crisis management was used to solve problems after they had occurred. As at 30 June 2019, the municipality had a balance of R3,13 billion in infrastructure assets but management spent less than 1% of that value on maintenance. The infrastructure was not maintained but rather repaired on an emergency basis. Consequently, the water loss incurred was 28% (R62 million).

While bank reconciliations were performed during the year at **MBOMBELA**, the reconciling items were not followed up and investigated timeously. As a consequence, management was not able to resolve the issues during the audit process due to the number of transactions involved.

INDICATORS OF DETERIORATING INTERNAL CONTROL ENVIRONMENT

Consultants used to do the work of employed staff

A total amount of R7,80 billion was spent on the wage bill, consultants and contracted services. This included R33,9 million of the financial management grant meant to sustainably improve the systems and controls that would ensure credible reporting and financial management. All the municipalities, except for Ehlanzeni District, used consultants for financial reporting, which is the core responsibility of the chief financial officer, despite 15 of those having an incumbent in that position. Only two of the municipalities that used consultants improved their audit outcomes. The other two district municipalities prepared their financial statements but used consultants to review them. The total cost spent on consultants for financial reporting was R95 million. A further R3 million was spent by municipalities of which the audits had not been finalised by the cut-off date of this report.

Some of the reasons why the use of consultants did not have an impact on the audit outcomes were a lack of effective preventative internal controls in processing the financial information throughout the year, the late appointment of consultants, and the scope of work not being clear. Most importantly, management was not effectively involved and did not monitor the work of consultants in a manner that would allow them to implement consequences for poor or non-performance. Where the services of consultants were used, the chief financial officers did not take accountability but delegated their responsibilities for the financial statements to the consultants.

We noted at Lekwa, Pixley and Victor Khanye that consultants instead of municipal officials responded to audit findings – an indication that municipal officials were unable to explain the transactions that made up the financial statements and did not have the necessary skills to perform the accounting tasks throughout the year and stabilise the internal controls.

At **GOVAN MBEKI**, consultants were appointed to assist with the preparation of the financial statements as well as the correction of prior year figures due to the disclaimer that the municipality received in the previous year. After a substantial amount of work had been performed, the consultants and the municipality did not fully agree on the scope of the engagement, with the result that the dispute had to be resolved by the court. Once the contract was terminated, the adjusted financial statements were reviewed by the municipality and upon discovering errors, they appointed a second consulting firm to finalise and correct the financial statements. This partly contributed to the late submission of the financial statements for auditing. The financials were subsequently submitted on 15 February 2020.

At **LEKWA**, consultants were appointed due to the high number of vacancies in nearly all aspects of the financial cycle, including performing bank reconciliations and preparing financial statements. At the time of submission of the financial statements for the year under review, the consultants were not able to provide supporting documents for the submitted financial statements, including the bank reconciliation for the bank accounts of the municipality. The municipality opened a new main bank account during the year under review and no bank reconciliation was performed on this account.

A good example of effective consequence management was identified at **PIXLEY** where the consultants were held accountable for the poor services that they delivered. Consultants were appointed for R2,2 million in August 2019 after the chief financial officer was suspended, to assist with updating the asset register and preparing the financial statements. It is clear that they did not have enough time to prepare the financial statements even though they accepted the job. The submitted financial statements contained numerous errors as most of the line items did not agree to supporting schedules and some of the presentation and disclosure requirements were either incomplete or omitted. The municipality invoked penalties in terms of the contract and only paid the consultants 65% of the contract amount, due to the issues reported on the quality of the financial statements. The consultants also offered to assist the municipality with resolving the issues after the audit for free and were still on site in January 2020.

Inability to spend conditional grants

We noted a trend of underspending on conditional grants – a total of R154,3 million was not spent as at 30 June 2019, mostly due to poor planning. **MBOMBELA** was unable to spend all grant funding in the year which led to the funds (R101,8 million) being taken back by the National Treasury. The municipality was not successful in requesting this money to be rolled over to the next period because it was not cash-backed. This further contributed to the financial challenges that the municipality was facing and could potentially delay service delivery on specific projects. This inability to utilise grant funding also contributed to the municipality's inability to achieve their planned service delivery targets, with only 55% of these being achieved.

Blatant disregard of compliance with key legislation with no consequences

With all these finance-related challenges, one would expect municipal leadership to exercise more care while carrying out their legislated responsibilities and pave the way for the administration to correct the situation. However, no such due care was evident. Of the previously reported unauthorised (R4,04 billion), irregular (R4,19 billion) and fruitless and wasteful expenditure (R1,06 billion), only R889 million of unauthorised, R65 million of irregular and R412 million of fruitless and wasteful expenditure were investigated and dealt with by the council. This also points to the ineffectiveness of most municipal public accounts committees, who did not have enough assistance to help them with further research on the reports that had been referred to them and did not have appropriate competencies to successfully execute their responsibilities.

Seven municipalities, namely Msukaligwa, Chief Albert Luthuli, Emalahleni, Lekwa, Emakhazeni, Thaba Chweu and Dipaleseng, did not investigate any of their previously reported unauthorised, irregular or fruitless and wasteful expenditure. Furthermore, municipalities continued to incur such expenditure of R1 094 million, R1 243 million and R706 million, respectively.

Intergovernmental support did not have the desired impact

The provincial government through the provincial treasury and provincial cooperative governance and traditional affairs department provided support to municipalities. The treasury provided support in the areas of budget, revenue and debt management, audit action plans, asset management, information technology governance, procurement plan implementation, financial statement preparation and the audit process. The department provided support in the areas of capacity building, alignment of the service delivery and budget implementation plan and integrated development plan, implementation of back-to-basics initiatives, addressing community concerns, and maintaining functional committees. Notwithstanding this support, the outcomes did not improve because of the systemic challenges around the control environment as well as the weak internal controls at local government as highlighted above.

Whilst there were very few exceptions, generally, the political and administrative leadership in Mpumalanga local government did not demonstrate decisiveness in dealing with the deteriorating internal control environment and had for far too long, despite the recommendations from various assurance providers, allowed unethical behaviour, misconduct and a culture of no consequences.

FINANCIAL ANALYSIS

Local government financial resources continued to dwindle at a time when municipalities are under increasing pressure to provide services

The financial health status of 13 municipalities is of concern or requires intervention. In an effort to improve this undesirable situation, a year ago the provincial government supported five financially distressed municipalities (Msukaligwa, Emalahleni, Thaba Chweu, Govan Mbeki and Lekwa) in terms of section 139(1)(a) of the Municipal Finance Management Act. Task teams led by the provincial treasury and provincial cooperative governance and traditional affairs department were dispatched to these municipalities to assist them with designing and implementing financial recovery plans. We noted during the year under review that this intervention had no impact on the financial health of these municipalities due to the late approval and implementation of the financial recovery plans.

Revenue management

The municipalities in the province actually billed a total of R7,01 billion from the sale of basic services and property rates during the 2018-19 financial year. While the budgeted own revenue was also a significant part (41%) of the local municipalities' budget of R20,3 billion, the measures put in place to generate this revenue were quite dismal. Maintaining reliable valuation rolls and correcting deficiencies in the billing systems were some of the measures that were not effective in ensuring that municipalities increased their revenue capacity. When these measures are not in place or effective, realistically, the anticipated revenue is insufficient to meet planned spending – a situation that puts pressure on the equitable share and the municipalities' ability to deliver services to their communities. As such, some municipalities initially submitted unfunded budgets, which the National Treasury advised them to revise.

Low collection rate and impact on honouring financial commitments

The municipalities struggled to convert the own revenue that was billed into cash. Consumers of municipal services in Mpumalanga owed municipalities a total of R11,87 billion. Municipalities estimated that they would not be able to collect R7,27 billion (61%) of this total and accepted that they had also lost R1,53 billion (13%) of this revenue due to it being irrecoverable. While the lack of effective collection processes contributed greatly to the situation, weaknesses in the billing controls as well as the inability to put together a credible valuation roll further contributed to the poor collection, as these weaknesses resulted in incorrect bills and dissatisfied consumers. When the municipalities are unable to collect their own revenue, they will not have sufficient cash to pay their creditors.

Distribution losses remained high

One of the contributing factors to the loss of revenue mentioned above is the volumes of electricity and water lost through the distribution process, partly because of the ailing infrastructure that was not being maintained and illegal connections that were not being addressed. The province reported exorbitantly high balances of electricity and water losses.

Employee costs as a significant portion of revenue

Employee-related costs at R5,4 billion took up a significant portion (30%) of the total revenue of municipalities. The equitable share received by municipalities in the province amounted to R4,5 billion. At some municipalities, the amount that was spent on salaries far exceeded what was billed to consumers for the sale of basic services (own revenue from service charges and property rates). Chief Albert Luthuli spent R184 million, which was 132% of own revenue; Bushbuckridge R480 million, which was 209% of own revenue; Nkomazi R440 million, which was 195% of own revenue; and Thembisile Hani R156 million, which was 144% of own revenue. This meant that these municipalities had to use the equitable share to be able to service the whole wage bill, taking away from what was allocated to basic services.

This and factors such as poor revenue and budget management and a low collection rate contributed to the increasing trend of non-payment of creditors, ultimately resulting in municipalities being in a weak financial position, which meant that it would be difficult for them to continue funding their operations in the next year.

EMALAHLENI's total revenue of R3,3 billion was comprised mainly of service charges of R1,5 billion; property rates of R477 million; fines of R273,8 million; interest revenue of R270,7 million; and government grants and subsidies of R520,5 million. It is important to also note that the revenue budgeted to be generated from service charges was reduced from R2 billion to R1,5 billion during the adjustment period, which indicated the municipality's struggle to generate the required revenue aligned to their spending needs and thus incurring a deficit of R55 million as well overspending on their budget by R518,8 million (the highest overspending in the province). This was a contributing factor to the municipality not achieving all their targets in relation to service delivery (recording an achievement of only 62%). The employee cost was R913,3 million, which represented 28% of the total revenue of the municipality.

It took the municipality an average of 179 days to convert the amount of own revenue generated into cash. The municipality also reported that they did not expect to collect R1,65 billion of their generated and billed revenue. This inability to collect billed revenue makes it difficult for the municipality to meet obligations as and when it becomes due, as the municipality's obligations due within a year as at 30 June 2019 were more than their assets that could likely be converted into cash within the same period.

One such obligation that the municipality was struggling to meet related to the provision of electricity by Eskom, which was reported at R2,9 billion. Since it was taking them an average of 813 days to pay this obligation, the debt had attracted interest of about R400 million due to late payment. This interest could have been avoided with stringent financial disciplines and controls, thus it constituted fruitless and wasteful expenditure. The municipality is the highest contributor to fruitless and wasteful expenditure in the province.

The municipality reported electricity and water distribution losses of R230 million and R123 million, respectively. The losses are potential revenue that could have contributed to funding the budget. The state of the municipality requires external intervention to assist them to get back to a viable status. It is important that the intervention provided by the provincial government is fast-tracked to ensure that the financial situation at the municipality does not get even worse.

MBOMBELA's total revenue of R3,3 billion was comprised mainly of service charges of R1,2 billion, property rates of R631 million, and government grants and subsidies of R1,2 billion. The employee costs of R976,4 million took up about 29% of the total revenue recognised by the municipality.

The municipality is commended for being able to generate their budgeted own revenue; however, despite being able to do so, the municipality struggled to convert this revenue into cash. It took an average of 47 days for the municipality to convert their generated revenue into cash that would be available for the day-to-day operations. Furthermore, the municipality reported that they did not expect to collect R86,5 million of the billed revenue and accepted that they had also lost R243,7 million of this revenue. This acceptance of defeat in the conversion of revenue resulted in an inability to pay obligations as they became due – it took the municipality 338 days to pay for services received. The late or non-payment of valid invoices had a negative impact on the sustainability of small businesses and negatively affected the achievement of service delivery since projects were delayed due to cash-flow constraints. While the municipality managed to generate the budgeted revenue, they did not sufficiently budget for what was needed in order to actually run their operations. The result was that the municipality was not able to cover their spending needs and recorded the highest deficit in the province at R199,6 million and an overspending of the budget (unauthorised expenditure) of R267,2 million.

Two of the biggest suppliers that Mbombela struggled to pay were Eskom and the provincial community safety, security and liaison department at R333 million and R324,6 million, respectively. The delayed payment to Eskom was a major contributor to the fruitless and wasteful expenditure of R38 million that resulted from the interest on overdue accounts. The non-payment of the department had a significant impact on the cash injection for the province as this department is the main contributor towards collection of own revenue that gets allocated by the provincial treasury across all the departments. The municipality was further burdened by loans from the Development Bank of Southern Africa of R266,4 million, which was used to build the 2010 World Cup Stadium. The municipality was not able to meet the capital repayment requirements as per the contractual arrangements, due to cash-flow constraints in the year under review.

Mbombela's electricity distribution losses amounted to R122 million, which could have contributed positively to the revenue of the municipality.

The above analysis indicates that municipalities did not spend sufficient resources on their core mandate of delivering services. This is represented by the low spending on infrastructure as well as on maintaining the ageing infrastructure. Whilst the highest expenditure seems to be on salaries, we also noted that year-on-year creditors take a significant portion of the annual allocations. Looking at the high number of days it takes to pay creditors (for example, 351 days for Chief Albert Luthuli and 263 days for Bushbuckridge), municipalities use allocations intended for the current year's services to settle rolling creditor balances from prior periods, hence only a small percentage of the current year's budget would be left for service delivery.

WAY FORWARD

Commitments to improve local government outcomes

We engaged all the executive mayors on their respective outcomes. While it was difficult for them to accept the outcomes, especially those whose outcomes had regressed, in the end each one of them committed to work on plans to improve. Pixley and Mbombela committed to submit the areas of concern to the audit office for an early audit. We also briefed the provincial Troika (made up of the premier and the members of the executive council for cooperative governance and traditional affairs and for finance, economic development and tourism). While acknowledging the most crucial issues around the funding model as well as other structural challenges facing municipalities, the premier took a 'first-things-first' approach and called for 'honesty in analysing the situation for what it is'. She tasked the two members of the executive council with specific responsibilities, including looking into the misalignment between the salary bill against the funds for service delivery while ensuring that critical positions are filled with the right skills; strengthening the planning and budgeting processes; and establishing effective planning and monitoring units at municipalities.

Engaging the legislature on these outcomes resulted in a progressive conversation. There was an acknowledgement that something needed to be done about the state of leadership at local government. The legislature made the following commitments that will be driven through the speaker's forum and the portfolio committee on cooperative governance and traditional affairs:

- Promote effectiveness of section 79 council committees through clarification of roles and responsibilities.
- Engage on addressing irregular expenditure balance.
- Look at capacitation of project management units at local government.

CONCLUDING REMARKS

Deteriorating accountability and financial management coupled with weakened oversight is at the centre of the significant regressions in audit outcomes for Mpumalanga local government. This state of affairs urgently requires a concerted effort from all the leaders – both political and administrative – to provide strong, ethical and courageous leadership in strengthening the control environment at local government. This includes capacitating and skilling the administration and oversight committees of councils and implementing consequence management. A strengthened control environment will ensure that the preventative internal controls that are put in place operate effectively all the time to ensure the integrity of financial and accounting information, promote accountability and prevent fraud. The speakers of various councils need to take the lead in ensuring that the council committees, including audit committees and internal audit units, are established and capacitated.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Gert Sibande District	DM		148 954	-	148 954	19 378 327	1%	2
2	Nkangala District	DM		450 000	-	450 000	10 800 124	4%	2
3	Bushbuckridge	LM		13 058 548	-	13 058 548	54 060 167	24%	3
4	Chief Albert Luthuli	LM		4 431 683	-	4 431 683	16 575 163	27%	4
5	Nkomazi	LM		10 263 392	-	10 263 392	28 059 300	37%	3
6	Steve Tshwete	LM		5 594 772	-	5 594 772	35 846 563	16%	3
7	City of Mbombela	LM		2 189 128	-	2 189 128	97 383 238	2%	1
8	Emalahleni	LM		3 996 450	-	3 996 450	148 112 778	3%	2
9	Mkhondo	LM		16 817 875	-	16 817 875	4 998 164	336%	2
10	Thaba Chweu	LM		3 528 269	-	3 528 269	18 138 277	19%	3
11	Thembisile Hani	LM		14 911 850	-	14 911 850	14 580 620	102%	3
12	Emakhazeni	LM		237 837	-	237 837	27 224 112	1%	2
13	Msukaligwa	LM		8 825 168	-	8 825 168	21 433 873	41%	2
14	Dipaleseng	LM		1 556 312	-	1 556 312	7 296 037	21%	2
15	Dr Pixley Ka Isaka Seme	LM		2 227 609	-	2 227 609	13 268 729	17%	2
16	Lekwa	LM		3 581 881	-	3 581 881	18 821 802	19%	1
17	Victor Khanye	LM		2 810 957	-	2 810 957	20 438 672	14%	1
18	Govan Mbeki	LM		2 609 862	-	2 609 862	49 773 362	5%	1
TOTAL				**97 240 546**	**-**	**97 240 546**	**606 189 308**	**16%**	**39**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

2.8 NORTHERN CAPE

AUDIT OUTCOMES

ZF MGCAWU

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19		2		3	1
2017-18	1	1	1	3	

Regressed

- ZF Mgcawu DM
- !Kheis LM
- Dawid Kruiper LM
- Kai !Garib LM
- Kgatelopele LM
- Tsantsabane LM

JOHN TAOLO

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19	1		1	1	1
2017-18		1	1	2	

Improved

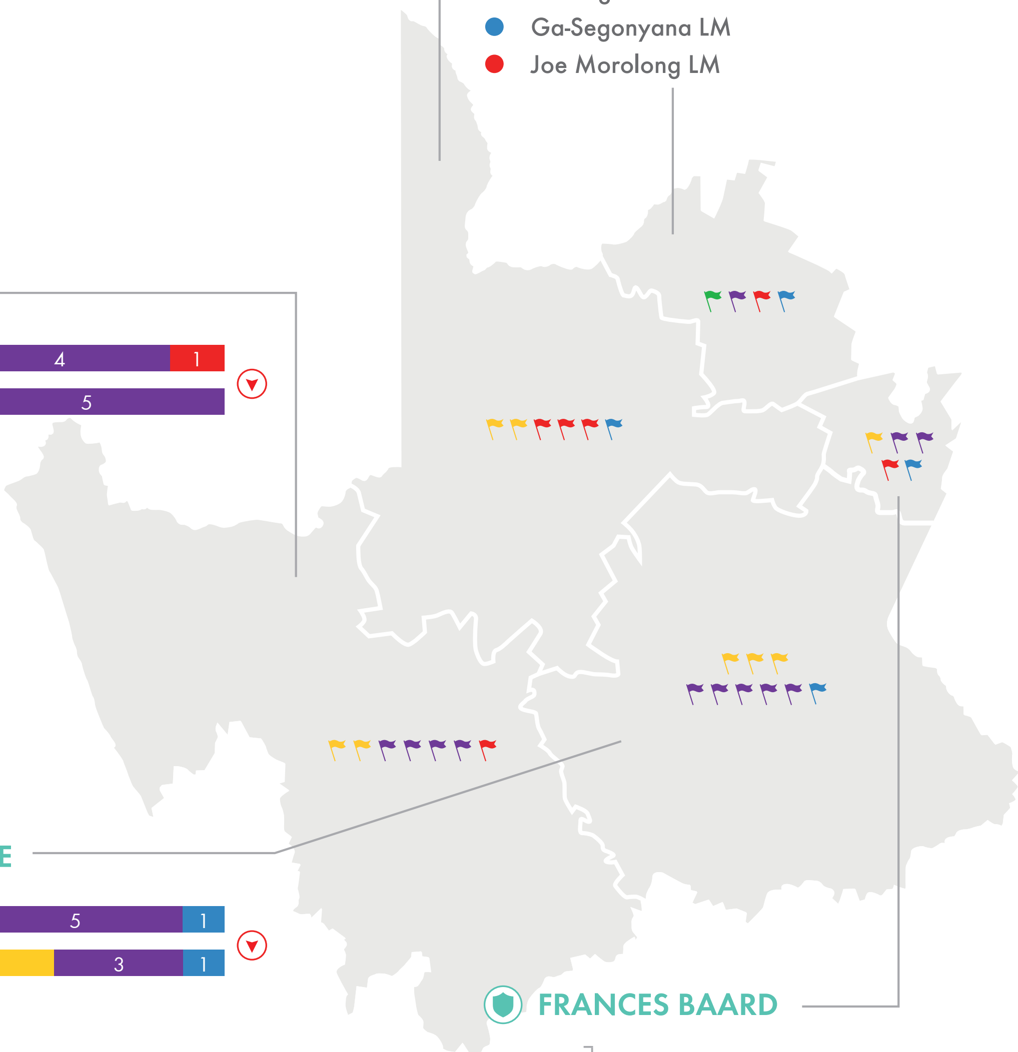
- John Taolo DM
- Gamagara LM
- Ga-Segonyana LM
- Joe Morolong LM

NAMAKWA

	Unqualified with findings	Qualified with findings	Disclaimed with findings
2018-19	2	4	1
2017-18	2	5	

Regressed

- Namakwa DM
- Hantam LM
- Kamiesberg LM
- Karoo Hoogland LM
- Khai-Ma LM
- Nama Khoi LM
- Richtersveld LM



PIXLEY KA SEME

	Unqualified with findings	Qualified with findings	Outstanding audits
2018-19	3	5	1
2017-18	5	3	1

Regressed

- Pixley ka Seme DM
- Emthanjeni LM
- Kareeberg LM
- Renosterberg LM
- Siyancuma LM
- Siyathemba LM
- Thembelihle LM
- Ubuntu LM
- Umsobomvu LM

FRANCES BAARD

	Unqualified with findings	Qualified with findings	Disclaimed with findings	Outstanding audits
2018-19	1	2	1	1
2017-18	1	2	1	1

Unchanged

- Frances Baard DM
- Dikgatlong LM
- Magareng LM
- Phokwane LM
- Sol Plaatje LM

Metropolitan municipality | District | **DM** District municipality | **LM** Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

The Northern Cape local government consists of 31 municipalities, made up of five district municipalities and 26 local municipalities. The province does not have any municipal entities and none of the municipal audits fell within the small-auditee category. The outcomes reported on relate to audits that had been completed by 31 January 2020. By this date, the audits of four municipalities (13%) had not been finalised.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

11%

6 Regressed

3 Improved

Clean audits

4%

(2017-18: 4%)

Financially unqualified financial statements

33%

(2017-18: 41%)

15% (4)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

4%

(2017-18: 4%)

Irregular expenditure

R390 m

(2017-18: R350 m)

No findings on performance reports

25%

(2017-18: 33%)

FINANCIAL HEALTH

Debt-collection period for local municipalities > 90 days

2018-19	50% (8)
2017-18	36% (5)

Creditor-payment period > 30 days

2018-19	100% (21)
2017-18	95% (18)

A prolonged state of undesirable audit outcomes

The overall audit outcomes show a net regression of three (11%) audits. This net regression consists of three (11%) improved and six (22%) regressed audit outcomes. The ongoing trend of regressions and unfavourable stagnations (on qualified and disclaimed) in the audit outcomes of municipalities is concerning. This confirms that leadership continued to disregard the importance of good internal control practices, the value of accurate financial reporting, and the benefit of proper accounting processes. This also highlighted that officials who did not perform their duties were still not being held accountable by municipal managers and senior management, perpetuating the culture of no consequences. The commitments by oversight (premier, speaker and member of the executive council for cooperative governance, human settlements and traditional affairs) as well as councils were again not implemented; and while consequences were often referred to in various meetings, very little action was evident.

The root causes outlined below have resulted in the province's current state of undesirable audit outcomes. But we also share the good practices adopted by municipalities that are doing well in the province.

BREAKDOWN IN PREVENTATIVE CONTROLS CONTRIBUTED TO REGRESSIONS AND STAGNATIONS IN THE ENVIRONMENT

The audit outcomes continue to reflect the poor state of internal controls within the province as only 7% of the municipalities (2017-18: 4%) were assessed as having good leadership as well as financial and performance management controls. The breakdown in preventative controls, in particular, is a concern that we have been highlighting continuously for several years, with limited or no response from political and administrative oversight. Poor internal financial and organisational controls created an environment on which we reported abuse in the supply chain management processes, bank accounts that were not properly scrutinised, revenue losses due to system failures and transactions that were recorded twice, and a lack of proper reconciliations (for example, between the monthly billing reports and the accounting system).

The oversight and administration could have ensured that these gaps were closed by putting the appropriate preventative control measures in place. These include, but are not limited to, daily processing of transactions performed by staff who are skilled and experienced and who have attended the relevant and necessary training; daily transactions recorded on the accounting system agreed to the relevant supporting evidence; accounting systems that perform the correct checks and balances; and, ultimately, continuous scrutiny of these processes by oversight to identify any further gaps.

The following two examples illustrate the impact of a breakdown in preventative controls.

KGATELOPELE is located in the small town of Daniëlskuil approximately 80 km from Kuruman and is part of the ZF Mgcawu district. The municipality has received a disclaimed audit opinion for the past three years.

During 2018-19, the accounting system was not working optimally, which resulted in some transactions being duplicated. The municipality did not have effective preventative controls in place, as evidenced by the lack of reconciliations between the monthly billing reports and the accounting system. The municipality used journals extensively, and some journals needed to be reversed as they were incorrectly posted and thus did not fix the original problem, resulting in the financial information not being credible. The lack of credibility of the financial information was also experienced in prior years; hence the auditors were unable to express an opinion on the financial statements of the municipality.

The municipality used consultants, who were appointed late and prepared financial statements based on data that was not credible because of the lack of preventative controls to support financial reporting as well as challenges relating to the financial system. This resulted in a poor set of financial statements being submitted for auditing and subsequently published, which contained a line item called 'undefined difference' of R16 million in the statement of comparison of budget and actual amounts. This clearly shows that the financial statements were force-balanced. Detailed attention was also not given to the preparation of the financial statements and a number of basic errors were identified during the audit process.

The local municipality, **GAMAGARA,** based in Kathu, is a strategic mining town situated at the centre of the biggest iron and manganese ore belt in the country, approximately 60 km from Kuruman. The municipality improved from a disclaimed to a qualified audit opinion in the current year.

The municipality recently suffered significant losses in revenue due to the implementation of a new accounting system for revenue. This revenue loss was also reported in the previous year. The former system allowed the billing of interim readings, which the municipality used as controls to ensure the completeness of monthly revenue billing. The new system, however, does not allow for interim readings and since actual readings were not done on all water and electricity meters at year-end, revenue from the sale of water and electricity was materially understated in the financial statements.

This deficiency in revenue was also reported in the previous year, indicating that management has not adequately responded to this risk, which resulted in an understatement of revenue and a negative impact on the municipality's cash flow, with the municipality being unable to pay suppliers that delivered goods and services.

MUNICIPAL MANAGERS AND CHIEF FINANCIAL OFFICERS LACKED CAPACITY AND WERE SLOW IN RESPONDING TO CHALLENGES

Municipal managers and chief financial officers continue year after year to be slow in responding to the challenges faced by their municipalities. We found that although most officials who occupy these positions have the required qualifications, they struggled to perform the duties required by that position. The vacancy rates at these levels were another contributing factor as five municipal manager positions (21%) and five chief financial officer positions (21%) were vacant during the year. The above percentages exclude Joe Morolong, Kgatelopele and !Kheis as the auditors were unable to express an opinion on their financial statements for the past two years due to the non-submission of accounting records.

The two examples below illustrate the challenges that municipalities in the province are facing.

Historically known as the city of firsts, **SOL PLAATJE** in Kimberley has failed to improve its audit outcomes since 2017. In 2018 the municipality faced a wave of community protests over the implementation of electricity tariffs, amongst other issues. The community contested the introduction of a R260 availability charge for electricity, which led to the suspension of both the municipal manager and the chief financial officer, although no formal suspension letters had been issued to them.

In addition to the suspension, the 2018 audit outcomes were already negative due to a weak control environment and the audit process was largely dependent on certain key officials to address audit findings. Various municipal staff members were appointed to act interchangeably on behalf of the suspended chief financial officer and municipal manager for the entire 2018-19 financial year. Acting staff members were given three-month appointment terms and did not have the capability to improve the municipality's audit outcomes. The short appointment terms of acting staff made it difficult to improve the control environment (as illustrated by the municipality being in arrears with Eskom during 2018-19 and having to negotiate repayment terms) but, most importantly, to bring stability in key positions charged with the responsibility to design processes for the control environment within the municipality. It has proven difficult for the acting appointments (including staff appointed by the member of the executive council for cooperative governance, human settlements and traditional affairs) to execute any initiatives designed to stabilise operations at the municipality.

RICHTERSVELD is located in Port Nolloth, approximately 900 km from Kimberley and 700 km from Cape Town. The municipality struggled to attract and recruit a suitably qualified municipal manager and chief financial officer. This is largely due to the remote location of the municipality, while the retention of officials with the required skills has also been a challenge. The lack of capacity has made it difficult to have continuity within the municipality and to ensure improvement in the audit outcomes. The vacancies at both municipal manager and chief financial officer level further complicated the implementation of consequence management processes.

The municipality was largely dependent on certain individuals as well as consultants to assist with the preparation of financial statements. The dependence on specific officials to run the functions of the municipality is not sustainable as such officials may be headhunted by other government institutions, leaving the municipality in a dire state from a financial management perspective.

INTERNAL AUDIT AND AUDIT COMMITTEE DID NOT PROVIDE THE REQUIRED ASSURANCE

The internal audit function and the audit committee are centralised at district level for most municipalities in the province, although a few local municipalities have their own internal audit unit and audit committee. The concerns of some local municipalities that do not make use of the centralised function relate to the following:

- Centralised functions have an inward focus and work done for local municipalities is of a lower standard in that it does not cover risk areas and is less detailed when compared to what was done at districts.
- Shared services are expensive and local municipalities cannot afford it, hence some of the municipalities were unable to pay for these services due to financial challenges.

The eight local municipalities in the **PIXLEY KA SEME DISTRICT** use a shared internal audit unit and audit committee model centralised at the district with a mandate to provide an independent and objective internal audit assurance and consulting service to all municipalities in the district.

The shared internal audit services provided by the internal audit unit did not provide the required assurance due to the following:

- The internal audit unit did not ensure that the internal audit plan addressed the key risks and misstatements identified by the external auditors.
- The internal audit unit was not appropriately skilled, adequately staffed and competent enough to ensure that where management requested them to conduct a specific review on key issues identified in the previous year by us, those issues were corrected in the current year and did not recur.
- The internal audit unit did not properly review the audit action plan before it was approved by the council and did not ensure that the action plan was practical to prevent the issues from recurring.
- The internal audit unit could not perform all of its quarterly reviews as not all the service level agreements between the local municipalities and the district were signed timeously, while recommendations made in the quarterly internal audit reports were not taken seriously as management did not respond to these recommendations.

The shared audit committee did not provide the required assurance due to the following:

- The audit committee, which is responsible for the review and monitoring of the audit action plan and internal audit plan, did not ensure that these plans were sufficient to address the risks and misstatements identified during prior year audits. The implementation of these plans was only assessed during the external audit process when we identified issues or raised findings.
- For some of the municipalities in the district (Siyathemba and Ubuntu), the audit committee was only functioning for half the year. The audit committee did not perform a review of the financial statements before they were submitted to the external auditors.
- The audit committee, which provides oversight to the internal audit unit, did not review and monitor management's audit action plan and internal audit plan, which contributed to the overall regression in the audit outcomes of municipalities in the district.

MUNICIPAL PUBLIC ACCOUNTS COMMITTEES AND COUNCILS STILL LACKED CAPACITY DESPITE EFFORTS TO CAPACITATE THEM

The lack of capacity at municipal public accounts committee and municipal council level is a subject that has been highlighted repeatedly in prior years and has contributed to the current situation where senior municipal officials are not held accountable for the undesirable audit outcomes and breakdown in preventative controls. This resulted in a lack of consequences at most municipalities. The following examples illustrate this worrying trend.

NAMA KHOI is located in Springbok and was marred by political instability during 2018-19 due to the inability of the two coalition parties governing the municipality to work together. This resulted in an ineffective municipal public accounts committee in terms of overseeing that accountability and consequence management were enforced within the municipality.

The municipality reported an irregular expenditure balance of R201 million (2017-18: R198 million) in the current year. The municipality obtained council approval to condone irregular expenditure amounting to R42 million, which was disclosed in the financial statements and subsequently reversed by the municipality during the audit as the irregular expenditure had not been investigated. Municipal public accounts committee members are aware of their roles and responsibilities and received training from various institutions within the province. The notable challenge, however, has been to execute these roles and responsibilities in respect of highly technical accounting matters as most of these individuals struggle to apply their knowledge in practice. As a result, the municipality was unable to determine the possible financial loss as a result of irregular expenditure incurred by the municipality in the procurement of goods and services, as the investigations required by the Municipal Finance Management Act were not performed.

KAMIESBERG, a local municipality on the outskirts of the Northern Cape, situated approximately 70 km from the western coastline of South Africa, is one of the smallest municipalities in the Namakwa district.

Even though the municipal public accounts committee was established and had met during the year, the committee did not perform its duties as required. One of the biggest shortcomings identified was that committee members did not investigate irregular and fruitless and wasteful expenditure as they did not know how the investigation should be conducted and how to hold officials accountable. This resulted in an increase in both irregular and fruitless and wasteful expenditure which has not been dealt with over several years.

CONSULTANTS PREPARING UNRELIABLE FINANCIAL STATEMENTS DUE TO POOR FINANCIAL INFORMATION OFFER NO VALUE

The cost of consultants amounted to R103 million. Of the R103 million, R42 million was spent on consultants that assisted with the preparation of the financial statements. A further R12 million was spent by municipalities on consultants for financial reporting of which the audits had not been finalised by the cut-off date of this report. It is concerning that some of these municipalities had appointed consultants to prepare financial statements even though a fully staffed finance unit existed, indicating that some officials in the finance unit are not able to perform the required duties. This matter was repeatedly highlighted in prior years.

We noted a tendency of over-reliance on consultants at some municipalities. We also noted that consultants were not monitored and their work was not reviewed, often due to a lack of capacity in the finance unit. Furthermore, the transfer of skills was not prioritised, often because this was not included as a requirement when consultants were appointed, but also due to the late appointment of consultants. The specifics at Emthanjeni and Joe Morolong are shared below.

EMTHANJENI in De Aar has been using consultants for a number of years and the consultant cost for the current year amounted to R10 million, of which R2 million related to financial services. Even though the audit outcome of the municipality was financially unqualified with findings in prior years (but regressed to qualified in the current year), we remained concerned about the role of the consultants in the audit process as the consultants were highly operational. Further, no systems were in place to process transactions and keep reliable records to produce credible reports. Thus, the consultants compiled financial records for reporting, without any reviews being performed by management. The extent to which audit requests were addressed by consultants, further illustrated the minimal involvement of management during the audit process and how reliant the municipality is on consultants. This shows that management has failed in their responsibility to effectively manage the affairs of the municipality.

JOE MOROLONG is located in the village of Churchill approximately 30 km from Kuruman. The municipality's audit outcomes have stagnated, with a disclaimed audit opinion received for the past three years. In the current year, the municipality spent R6 million on financial services-related consultants.

The municipality has been using consultants for the past few financial years to prepare financial statements and to assist in the preparation of the asset register. As management and, more specifically, the chief financial officer and finance unit rely solely on consultants to prepare the financial statements, they are annually appointed for this purpose, normally late in the financial year. The consultants will then get information that is of a poor quality and use this to prepare the financial statements and update the already inaccurate asset register (illustrating the 'garbage in garbage out' principle), resulting in financial statements of a very poor quality.

Consultants are often aware of the issues (poor accounting records, lack of competency in the finance unit, and lack of accountability) yet they still prepare the financial statements as it is a business opportunity for them. We also noted that based on the consultants' awareness of the issues at the municipality, they themselves do not have trust in the reliability of information required for the financial statements, as in some instances they are expected to pass journals or entries without the supporting documents, resulting in force-balancing certain amounts in the financial statements.

WHAT DO THE FINANCIAL STATEMENTS SAY?

Our analysis of the financial statements submitted for auditing highlights the dire situation in which municipalities in the province find themselves. Most municipalities are crippled by poor and aged infrastructure, resulting in them struggling to render services to the communities they serve. The challenges faced by municipalities, as outlined under the themes above, are translated and reported in the financial statements. The key messages from the analysis performed below and the situation at the four municipalities used as examples, highlight the difficulties that were prevalent in the current and prior years.

The cost of employing municipal staff amounted to R2,4 billion (including councillor remuneration) or 175% of the equitable share of R1,4 billion. Own revenue (service charges from water and electricity as well as property rates) amounted to R2,9 billion, while the main municipal expenditure line items (bulk purchases, repairs and maintenance, debtor impairment and write-off, and contracted services) amounted to R2,4 billion. The shortfall of roughly R500 million severely affected municipalities' ability to ensure service delivery and to pay service providers. Twelve municipalities incurred a deficit in the current year, which explains the R325 million (39%) growth in amounts owed to Eskom (the 2018-19 outstanding balance amounted to R1,2 billion) and why 56% of the municipalities were considered to be in a financially vulnerable position. Pressure on cash flows resulted in some municipalities using conditional grants to fund their operations. This, in turn, had a negative impact on service delivery as funds earmarked for specific purposes (such as capital projects to improve infrastructure) were misspent.

The salary bill outlined above includes R209 million spent on the salaries of staff in the finance units and an additional R42 million on consultants for financial reporting in the current year, yet the quality of financial statements remained poor. This is concerning considering that many municipalities have a fully staffed finance unit, which means that consultants should not be required. The poor quality of financial statements in some instances made it difficult to perform a proper analysis due to information being incomplete or unreliable.

A high-level review of the financial statements of **SOL PLAATJE** confirms the struggles that the municipality experienced over the past 18 months, which resulted in repeat qualifications on property, infrastructure and equipment as well as investment properties. Most of the R143 million increase in respect of property, infrastructure and equipment was due to attempts to address the issues in the asset register where assets were identified that had not previously been included in the asset register.

In addition, the municipality did not regularly maintain its ageing infrastructure, which ultimately caused it to be severely damaged. This neglect unnecessarily pushed up the cost of repairs, which amounted to R159 million (9% of total expenditure). This is further evident in the R118 million or 26% of distribution losses on electricity as well as R58 million or 62% on water. In addition, the alarming state of road infrastructure in the municipal area confirms that the focus needs to be on a strategic and proactive plan that is properly funded and implemented, rather than on attempting to repair networks when and where damage occurs.

The municipality experienced serious difficulty in collecting money owed by customers and it took the municipality's customers 357 days on average to settle their debt. The municipality's inability to collect money owed by customers, in turn, placed further pressure on the municipality's ability to pay suppliers. It took the municipality 82 days on average to pay its suppliers, which is far longer than the norm of 30 days. Current liabilities as a percentage of the next year's expenditure budget amounted to 27%, indicating that a large portion of the next year's revenue will be spent on paying prior year suppliers.

The municipality was previously able to pay the suppliers of bulk services as the amounts became due without exception. However, the municipality got into arrears with Eskom during the current year, owing them R63 million at year-end. This confirms that the municipality's cash flow became more restricted in recent times, with challenges at both political and administrative level being the main cause of this.

Attempts to ensure the completeness of accounting records also fell short on irregular expenditure with the balance increasing from R16 million in the previous year to R53 million in the current year. This resulted in the municipality receiving a qualification on irregular expenditure. Investigations into irregular expenditure stalled during the past 18 months due to instability at senior administrative and political levels.

Lastly, with regard to the key observations caused by instability, a decision was taken to discontinue the implementation of a R260 electricity availability charge in 2017-18. This decision resulted in less revenue being billed, which further exacerbated the poor debt collection of the municipality. A total of R960 million (40%) of the debtors' book might not be collected from customers, compared to R807 million (39%) in 2017-18. These factors have put a strain on cash flows, which in turn has affected a number of operations such as the following:

- Reduction of self-funded projects
- Cut in overtime, with an impact on service delivery
- Worsening payment of suppliers
- Challenges in paying salaries subsequent to year-end

Further to the challenges shared under *Consultants preparing unreliable financial statements due to poor financial information offer no value* above, the analysis of **EMTHANJENI** confirms the difficulties that the municipality experienced with keeping underlying records. Some of the reported figures had no accounting records as they were withheld by the suppliers, such as revenue from prepaid electricity. In addition, employee costs amounted to R87 million (including councillor remuneration) or 214% of the equitable share of R41 million, and the municipality had a deficit for the year of R88 million. These shortfalls will have a severe impact on the municipality's ability to ensure service delivery and pay service providers. For example, the municipality owed Eskom R56 million at year-end. Disputes with the suppliers are inevitably going to affect the delivery of services because Eskom, subsequent to year-end, decided to cut the electricity supply to the municipality, which was subsequently averted as the municipality entered into a payment arrangement.

The municipal manager and municipal staff seem to have acted with no regard for the budgets and the parameters of acceptable norms. The analysis below reveals how the municipality has, over the years, plunged into financial difficulties:

- The municipality's inability to collect money owed by customers (outstanding for 109 days on average), with 82% of debtors provided for as doubtful already putting pressure on the municipality's ability to pay creditors.

- The average suppliers' payment period of 250 days is far above the norm of 30 days. Current liabilities as a percentage of the next year's expenditure budget amounted to 39%, indicating that a large portion of the next year's revenue will be spent on paying suppliers.
- The municipality suffered a loss of R88 million (2017-18: R45 million), which can be attributed to a 16% increase in expenditure, while revenue grew by only 1%. The 25% increase in employee cost is particularly concerning.

In addition to the challenges highlighted under *Breakdown in preventative controls contributed to regressions and stagnations in the environment* above, **KGATELOPELE**`s status of accounting records and the limitations experienced affected the usefulness of the financial information. There were also qualifications on a number of line items in the financial statements (revenue, expenditure, assets and liabilities), which resulted in the municipality receiving a disclaimed audit opinion for the past three years. Therefore, a proper analysis was not possible and no reliance could be placed on the financial statements.

The municipality used consultants for the compilation of financial statements at a cost of R1 million, while no significant vacancies were noted in the finance unit. Concerning is a mathematical error in the statement of net assets: instead of subtracting a deficit of R13 million for the year, the deficit was added to changes to net assets.

The municipality disclosed a negative debtors' balance of R4 million indicating that it actually owed money to some of its customers. This confirmed that the information in the financial statements was not accurate and that there was no correlation between the different statements included in the financial statements. The cash flow statement showed R58 million in receipts from customers, while the statement of financial performance showed revenue from service charges and property rates of only R50 million, making the amount reported as revenue received in the cash flow statement unlikely due to the unreliable information as highlighted above.

The municipality realised a deficit for the past two years, which was mainly due to an increase in the impairment loss. In addition, repairs and maintenance represented only 2% of total expenditure, indicating that municipal assets were not properly maintained, most probably due to cash-flow restrictions. The credibility of these analyses is questionable due to the poor state of the municipality's financial statements.

We also noted that in addition to the concerns shared under *Municipal public accounts committees and councils still lacked capacity despite efforts to capacitate them*, **KAMIESBERG**'s equitable share of R21 million was not sufficient to cover its employee cost of R26 million. This contributed to the municipality's loss of R7 million. The financial strain experienced by the municipality was evidenced by its inability to pay suppliers. The municipality owed Eskom R17 million at year-end and the financial statements showed unspent conditional grants of R6 million, while cash in the municipality's bank accounts amounted to only R2 million. This is an indication that the municipality is spending funds earmarked for specific projects to fund operations – a practice that will have a negative impact on service delivery.

BETTER AUDIT OUTCOMES CAN BE ACHIEVED BY STRONG ACCOUNTABILITY

Despite the overall poor performance of municipalities in the province, a handful of municipalities continued to deliver good audit results. These municipalities managed largely to respond to the risks they face pertaining to accurate financial and performance reporting as well as compliance with legislation. These municipalities either achieved clean audit outcomes or are very close to achieving this status. John Taolo Gaetsewe and ZF Mgcawu are district municipalities that are leading by example, as described below.

JOHN TAOLO GAETSEWE DISTRICT, which is located in the town of Kuruman, achieved a clean audit outcome. The municipality has a sound control environment, which is clear upon arrival at the municipality, as it has an access control system that uses fingerprint recognition.

It is a pleasure to audit the municipality and officials are disciplined in the sense that they take responsibility for their respective work duties. This has also been evident in the adequate and effective record-keeping processes in place, which ensures the safeguarding of municipal information. Access to the filing room is limited to a few officials, which ensures that when information is removed from the filing room, it is signed for by either the auditors or the official who requested the information. This was also apparent in the smooth audit process where all the requested information was provided by the municipality. The effective controls ensured that information could easily be retrieved or located when requested.

The municipal manager has implemented consequence management processes, which sets the correct ethical tone and filters through to management and lower-level staff members. In addition, the municipal manager is highly involved in the audit process and pays attention to detail. He also holds staff members accountable for findings we raised. This has resulted in officials ensuring that requested information is submitted timeously and that where things were done incorrectly, our recommendations have been implemented over the years.

The municipality fosters an environment where officials learn from the audit process and implement our recommendations to improve the audit outcomes. Officials also take responsibility for their work and do their work correctly. The municipality appointed consultants to bridge the knowledge gap and the chief financial officer accepted accountability for the consultants' work, ensuring that the financial statements were free of material misstatements.

ZF MGCAWU DISTRICT in Upington has also been one of the leading municipalities in the province for a number of years, receiving a clean audit outcome for six consecutive years up until 2017-18.

The municipality's finance unit is well capacitated and is led by the deputy chief financial officer, who is a qualified chartered accountant. The municipality has been compiling financial statements without the assistance of consultants, submitting quality financial statements that are free of material misstatements year after year. The municipality achieved good audit outcomes by staying disciplined in executing daily, weekly and monthly controls – a practice that originated from a strong drive from leadership to hold staff accountable.

It is unfortunate that the municipality regressed in 2018-19 (we reported one compliance finding), due to proper preventative controls not being implemented for competitive bidding. The municipality should ensure that it does not become complacent in the way it operates and should identify potential risk areas that may have an impact on operations.

CONCLUDING REMARKS

The picture painted above and observed over several years clearly depicts a breakdown in the control environment; a lack of capacity for chief financial officers, municipal managers, municipal public accounts committees, councils, internal audit units and audit committees to provide the required assurance; the use of consultants despite poor financial information, resulting in no value being added for the money paid for these services; and the extent of financial challenges the municipalities are facing as highlighted by the analysis of the financial statements. These all underpin our message regarding a prolonged state of undesirable audit outcomes.

The province's downward spiral will continue until both political and administrative leadership start responding to the various challenges that municipalities in the province are facing. The oversight and administration should take advantage of the principle of preventive control strategies by making sure that measures are put in place to avoid the shortcomings and gaps identified above, which will go a long way in ensuring that resources are used for service delivery initiatives. Leaders must put the needs of citizens above their own and dedicate themselves to finding answers to the challenges their communities face. The province needs to be put on a path of progress and prosperity and cannot afford further regressions. This will only be achieved through committed leaders with a shared vision who are dedicated to improving the audit outcomes in the province, which in turn will promote a credible environment for the delivery of services to citizens.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	John Taolo Gaetsewe	DM		3 311 165	-	3 311 165	8 942 142	37%	1
2	Pixley Ka Seme District	DM		212 510	-	212 510	4 198 608	5%	1
3	Dawid Kruiper	LM		2 003 566	-	2 003 566	19 498 696	10%	2
4	Hantam	LM		2 273 030	-	2 273 030	7 748 952	29%	2
5	Kareeberg	LM		497 950	-	497 950	7 269 905	7%	1
6	Siyancuma	LM		1 393 426	-	1 393 426	14 727 330	9%	1
7	Emthanjeni	LM		2 144 713	-	2 144 713	4 696 816	46%	1
8	Gamagara	LM		1 932 811	-	1 932 811	29 995 388	6%	1
9	Karoo Hoogland	LM		476 501	-	476 501	4 298 285	11%	1
10	Khai-Ma	LM		896 267	-	896 267	4 793 265	19%	1
11	Magareng	LM		1 728 257	-	1 728 257	7 158 185	24%	2
12	Nama Khoi	LM		1 146 158	-	1 146 158	13 274 783	9%	1
13	Richtersveld	LM		701 239	-	701 239	6 256 408	11%	1
14	Siyathemba	LM		1 414 956	-	1 414 956	7 311 202	19%	1
15	Thembelihle	LM		1 747 120	-	1 747 120	2 786 284	63%	2
16	Ubuntu	LM		2 354 576	-	2 354 576	5 545 121	42%	2
17	Umsobomvu	LM		3 267 906	-	3 267 906	10 690 000	31%	2
18	Dikgatlong	LM		2 375 535	-	2 375 535	11 606 318	20%	3
19	Joe Morolong*	LM		6 207 976	-	6 207 976	9 011 623	69%	3
20	Kai !Garib	LM		4 535 817	-	4 535 817	14 816 663	31%	2
21	Kamiesberg	LM		117 818	437 629	555 447	6 355 907	9%	2
22	Kgatelopele*	LM		1 300 000	-	1 300 000	8 400 640	15%	1
23	Ga-Segonyana	LM		10 426 561	-	10 426 561	20 762 944	50%	1
24	Tsantsabane	LM		1 169 742	-	1 169 742	8 940 139	13%	2
TOTAL				**53 635 600**	**437 629**	**54 073 229**	**239 085 604**	**23%**	**37**

* Consultant cost is not reported for repeat disclaimed municipalities as the information is not obtained during the audit process. However, this schedule includes the cost for these two municipalities with repeat disclaimers as the provincial overview includes the information.

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

NOTES

2.9 NORTH WEST

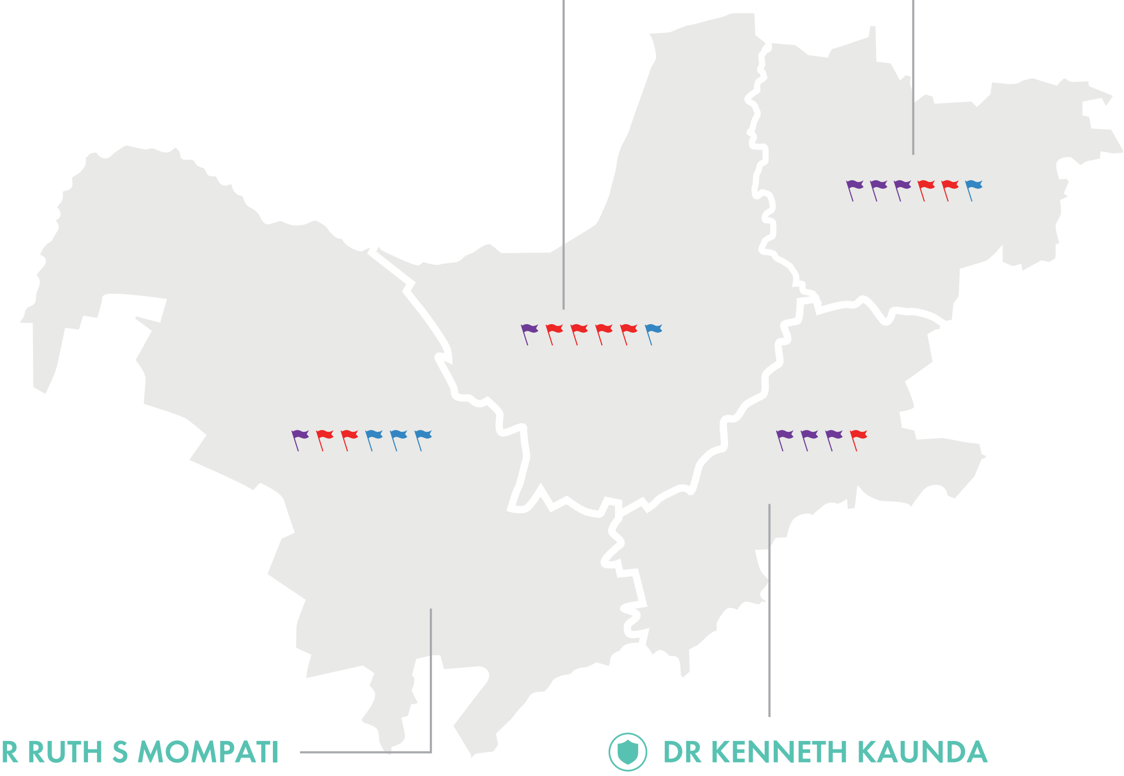
AUDIT OUTCOMES

NGAKA MODIRI MOLEMA

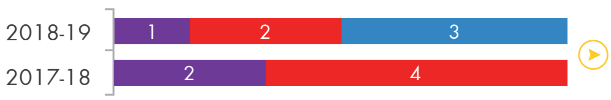
- Ngaka Modiri Molema DM
- Ditsobotla LM
- Mahikeng LM
- Ramotshere Moiloa LM
- Ratlou LM
- Tswaing LM

BOJANALA

- Bojanala DM
- Kgetlengrivier LM
- Madibeng LM
- Moretele LM
- Moses Kotane LM
- Rustenburg LM

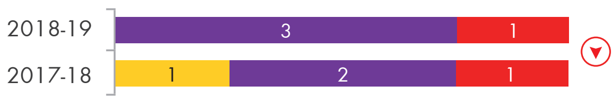


DR RUTH S MOMPATI



- Dr Ruth S Mompati DM
- Greater Taung LM
- Kagisano-Molopo LM
- Lekwa Teemane LM
- Mamusa LM
- Naledi LM

DR KENNETH KAUNDA



- Dr Kenneth Kaunda DM
- JB Marks LM
- Matlosana LM
- Maquassi Hills LM

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PERFORMANCE SNAPSHOT

The North West local government consists of 25 auditees, broken down into 18 local municipalities, four district municipalities and three municipal entities. The audit outcomes of the three municipal entities are not included in the analysis in this report as they were classified as small entities. Five audits were outstanding at the cut-off date of 31 January 2020.

Overall audit outcomes

OVERALL REGRESSION IN AUDIT OUTCOMES

3 Regressed

2 Improved

Financially unqualified financial statements

0% (2017-18: 6%)

0% (0)

Municipalities submitted financial statements without material misstatements

Overall irregular expenditure

R3,7 bn (2017-18: R4,3 bn)

Outstanding audits or audits subsequently finalised

R1,8 bn (2017-18: R376,8 m)

Municipalities under administration

13 (2017-18: 5)

Submission of financial statements

12 (55%) [2017-18: 20 (91%)]

Cost of using consultants

R179,8 m (2017-18: R124,4 m)

Local government finance – the stark reality

Income statement

Revenue

- **Equitable share** of **R4,1 billion** (2017-18: R3,7 billion) and **conditional grants** of **R2,8 billion** (2017-18: R2,4 billion)
- **Revenue** of **R10,3 billion** (2017-18: R9,6 billion) was generated from billing

Expenditure

- **Salaries and wages** (including councillor remuneration) of **R4,2 billion** (2017-18: R3,7 billion)
- **Average supplier payment period** of **312 days** (2017-18: 273 days)
- **Fruitless and wasteful expenditure** of **R280,2 million** (2017-18: R114,4 million)
- **Unauthorised expenditure** of **R1,9 billion** (2017-18: R1,2 billion)

Net result

- Municipalities that incurred a **deficit**: **47%** (2017-18: 41%)
- Total **deficit in local government: R2,3 billion** (2017-18: R669 million)

Balance sheet

- Total **consumer debtors** at year-end of **R17,3 billion** (2017-18: R14 billion)
- **87%** (2017-18: 80%) of **debtors impaired** (not expected to be recoverable)
- **Debt-collection period** (after the impairment) of **92 days** (2017-18: 117 days)
- Total **creditors** at year-end of **R7,4 billion** (2017-18: R5,3 billion)
- **Cash available** at year-end of **R1,5 billion** (2017-18: R732 million)

Note: *Nine of the municipalities included in the analysis had disclaimed opinions, which means that the information presented in their financial statements may not be valid, accurate and complete*

Outstanding debt	Total amounts owed (as at June 2019)	Total amounts in arrears (31 days and over)
Eskom	R1,7 billion	R1,0 billion
Water boards	R1,7 billion	R1,4 billion

Systemic breakdown in the discipline of financial control

The regression in the 2018-19 audit outcomes completes a three-year downward trajectory in the audit outcomes of the province since the new administration took office after the local government elections in 2016. The availability of documents or evidence to support the financial activities remains a vast challenge across the municipalities in the province. This is evident from the number of repeat disclaimed audit opinions. The inability of the province to reverse the trend of negative audit outcomes over the years points to a culture that is not proactive in dealing with weaknesses in the control environments, as evidenced by nine municipalities receiving disclaimed audit opinions and eight receiving qualified audit opinions.

The local government culture in the province is characterised by a history of a lack of discipline in the basic internal controls required to manage financial and performance records, and senior management that is unwilling to implement our recommendations and those of other governance structures. Internal audit units and audit committees are rendered ineffective by unresponsive municipal managers, and councils that are tasked with oversight lack the political will to effect consequences. This resulted in an additional eight municipalities being put under administration from the initial five placed under administration during the previous year. It remains a concern that accountability keeps on deteriorating as the 'plan, do, check, act' cycle that underpins a healthy financial system remains either ineffective or non-existent at the majority of municipalities.

The accountability failures at all levels of assurance are indicative of a systemic breakdown in the discipline of financial and performance management controls. This breakdown resulted in 10 municipalities (45%) submitting their financial statements after the legislated deadline. The fact that not a single municipality was able to achieve at least a financially unqualified audit outcome indicates the political leadership's failure to set a tone for clean administration by creating an environment conducive to accountability, good governance and consequence management.

The cost of using consultants increased significantly by 45%. This remains a concern as both the quality and the submission rate of financial statements regressed from the previous year. Irregular expenditure remained high and increased by R719,8 million due to a lack of political will to effect consequences, creating an environment that was conducive to a blatant disregard of the supply chain management laws and regulations. This continued increase in irregular expenditure demonstrates a culture where compliance is not proactively monitored and transgressions and poor performance are not decisively dealt with.

The state of financial health of local government in the province is cause for distress. The deficit increased by 243% and the equitable share, which enables municipalities to provide basic services to poor households and perform core municipal functions, did not even cover salaries, which exceeded the equitable share by R56,3 million. This unfortunately meant that a portion of salaries was funded by conditional grants, especially at municipalities where own resources were limited.

An indicator of the deteriorating accountability in the province is the inability to prevent the increasing trend of not timeously preparing credible financial statements and submitting these for audit purposes within the legislated deadline. This demonstrates to the communities of North West that there is a lack of accountability and transparency in the usage of public funds.

The root causes outlined in further detail below have resulted in the province's current state of undesirable audit outcomes.

LACK OF DISCIPLINE TO SUBMIT FINANCIAL STATEMENTS FOR AUDITING BY LEGISLATED DEADLINE RESULTED IN MUNICIPALITIES FAILING TO DEMONSTRATE ACCOUNTABILITY FOR HOW PUBLIC FUNDS WERE SPENT

In previous years, local government struggled with the timely submission of financial statements, but this improved over the years through the intervention of the provincial treasury, resulting in a 100% submission for the 2016-17 financial year. However, the discipline of timely submission of financial statements began deteriorating in 2017-18 when 20 municipalities (91%) submitted financial statements on time. It culminated in an all-time low submission rate, since 2011, of 55% for the 2018-19 audit cycle when 10 of the 22 municipalities (45%) failed to submit their financial statements by the legislated date. By the cut-off date of this report, two municipalities were yet to submit their financial statements and the audits of two municipalities that submitted late were outstanding. This lack of discipline was demonstrated by the absence of preventative controls such as the quarterly preparation of financial reports, monthly reconciliations and safeguarding of records that would enable reliable and timely financial reporting. Management was not concerned with the resulting non-compliance with legislation and therefore did not give it the necessary attention.

The examples below illustrate municipalities where there were failures in the discipline of financial controls and resultant non-compliance with legislation.

The audit outcome of **NALEDI**, located in Vryburg, has seen a regression over the years from being qualified two years ago to disclaimed in the previous year. The municipality missed the legislated deadline for submission of financial statements and only submitted these during November 2019. A municipal strike action of longer than two months made it difficult for the municipality to retrieve or complete the financial information from the financial system. As a result, the municipality's general ledger was incomplete and additional information needed to be processed on the system to ensure that their year-end processes were carried out accurately. This indicated that the municipality had failed to make alternative operational arrangements to ensure continuity of transaction processing and record keeping during the strike.

At **LEKWA TEEMANE**, located in the towns of Christiana and Bloemhof, the new chief financial officer that was appointed after year-end did not receive a proper handover from the previous acting incumbent. Transactions were incorrectly processed when the municipality was unbundling their assets, with the result that prior year closing balances did not agree to current year opening balances on the financial system. Their attempts to resolve these issues resulted in the late submission of the financial statements during September 2019. The municipality struggled with asset management in that they did not perform monthly reconciliations of assets, nor regular physical inspections of assets including asset counts, to enable reliable and timely financial reporting. This contributed to the municipality receiving a disclaimed audit outcome for the past two years.

THE PERSISTENT USE OF CONSULTANTS FOR FINANCIAL REPORTING DID NOT RESULT IN IMPROVED QUALITY OF FINANCIAL STATEMENTS

Generally, municipalities in the province struggled because the local government environment was not conducive to attracting and retaining skilled chief financial officers and finance staff. This contributed to a culture of dependency on consultants to supplement the financial reporting capacity, due to ongoing skills gaps and vacancies. Even when consultants were used to prepare financial statements, they were used ineffectively, as financials would not be credible because in-year preventative controls were not in place that would enable reliable and timely financial reporting, such as proper record keeping and daily and monthly reconciliations, as evidenced by the regression of audit outcomes with a trend of disclaimed and qualified opinions. This meant that municipalities paid their staff and the consultants for the same service without any value being realised, causing a waste of scarce public resources. Moreover, using consultants did not guarantee that the financial statements would be submitted by the legislated deadline, as showed by four municipalities that submitted late and whose audits were outstanding at the cut-off date of this report. In total, R179,8 million (2017-18: R124,4 million by 21 municipalities) was spent on consultants, which included amounts paid by the provincial treasury. A further R47 million was spent by municipalities of which the audits had not been finalised by the cut-off date of this report.

Despite continuity in the use of consultants for two consecutive years, **DR RUTH SEGOMOTSI MOMPATI DISTRICT**'s audit outcome regressed from a qualified opinion to a disclaimed opinion. This was due to the lack of basic controls, namely proper record keeping as well as daily and monthly reconciliations of key balances like assets. The combination of a vacancy in the position of chief financial officer as well as a lack of skills in the finance unit gave rise to the continued use of consultants. We noted evidence of deteriorating accountability on the part of the municipality's management, as all processes during the audit were led by the consultants. The basic errors identified in the financial statements were indicative of a lack of review and proper monitoring of the work done by the consultants. The finance unit, consisting of 25 staff members, had a salary cost of R9,3 million and a further R15,6 million was spent on consultants without any value being realised.

MADIBENG, located in Brits, continued to use consultants but again received a disclaimed audit opinion for the fourth consecutive year. The finance section's salary cost was R33,6 million for 105 staff members whilst a further R35,4 million was spent on consultants. This is the highest cost of consultants in the province and yet no value was realised due to a lack of proper record-keeping practices, which at times appeared deliberate in order to hide the extent of irregularities. There was also instability at both municipal manager and chief financial officer level during the financial year and the provincial treasury seconded staff to the municipality to assist in these roles after year-end. However, even the provincial treasury's seconded staff could not assist the municipality due to an inability to maintain proper records to support the information presented in the financial statements. This made it difficult for the consultants to rectify or prepare a credible set of financial statements, as they were provided with incomplete ledgers and trial balances. Public funds are a scarce resource and should be used only to create value for the community; therefore the leadership of the municipality should ensure that funds are not misused to this extent.

A further example of an environment where consultants were heavily relied on for financial reporting is **MAMUSA**, which is located in the town of Schweizer-Reneke. This municipality has received 11 consecutive disclaimed opinions. They did not have a proper records management system, as documents were not kept in a strongroom or even in file cabinets. Instead, documents were stacked against the walls on office floors. The absence of a capacitated and empowered finance unit, lack of continuity in the consultants used, and weak record-keeping practices made it difficult for succeeding consultants to improve the audit outcomes, as they would mostly be unable to trace and justify prior year journal adjustments. The fact that all interactions and responsibilities relating to financial reporting were left to the consultants further disempowered the municipal finance unit, which illustrated the ineffectiveness of the combined assurance model. Furthermore, consultants were appointed by the provincial treasury after year-end, when they realised that the municipality would not be able to submit financial statements on time due to protest actions and disruptions at the municipality. This was followed by the municipality being put under administration. The provincial treasury's support was ineffective as it was not timely and they did not monitor the work of the consultants they appointed.

Municipalities can derive value from the use of consultants if they use them effectively. Notwithstanding the above three examples, the use of consultants at **MOSES KOTANE** was encouraging. Moses Kotane is a rural municipality located in the northern part of the province close to Sun City with a seat in the town of Mogwase. Initially there were challenges when consultants were appointed in 2016-17 due to their focus on getting immediate results. These challenges included their attitude towards audit findings, arguing with the auditors instead of focusing on the nature of the findings and how they could assist the municipality to address them. However, because the same consultants were used for the 2017-18 and 2018-19 financial years to supplement the capacity shortages in the municipality with a specific focus on reconstructing the asset register, the resulting continuity together with management holding the consultants accountable for their work, resulted in increased benefit. In the following year, the consultants became proactive by liaising with auditors often and performing daily and monthly reconciliations of assets. This change in attitude and approach enabled credible financial reporting informed by proper records management and reconciliations. Management also insisted that auditors conduct the status of records reviews to ensure that they paid attention to matters raised. Furthermore, contrary to what most municipalities did, the management in the municipality did not delegate their responsibility for financial statements to the consultants. They remained directly involved in the audit process and this provided some level of assurance. This approach resulted in the restoration of the discipline of financial controls in the municipality, which in turn resulted in an improvement in the audit outcome from disclaimed to qualified.

THE EFFECTIVENESS OF GOVERNANCE STRUCTURES WAS WEAKENED BY THE LACK OF CAPACITY OF THESE STRUCTURES AS WELL AS A NON-RESPONSIVE MANAGEMENT AND LEADERSHIP

The internal audit units of the municipalities in the province did not provide the required level of assurance for financial reporting due to management being non-responsive to internal audit recommendations. The audit committees did not adequately follow up with management on the implementation of these recommendations, resulting in limited assurance being provided. In addition, the controls to prevent misstatements were inadequate even though the financial statements went through various levels of review (including by the audit committee). This contributed to the continued regression of audit outcomes. Chairs of audit committees should table their reports to council on a quarterly basis to encourage the discipline of financial reporting and transparency.

Political instability at council level and the lack of research staff to support municipal public accounts committees in investigating huge backlogs of irregular expenditure mainly contributed to the limited assurance provided by these oversight structures. Councils are accountable to the community in ensuring that municipal services are provided in a financially sustainable manner. Therefore, councils should have zero tolerance for weak financial governance and the misuse of municipal funds. It is of serious concern that this has not been the case as evidenced by the regression of audit outcomes in the previous two years without any decisive action being taken. This does not set the tone for clean administration and perpetuates or promotes poor performance. Furthermore, the limited progress of investigations into the unresolved balance of irregular expenditure amounting to R16,4 billion as at 30 June 2018 as well as the unresolved balance of fruitless and wasteful expenditure amounting to R652,3 million as at 30 June 2018 indicates the lack of political will to effect consequences for those charged with the responsibility of improving the control environment of municipalities.

Accountability for the financial sustainability of municipalities and the delivery of services to the community rests with council. Of concern is their resistance to supporting the interventions of the provincial treasury and the provincial department of cooperative governance aimed at assisting municipalities to improve their control environments to ensure service delivery in a financially sustainable manner.

PROVINCIAL INTERVENTIONS DID NOT HAVE THE DESIRED IMPACT

The intervention by the provincial treasury and the provincial department of cooperative governance was riddled with political infighting and caused further instability within the municipalities, delaying improved delivery of services to communities.

Municipalities were characterised by a poor state of financial management, lack of service delivery, and poor governance and oversight, which led to the need for interventions by the provincial treasury and the provincial department of cooperative governance. The nature of these interventions and their success are dependent on a strong political leadership tone, which is currently lacking.

The provincial department of cooperative governance invoked section 139(1)(b) of the Constitution at eight municipalities during May 2019, in addition to the five municipalities where they did this during August 2018. This brought the total number of municipalities under intervention to 13. Section 139(1)(b) provides for the provincial government to intervene by assuming the responsibility of the executive authority through an appointed administrator to facilitate the intervention process. Many challenges were experienced when the interventions were initiated, the main one attributable to the lack of clarity on the roles and responsibilities of the appointed administrators. This resulted from inconsistencies between their appointment letters, the terms of reference concluded with the provincial department of cooperative governance, and misalignment with the requirements of legislation. The intervention therefore had little impact on the audit outcomes of the municipalities. We acknowledge that some interventions would not have had an immediate impact as they are medium- to long-term in nature and ought to take time to restore disciplines of financial management and service delivery.

In an attempt to improve financial reporting by municipalities, the provincial treasury also assisted by appointing several consulting firms at a cost of R27,3 million (2017-18: R10,9 million) to provide support on various components of financial reporting such as compliance with Generally Recognised Accounting Practice, contract management and commitment registers. These interventions also had a limited impact on the audit outcomes due to the lack of monitoring by the provincial treasury of the work done by these consultants as well as the timing of the appointments.

The misalignment between legislation and the practical implementation of section 139(1)(b) was exposed to political infighting and resistance that further delayed the realisation of the benefits of these interventions in restoring service delivery, governance and the disciplines of financial management. This was evidenced at **JB MARKS**, which is located in Potchefstroom, which stagnated on a qualified audit opinion. The administrator wrote to us for assistance in clarifying his role, which was being confused with the role of the accounting officer in the terms of reference concluded with the provincial department of cooperative governance. This confusion caused disputes between the administrator and the municipal manager. Consequently, at the time of issuing the audit report, a court case was ongoing in terms of which the municipality was contesting the intervention.

At **KAGISANO-MOLOPO**, located about 70 km north-west of Vryburg in the town of Ganyesa, the administrator was never allowed access to the municipal offices from the commencement of the intervention. The municipality legally contested the intervention, and the court ruled in their favour. This may pose a risk to the successful implementation of similar interventions in the province; however, it is noteworthy that the court granted the provincial department of cooperative governance leave to appeal the ruling – the appeal is yet to be heard.

Located in the town of Wolmaransstad, **MAQUASSI HILLS** obtained a repeat disclaimed audit opinion. The council appointed a municipal manager and the administrator appointed a different municipal manager, with the result that the municipality had two accounting officers. This muddled accountability totally disrupted not only the audit process but also the operations of the municipality, as no decisions could be made or actioned. The resistance to these interventions demonstrated the lack of political will to change the status quo and improve accountability and governance by implementing preventative controls that would safeguard the financial and performance systems and change the focus of the municipality towards service delivery.

At **MAMUSA**, the political infighting was the most severe and was aggravated by service delivery protest actions. This affected our audit process as the administrative and political leadership did not take responsibility for the audit process. As a result, the audit was finalised after the cut-off date for inclusion in this report. The administrator received numerous threats and was prevented access to the municipal buildings by the protesters who at one stage moved to the guest house from where she was attempting to work. This resulted in her vacating the role. The provincial department of cooperative governance then instituted a further intervention in terms of section 139(1)(c) in October 2019, whereby the council was dissolved as required. A new council was subsequently elected early in January 2020. The newly appointed council is intent on improving governance; the impact of which should be seen in due course.

THE PROVINCE WAS MAKING NO PROGRESS IN PREVENTING NON-COMPLIANCE WITH SUPPLY CHAIN MANAGEMENT LEGISLATION RESULTING IN THE CONTINUING INCREASE OF IRREGULAR EXPENDITURE

Similar to previous years, all municipalities continued to have findings on non-compliance with laws and regulations relating to procurement and contract management, specifically in the areas that result in unauthorised, irregular and fruitless and wasteful expenditure. As a result, irregular expenditure increased by a further R3,7 billion (2017-18: R4,3 billion) in 2018-19. This amount, however, is not a true reflection of the full extent of the irregular expenditure for the province, as 16 of the 17 municipalities (94%) were qualified for not disclosing all irregular expenditure incurred. In addition, we were unable to audit procurement amounting to R100,8 million due to missing or incomplete information. The common findings that resulted in a major portion of the irregular expenditure incurred, related to bid adjudication committees that were not properly constituted, unfair procurement processes, inadequate contract management, and a tolerance for deviations from competitive processes without sound reasons. Comprehensive contract registers and record keeping are key to contract management – a discipline that still evaded the province. The three municipalities that contributed most of the irregular expenditure were Rustenburg (R919,8 million), JB Marks (R680,8 million) and Madibeng (R443,8 million). This can be attributed to the weak tone and attitude of leadership, and their failure to be disciplined in dealing with officials for the way in which they used public resources, which had cascaded down to management and led to a blatant disregard of any authority or law.

Over the years we have highlighted a systemic failure by the provincial leadership to establish the required systems, processes and controls to promote the efficient, economical and effective use of resources. All municipalities had material findings relating to their poor track record in dealing with irregular expenditure. In addition, the irregular expenditure of prior years was not investigated at all, or not properly investigated, by either the accounting officer or municipal public accounts committee, bringing the total unresolved balance of irregular expenditure to R17,8 billion as at 30 June 2019. The lack of such investigations coupled with no actions to hold officials responsible by the accounting officer has created an environment where officials act with impunity, with no consequences for transgressions. There is a need for councils and municipal public accounts committees to give urgent attention to performing their oversight functions.

AUDIT PHASED IN FOR IMPLEMENTATION OF PUBLIC AUDIT ACT AMENDMENTS

Irregular expenditure at Ngaka Modiri Molema District increased significantly to R2,7 billion from R1,2 billion as reported in the previous year, clearly demonstrating the continued disregard by management of our recommendations to avoid the abuse of supply chain management legislation.

The district municipality is located in the central part of the province, including the capital of Mahikeng, and has a history of poor service delivery and high irregular expenditure. Irregular expenditure of R1,6 billion was incurred during 2018-19 (2017-18: R151,2 million) and little or no consequences had ensued. As such, the district municipality was selected for implementation of the phased-in amendments to the Public Audit Act for the 2018-19 financial year, but the audit had not been finalised by the cut-off date of this report.

We identified three material irregularities due to various non-compliance areas during the course of the audit, which were communicated to the accounting officer. The accounting officer responded positively to all of these material irregularities and indicated that appropriate action would be taken to address them. Whether appropriate actions have been taken, will be followed up during next year's audit. (Refer to section 3 of this report for further details on the material irregularities identified and the process to follow up on these matters.)

The culture that prevails in the province is one of continued irregularities and resultant losses that are not prevented from happening, or not appropriately dealt with, and there is little willingness to institute measures that will change the status of the province. Such were the reasons for the changes to our mandate. The amendments to the Public Audit Act empower us to refer material irregularities to relevant public bodies for further investigation; take binding remedial action for failure to implement our recommendations on material irregularities; and issue a certificate of debt for failure to implement the remedial action if financial loss was incurred. The amendments are intended to act as a complementary mechanism to contribute to improved accountability; assist oversight structures such as the council and municipal public accounts committee to appreciate their role; and support accounting officers to fulfil their roles as legislated. Therefore, we encourage accounting officers to take swift action and a strong stance against the abuse of public funds by ensuring that transgressions are appropriately investigated by the relevant oversight structures and any financial losses are recovered so that there will be no need for us to use our remedial and referral powers.

DISTRICTS WERE IN FINANCIAL DISTRESS, LIMITING AVAILABLE RESOURCES FOR SERVICE DELIVERY AND FOR MAINTAINING OPERATIONS

North West has four district municipalities. Amongst others, the functions of two districts namely Ngaka Modiri Molema and Dr Ruth Segomotsi Mompati include the provision of basic services such as water and sanitation, whilst the functions of the other two districts namely Bojanala and Dr Kenneth Kaunda include integrated development planning (district coordination, municipal health awareness services and local tourism to promote economic activity). These functions can be adjusted in terms of legislation by allocating any functions vested in the local municipality to the district municipality, or vice versa. Prevalent amongst the districts is a lack of the efficient, effective and economical use of their already limited resources caused by a lack of clarity in defined functions, which has led to environments that are financially distressed and where salaries make up a large percentage of costs incurred, leaving little or no resources for service delivery.

We highlighted above that **NGAKA MODIRI MOLEMA DISTRICT** had increasing amounts of irregular expenditure. Their state of affairs illustrates a district struggling to use their limited resources efficiently, effectively and economically. The district municipality has appointed its local municipalities to provide water and sanitation services in urban areas whilst it continues to provide rural areas with water through tankering services. Overpayment for goods and services or goods and services not received was a common feature of water tankering services in the district. The district failed to ensure that claims received from the supplier were appropriately checked before payments were made, resulting in payments made for distances longer than those actually required to be travelled to deliver water to rural communities. Total revenue amounted to R1,2 billion, of which R696,4 million (57%) was from the equitable share allocation and R500,5 million (41%) was from conditional grants. We noted with concern that 49% of the equitable share was spent on salaries. Additionally, the municipality had positions that were not budgeted for on the staff establishment and as a result paid R510,9 million to officials in these positions from 2012-13 to 2018-19. This is a clear example of a lack of processes and systems to ensure that all posts created are within the staff establishment of the municipality.

The equitable share allocation is meant for the provision of free basic water services to indigent communities. This means that the district has negligible own sources of funding, mainly because they are not billing consumers for water and sanitation services. Consequently, the district is solely dependent on grant funding. These services are billed by the local municipalities who as per agreement were appointed by the district as water services providers to the urban communities. However, the district – which ultimately remains responsible for these services – only transferred R15 million to the local municipalities from the R484,1 million included in the equitable share for these services. This was due to a lack of monitoring and the fact that the local municipalities did not have proper systems to record the cost of the services they provided on behalf of the district, which put a strain on the financial health of the local municipalities.

Similarly, **DR RUTH SEGOMOTSI MOMPATI DISTRICT** is also in financial distress compounded by the investment of R150,7 million in VBS Mutual Bank during 2017-18, which was written off as a financial loss. The amount invested included R100 million from the municipal infrastructure grant as well as R29 million from the regional bulk infrastructure grant received from the National Treasury. Service delivery was negatively affected as projects were not completed in the previous year. The municipality also had to significantly scale back their rural sanitation programme as a result of a lack of funding. The suspended municipal manager, who was responsible for this investment, was reinstated without any actions being taken despite recommendations to the council by the disciplinary board in this regard. This caused an uproar in the community and led to protest actions. In order to avoid the withholding of the entire equitable share allocation for 2018-19, the municipality entered into a repayment agreement with the National Treasury for the unspent grants. This resulted in a significant increase in money owed to suppliers and unspent conditional grants. The district municipality was also dependent on grants, as from the total revenue of R719,3 million, R337,2 million (47%) was from the equitable share allocation and R371,2 million (52%) was from conditional grants. Salaries were a major expense at R133,4 million, which was 40% of the equitable share allocation. This is a clear indication that the district did not use their limited resources effectively, thereby negatively affecting the communities who are dependent on them for the provision of basic water and sanitation services.

In the past, **BOJANALA DISTRICT** received disclaimed audit opinions mainly because of their inability to properly reconcile outstanding amounts due to suppliers, doing monthly bank reconciliations and properly clearing suspense accounts. Strong, sustainable financial controls, recommended in our prior year reports, were not developed and implemented; instead, the municipality relied on consultants to prepare financial statements and on the audit process to improve the credibility thereof. The district's cash reserves declined over the years to the extent that the municipality was unable to pay their biggest expense, being salaries, as they generally lacked disciplined financial management and were not prudent with their spending, thereby not only limiting service delivery but also threatening operations. Their inability to submit their financial statements by the legislated deadline was due to protest action by staff who stopped working due to the non-payment of salaries. This was further worsened by historical challenges with the completeness of the asset register and system errors when consultants processed journals without supporting documents. There is an urgent need to restore the culture of accountability and the internal control environment to ensure a functional district.

EFFORTS TO ALLEVIATE FINANCIAL DISTRESS AT DISTRICT LEVEL

Contrary to the province's character of unwillingness to implement recommendations and act towards achieving good financial disciplines, Dr Kenneth Kaunda District was responsive in implementing recommendations and demonstrated a culture that was intent on achieving good financial discipline.

In the past, **DR KENNETH KAUNDA DISTRICT** obtained qualified audit outcomes through the use of consultants. In the year under review, they attempted to effectively use internal resources and prepared financial statements without the use of consultants. Despite this, the municipality was still prone to district challenges that resulted in financial distress although there had been a concerted effort to change this by evoking austerity measures over the years, such as limiting the use of contractual services and consultants. The district is responsible for functions such as district health services, disaster management, tourism as well as local economic development, which all have to be financed from the equitable share allocation. Total revenue amounted to R189,2 million which was primarily funded from the equitable share of R180 million (95%) and other grants, with the main source of own funding being interest on investments of R3,6 million (5%). The municipality had 136 employees and spent most of their money on salaries and wages of R100,5 million (53%) and contracted services of R33,2 million (18%). These financial resources driven by prudent spending reflected a cash reserve of R36 million as at 30 June 2019; however, this was not enough to provide for district functions as well as financial support to local municipalities in the district.

The functions of districts need to be reassessed in order to promote focused efforts in ensuring they function as intended. The equitable share is directed towards salaries instead of service delivery and it is critical that resources expensed towards salaries are aligned to the value of the output achieved.

WHAT DO THE FINANCIAL STATEMENTS SAY?

The financial health of municipalities is of concern as it was characterised by poor budgeting, in-year monitoring and cash-flow management

The total revenue of the 17 municipalities where audits were completed was R17,2 billion, which consisted of equitable share allocations of R4,1 billion (24%), conditional grants of R2,8 billion (16%), and revenue from own sources including billing for services like water, electricity and property rates of R10,3 billion (60%). However, our analysis of the financial statements highlights the dire situation that municipalities in the province find themselves in. Most municipalities did not collect debt from consumers as evident by the increase in total consumer debtors to R17,3 billion, of which 87% was impaired due to not being recoverable. Because they could not collect their own revenue from consumers, municipalities were reliant on conditional grants and equitable share allocations to pay operational expenditure like salaries and wages, bulk purchases and contracted services. This resulted in their inability to pay suppliers on a timely basis with total creditors increasing to R7,4 billion, with only R1,5 billion in cash being available at year-end. It took on average 312 days to pay creditors, which consequently affected the delivery of services as well as the sustainability of suppliers. These suppliers included Eskom where the total amount due as at 30 June 2019 had increased to R1,7 billion (R1,0 billion of which was in arrears) and water boards where the total amount due had also increased to R1,7 billion (R1,4 billion of which was in arrears).
A financial statement analysis of various municipalities across the province follows below, highlighting some of the specific challenges they currently face.

MAHIKENG, which again received a disclaimed audit opinion, is located next to the Botswana border in Mahikeng. The town of Mahikeng was established in 1852 and was the capital of the former Bophuthatswana. It is now the capital city of North West and houses the seat of the provincial government. Although Mahikeng is the capital, a large part of the municipality is still rural in nature: electricity services are provided directly to the consumers by Eskom and water services are provided by a combination of the local municipality, the district and Sedibeng Water. The story of Mahikeng remains one of an uncertain future due to the municipality's inability to address several red flags.

Of the total revenue amounting to R946,7 million, 24% (R226,6 million) was from the equitable share and 6% (R57,7 million) from conditional grants. However, salaries and wages amounted to R345,1 million which meant that the equitable share and grants were not enough to pay for these expenses. Additionally, the municipality paid R20,1 million to consultants to assist with the preparation of the financial statements and asset registers. The financial difficulties were further compounded by the fact that the municipality, on average, only collected 23% of the revenue billed to the community and 86% of all debts were impaired due to it being unlikely to be collected. The municipality also wrote off consumer debts of R349,7 million without following the credit-control and debt-collection policy. This amount was more than the billing for service charges for the year of R235,8 million. This meant that the municipality was fully dependent on grants to pay operational expenses and that the delivery of services to the community was unsustainable due to low payment levels.

The municipality owed suppliers in excess of R553 million at year-end. Included in the overdue amount were arrears totalling R285 million due to the water board for bulk water. In the previous year, the municipality impaired an investment with VBS Mutual Bank of R83,4 million. The then municipal manager was suspended, but to date no further action had been taken as the investigation was still underway. The failure of the municipality to collect outstanding debt and recover the financial loss from the VBS investment took away financial resources from the delivery of services to the community and resulted in the municipality only having a R7 million bank balance at year-end. This shows how cash-strapped the municipality is and the impact will be felt by the community through a lack of service delivery.

Due to these financial constraints, a service provider which leased fleet vehicles to Mahikeng for waste and refuse removal took back all vehicles after non-payment by the municipality. The contract was subsequently cancelled by the municipality. Although the municipality lost a court case in this regard and has to pay the supplier, the municipality instead disclosed an amount to be received from the supplier of R12,6 million in the financial statements. As a result of the municipality not having the vehicles to provide the services, all waste and refuse removal services to the community came to a halt.

LEKWA TEEMANE, which also again received a disclaimed audit opinion, is situated in Christiana – an agricultural town situated on the banks of the Vaal River – and also includes the town of Bloemhof. The area is known for the discovery of diamonds in the river banks but now the main economic activities are agricultural, including the production of maize, onions, sorghum, groundnuts and beef. Businesses are solely dependent on the municipality for the supply of electricity and water. The financial statements paint a bleak picture of serious cash-flow problems and a municipality on the brink of collapse.

Of the total revenue of the municipality of R343,2 million, R44,7 million (13%) was from the equitable share allocation and R23 million (7%) from conditional grants. Salaries and wages amounted to R71,8 million and the municipality paid R1,2 million to consultants. However, after taking into account the debt impairment (R128,6 million) and bulk purchases (R71,6 million) during the year, there was almost no money left to pay operational expenses. The equitable share and grants were not even enough to cover the shortfall. In addition, debt collection was poor with more than 93% of all debts being impaired due to it being unlikely to be collected as a result of credit-control processes not being rigorously implemented.

With payables in excess of R352,7 million, including an outstanding amount due to the water board for bulk water of R245 million and a bank balance of only R1,1 million at year-end, it took on average 762 days to pay suppliers. Due to these cash-flow constraints, the municipality used conditional grants to fund their operations, which in turn affected service delivery as funds earmarked for capital projects to improve infrastructure were misspent. At one stage during the year the municipality had to source money from a supplier to settle a debt with Eskom to prevent the electricity supply to the municipality from being cut. Intervention is required to prevent the total collapse of the municipality to avoid the devastating consequences this will have for the community.

The **CITY OF MATLOSANA** is the biggest of the three local municipalities that make up the district of Dr Kenneth Kaunda, accounting for a quarter of its geographical area, and encompasses the towns of Klerksdorp, Stilfontein, Hartebeesfontein and Orkney. Traditionally this is one of the hubs of the South African gold mining industry, although its importance has been decreasing in recent years. Apart from mining, Klerksdorp is positioned as a notable medical and retail centre, and also has the largest agricultural cooperative in the southern hemisphere, named 'Senwes'. While the municipality has been one of the better-performing municipalities in the past, the financial statements show a rapidly regressing financial situation.

In total, R392,9 million (13%) of their total revenue of R3 billion was from the equitable share allocation and R174,2 million (6%) from conditional grants. At first glance, it would appear that the municipality is mostly funded from own revenue. However, the municipality had a significant problem in terms of debt collection with approximately 87% of all debts being impaired due to it being unlikely to be collected. This resulted in cash not being available to pay suppliers as was evident from the payables increasing to R1,3 billion in 2018-19. Included in these payables were arrear amounts of R324,8 million and R375 million due to Eskom and bulk water providers, respectively. The municipality was therefore increasingly dependent on conditional grants to pay operational expenses including salaries of R669,8 million. This was further evident from the municipality only spending 71% (R174,2 million) of the R246,3 million in grants received during the year, resulting in an underspending of 29%. The most significant underspending was on the municipal infrastructure grant and the neighbourhood development partnership grant of R51,5 million and R22,5 million, respectively. The increase in the unspent conditional grants highlighted the significant impact of the cash-flow constraints on service delivery as the municipality was unable to spend the grants on the projects for which it was intended.

MADIBENG, situated in Brits and located 100 km north-west of Pretoria, is known for its diversified economy with mining, manufacturing, agriculture and tourism being the predominant economic activities. The municipality includes the popular tourist area of Hartebeespoort Dam and also houses one of the only two plants of Firestone South Africa in the country which employs many people in the community. The municipality has received service delivery complaints in recent years regarding the inadequate provision of water to communities and businesses with frequent interruptions in the water supply.

Of their total revenue of R1,9 billion, R625 million (33%) was from the equitable share allocation and R233,6 million (12%) from conditional grants. This high percentage of funding from grants already indicated the municipality's dependency on this funding to pay operational expenses like salaries and wages of R531,1 million. The municipality also had a significant problem in terms of debt collection with R1,7 billion of the consumer debtors of R2,0 billion (approximately 85% of all debts) being impaired due to it being unlikely to be collected. The municipality incurred a deficit of R1,1 billion, meaning that expenses exceeded income. Added to this was the increase in outstanding payables to R1,1 billion with cash reserves of only R89,2 million at year-end. The financial statements showed that the current liabilities exceeded current assets by R719,6 million; however, this was not the full picture because an overdue loan to the Public Investment Corporation of over R1,1 billion was not included in the financial statements. This was despite the fact that the municipality lost a court case to the Public Investment Corporation when it was contesting the amount due. The inclusion of this loan in the financial statements changed the financial position of the municipality further into a net current liability position, indicating that the municipality did not have sufficient cash to deliver services to the community.

The municipality's financial situation worsened in the previous year after it invested R31,5 million in VBS Mutual Bank, which was written off as a financial loss. The municipal manager and chief financial officer resigned in December 2018 following an investigation into the matter. However, no further action has been taken pending the finalisation of the investigation. During the 2017-18 audit, we identified unauthorised debit orders against the municipality's bank account indicative of an environment that was vulnerable to misappropriation, wastage and the abuse of funds. The sum total of these debit orders could not be quantified due to a lack of records and documentation at the municipality. These were used to pay accounts of private individuals for items such as clothing, DSTV and AMC cookware – and are definite indicators of fraud. These matters have been reported to the municipal manager and executive mayor to empower them to act in preventing further losses by putting in place and strengthening access controls to accounts. This would permit only the authorised personnel, once relevant support is provided and appropriate checks are performed, to effect only authorised debit orders. Despite reporting this to the municipal public accounts committee as well, no investigation or action has been taken to stop these transactions or to recover the money from the individuals and safeguard the municipality from continuing to incur financial losses. Public funds should be used to provide services to the community and this is a clear example where the leadership of the municipality has failed to implement the discipline of financial controls over public funds, which further hindered the municipality from delivering services to the community. We remain concerned by this lack of action and the continued disregard of our recommendations.

CONCLUDING REMARKS

The status quo in the province will not change unless there is a willingness by all assurance providers led by the executive leadership level to take urgent and decisive actions and to put in place necessary measures to serve as preventative controls that will safeguard the use of funding, ensure compliance and effect consequences where there are transgressions. Consultants should only be used if they are appointed timeously, their work is monitored and their effectiveness is ensured by empowering them with relevant documents and records to enable them to add value. In addition, they should be held accountable by accounting officers for the quality of work done for municipalities. A requirement for skills transfer to finance units should also be incorporated in their contracts.

Despite numerous initiatives being put in place, including our status of records review that is an early warning tool to assist auditees in addressing their concerns ahead of audits, there were limited improvements due to the lack of interest shown by political and administrative leadership to improve the situation. If effectively used by the council, the status of records reviews could assist council members in their oversight role. Councils would be empowered to insist on credible financial statements from management and other assurance providers throughout the year and not only at year-end. Where there is a willingness and management uses the status of records reviews for its intended purpose, environments have a great opportunity to improve. This was evident at Moses Kotane, which was the only municipality to respond positively and demonstrate a willingness to act. Management took the opportunity to address some of the matters identified during the status of records review and this ultimately resulted in an improved audit outcome from disclaimed to qualified.

Local government performance is strongly affected by the attitudes of the political and administrative leadership, management and general employees. Overall, non-compliant practices, the absence of effective preventative controls, weaknesses in oversight and a lack of political will have remained constant concerns over the past years. We therefore urge the political and administrative leadership to lead by example by planning, doing and acting in a manner that promotes the desired performance and accountability. The provincial leadership should continue to promote high levels of ethics, accountability and transparency and have regular and rigorous engagements with all municipalities, follow up on progress made to implement audit recommendations, and emphasise the need to develop the disciplines to design, implement and monitor preventative controls in all aspects of financial and performance management.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	Dr. Kenneth Kaunda District	DM		-	811 647	811 647	5 500 000	15%	2
2	City of Matlosana	LM		14 086 386	914 549	15 000 935	98 873 656	15%	3
3	JB Marks	LM		14 332 395	981 410	15 313 805	36 855 306	42%	3
4	Kagisano-Molopo	LM		-	1 716 388	1 716 388	8 364 540	21%	2
5	Moretele	LM		2 699 933	1 319 188	4 019 121	16 518 986	24%	3
6	Moses Kotane	LM		12 594 690	914 549	13 509 239	36 233 266	37%	4
7	Rustenburg	LM		4 083 066	981 410	5 064 476	53 270 142	10%	2
8	Tswaing	LM		7 965 663	376 372	8 342 035	8 373 383	100%	3
9	Dr. Ruth Segomotsi Mompati District	DM		14 704 656	914 549	15 619 205	9 318 388	168%	3
10	Ditsobotla	LM		2 684 976	2 153 858	4 838 834	37 605 420	13%	4
11	Kgetlengrivier	LM		7 288 691	914 549	8 203 240	2 673 263	307%	3
12	Lekwa Teemane	LM		1 201 875	4 347 504	5 549 379	12 937 494	43%	3
13	Madibeng	LM		34 563 400	847 688	35 411 088	33 641 675	105%	4
14	Mahikeng	LM		20 155 115	847 688	21 002 803	R24 221 732	87%	5
15	Maquassi Hills	LM		2 190 615	4 470 673	6 661 288	14 573 000	46%	4
16	Ramotshere Moiloa	LM		9 529 670	2 959 441	12 489 111	24 189 539	52%	4
17	Ratlou	LM		4 438 450	1 802 459	6 240 909	10 346 000	60%	4
18	Bojanala Platinum District	DM		2 404 968	1 437 923	3 842 891	14 087 602	27%	2
19	Ngaka Modiri Molema District	DM		24 780 873	914 549	25 695 422	20 679 620	124%	5
20	Greater Taung	LM		2 589 101	847 688	3 436 789	14 539 911	24%	5
21	Mamusa	LM		-	10 105 195	10 105 195	7 600 000	133%	3
22	Naledi	LM		-	4 099 326	4 099 326	15 747 840	26%	2
TOTAL				**182 294 523**	**44 678 602**	**226 973 125**	**506 150 763**	**45%**	**73**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM =** district municipality **LM =** local municipality

2.10 WESTERN CAPE

AUDIT OUTCOMES

WEST COAST

	Unqualified with no findings	Unqualified with findings
2018-19	4	2
2017-18	4	2

Unchanged

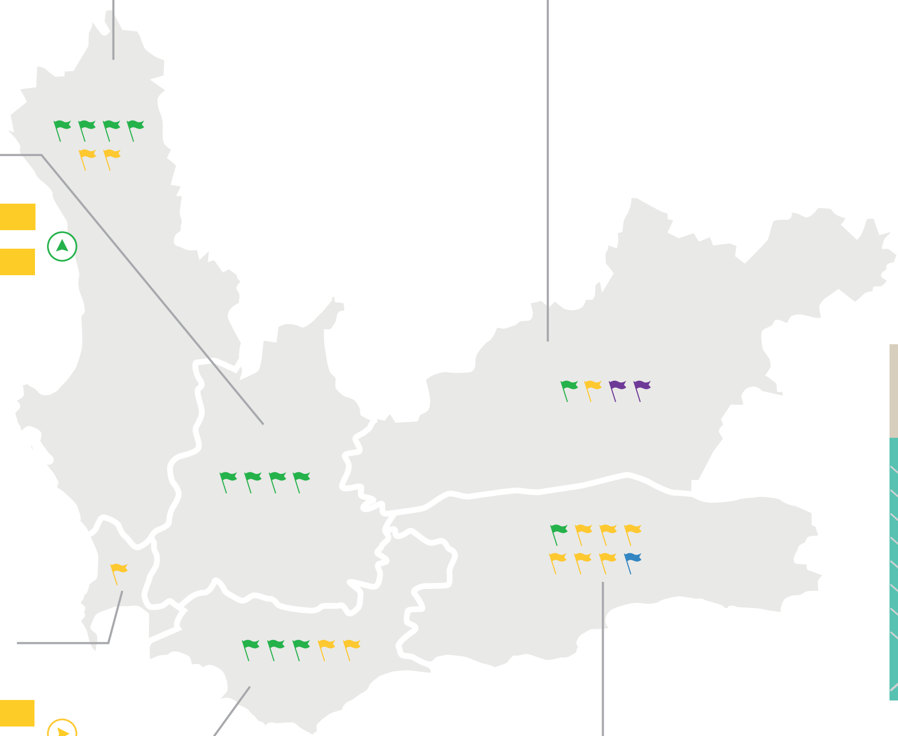
- West Coast DM
- Bergrivier LM
- Cederberg LM
- Matzikama LM
- Saldanha Bay LM
- Swartland LM

CENTRAL KAROO

	Unqualified with no findings	Unqualified with findings	Qualified with findings
2018-19	1	1	2
2017-18		2	2

Improved

- Central Karoo DM
- Beaufort West LM
- Laingsburg LM
- Prince Albert LM



CAPE WINELANDS

	Unqualified with no findings	Unqualified with findings
2018-19	4	2
2017-18	3	3

Improved

- Cape Winelands DM
- Breede Valley LM
- Drakenstein LM
- Langeberg LM
- Stellenbosch LM
- Witzenberg LM

CITY OF CAPE TOWN METRO

	Unqualified with findings
2018-19	1
2017-18	1

Unchanged

GARDEN ROUTE

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Outstanding audits
2018-19	1	6		1
2017-18	1	5	2	

Improved

- Garden Route DM
- Bitou LM
- George LM
- Hessequa LM
- Kannaland LM
- Knysna LM
- Mossel Bay LM
- Oudtshoorn LM

OVERBERG

	Unqualified with no findings	Unqualified with findings
2018-19	3	2
2017-18	4	1

Regressed

- Overberg DM
- Cape Agulhas LM
- Overstrand LM
- Swellendam LM
- Theewaterskloof LM

Metropolitan municipality | District | DM District municipality | LM Local municipality | Improved | Unchanged | Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

The Western Cape local government consists of 30 municipalities and two municipal entities. The audit outcomes of the municipal entities are not included in the analysis in this report. We set the cut-off date for inclusion of the audit outcomes in this report as 31 January 2020. By this date, one audit was outstanding.

AUDIT OUTCOMES

Overall audit outcomes

OVERALL IMPROVEMENT IN AUDIT OUTCOMES

4 *Regressed*

7 *Improved*

Clean audits

45%

(2017-18: 41%)

Financially unqualified financial statements

93%

(2017-18: 86%)

72% (21)

Municipalities submitted financial statements without material misstatements

No findings on compliance with legislation

45%

(2017-18: 41%)

Irregular expenditure

R2,7 bn

(2017-18: R0,68 bn)

No findings on performance reports

79%

(2017-18: 86%)

83% (24)

Reported achievement reliable

FINANCIAL HEALTH

Debt-collection period > 30 days

2018-19	86% (25)
2017-18	79% (23)

Creditor-payment period > 30 days

2018-19	76% (22)
2017-18	76% (22)

Vulnerable financial position

2018-19	7% (2)
2017-18	3% (1)

Improved outcomes but concerns remain

The province has seen an overall improvement in the audit outcomes for the 2018-19 audit cycle compared to a significant regression in the previous year. Thirteen municipalities (45%) received a clean audit outcome, with eight having retained their status of the previous year. It is noteworthy that six of the eight municipalities that sustained their clean audits have maintained this status for the past five or more years; and in total, 93% of the municipalities had financially unqualified opinions on their financial statements. Overall, 55% of the municipalities failed to comply with legislation, with procurement and contract management findings raised at 12 (41%). These findings played a major role in the increase in irregular expenditure from R0,68 billion to R2,7 billion; the three biggest contributors being the City of Cape Town Metro (R950 million), George (R621 million) and Oudtshoorn (R170 million). One of the main reasons for irregular expenditure was improper contract management resulting from inadequate systems to monitor expenditure on, and expiration of, contracts. Overall, debt-collection periods exceeding 30 days have deteriorated mainly due to the overall socio-economic conditions.

AUDIT OUTCOMES CHARACTERISED BY THREE TYPES OF MUNICIPALITIES

(1) Municipalities with control environments that are institutionalised

Those municipalities that have sustained their clean outcomes are characterised by control environments that are institutionalised, preventative in nature and reinforced by a strong tone set by leadership. These include operational controls that are institutionalised within their systems independent of individuals, which implies that staff turnover will not result in the failure of controls. In addition, management has a low tolerance for audit findings and a high level of accountability, while all the relevant assurance providers know their roles and do their part in the control environment. In these instances, municipalities focus on their own processes by incorporating robust risk analysis into their action plans, thus enabling audit outcomes to be a by-product.

WITZENBERG in the Cape Winelands district is an example of a strong leadership tone at the top and active involvement of the municipal manager in all areas of the municipality, including the audit process, which enables a strong control environment and contributes to a culture of accountability. The municipality has their own well-capacitated internal audit unit – the importance of which is evidenced by management's responsiveness to the internal and external audit findings. The audit committee has the appropriate skills and the municipality ensures that they have the required experience in finance, legal matters and information technology as a minimum. They also have an adequately functioning municipal public accounts committee and an effective council. Although the municipality has had a chief financial officer vacancy for most of the financial year under review, processes and procedures have been institutionalised to ensure clean administration. These included policies and procedures that are regularly updated, job descriptions that are well defined, and staff members being aware of their individual role within the municipality. Consequence management is timeous as adequate disciplinary action is taken for transgressions and staff have good institutional knowledge of the municipality.

WEST COAST DISTRICT has a strong governance structure, a high level of accountability and a culture of implementing consequences when breaches are identified. This has contributed to their nine consecutive clean audits. The municipality has a good mix of skills and experience within the governance and management structures, as evidenced by the following:

- Zero vacancy rate at senior management level.
- The municipal manager is a chartered accountant and former chief audit executive at a local municipality within the district.

- The chief financial officer is also a chartered accountant and has been involved in the public sphere for at least 30 years.
- The internal audit manager has Auditor-General of South Africa experience, while the audit committee chairperson has more than 30 years' experience in the public sector and has served on various audit committees within the province throughout his tenure.

While the municipality appoints consultants, they are not used to supplement skills at the municipality but rather to provide technical expertise in relation to contentious and technical matters. Action plans are prepared and monitored to ensure that the audit findings are addressed. The municipality also uses the status of records review as a measure to identify any issues that may arise.

CAPE WINELANDS DISTRICT is another example of a municipality that has maintained their clean audit status for the past six years, as a result of continuous efforts by the political and administrative leadership. They have a strong senior management team which, together with oversight by the audit committee, ensures that the control environment of the municipality is stable to prevent and detect material errors in financial and performance reporting as well as material non-compliance with legislation. They are supported by an internal audit unit in key risk areas within the municipality to ensure that deficiencies identified are adequately responded to and monitored through management's action plans.

Five municipalities, namely **DRAKENSTEIN**, **LANGEBERG**, **PRINCE ALBERT**, **SALDANHA** and **THEEWATERSKLOOF**, improved from financially unqualified opinions with findings in the previous year to a clean audit outcome after addressing the compliance findings previously identified. These municipalities have in common a leadership with a desire and commitment towards clean administration. The management is responsive to our findings while specifically addressing the root causes identified; they also respond with the same rigour to internal audit findings as they do to external audit findings. They all have functional municipal public accounts committees and councils who carry out their duties effectively and hold their respective municipalities accountable.

(2) Municipalities that are reactive and susceptible to change

Municipalities falling within this category commonly have controls that are not always institutionalised and follow a reactive rather than a proactive approach. This results in audit outcomes moving from clean to financially unqualified with findings. In some instances, political instability results in instability in key positions such as those of the municipal manager and chief financial officer, as well as a change in the tone at the top. Municipalities within this category are those that had been clean previously but lost that status, resulting in a 'state of shock' and inability to move past the issues and ultimately prevent them from recurring. This can be attributed to a state of comfort, with controls that are not responsive enough to overcome the setbacks.

The **CITY OF CAPE TOWN METRO** maintained a clean audit outcome for four consecutive years before regressing in 2016-17 to financially unqualified with findings on compliance with legislation. This regression was mainly due to political instability and a breakdown in preventative controls, which we have highlighted over a number of years, and ultimately resulted in the stagnation of their audit outcome. While the metro devised an audit action plan, implementation of this plan did not have the desired impact during 2018-19. The metro is encouraged to continue implementing their action plan to address the identified root causes relating to audit findings and also consider a proactive approach in resolving audit findings by focusing on those controls that will prevent audit findings.

Contract management is especially of concern, as the metro has been plagued with issues in this area for some years. The metro's systems are not adequately designed or configured to monitor expenditure on contracts. For example, the financial system is not configured to prevent payments being made after the expiry date of contracts or in excess of the contract amounts. This results in expenditure being incurred in contravention of supply chain management prescripts, which is then consequently classified as irregular expenditure. Furthermore, the issues regarding contract management affect the metro's ability to effectively deliver on their housing projects, contributing to capital underspending of R1,3 billion. This has also been raised at council meetings where the communities' displeasure and disappointment have been highlighted. Despite raising these concerns each year, the issue constantly recurs and is in fact worsening.

SWARTLAND in the West Coast district enjoyed a long-celebrated history of clean audit outcomes. They regressed in 2017-18, however, and were not able to improve on that audit outcome in 2018-19. In 2017-18 they regressed as a result of the late submission of their financial statements due to implementation challenges with the municipal standard chart of accounts. There was an expectation that they would quickly improve in

2018-19 but that expectation was not realised. The regression shocked the system and instead of bolstering controls, the municipality opted to deflect and dispute findings. A number of material misstatements due to the ineffective implementation of controls in the finance unit were identified in the 2018-19 financial statements, which were subsequently corrected. The robust preventative controls that had prevented material misstatements from occurring in the past were no longer in place, which contributed to the stagnation in the audit outcome. The municipality has what it takes to improve, as they had demonstrated during their period of clean administration. A determining factor will be the change in attitude towards the audit by leadership and management.

(3) Municipalities with dysfunctional control environments

Municipalities' dysfunctional control environments can generally be attributed to the leadership's weak tone and attitude, their lack of visibility and their high tolerance for poor audit outcomes. This attitude can be termed the '*dit maak nie saak nie*' (it doesn't matter) attitude. This then cascades down to management and other staff who apply controls that are ideal on paper but absent in reality. These types of environments are prevalent within the Central Karoo and Garden Route districts where we find some of the worst-performing municipalities.

The current audit outcomes of **BEAUFORT WEST** in the Central Karoo district are the result of a lack of internal control. There is an overall lack of accountability and no actions are being taken by the council, the executive mayor and the municipal manager to ensure that controls are implemented.

The council does not ensure proper consequence management and does not exercise oversight of the commitments made by management. The leadership has not been stable at council level and some council members are appointed to positions in the administration of the municipality. Decisions detrimental to the municipality's financial resources are made without due diligence being performed. This included the selection of projects that are labour intensive at the expense of the financial resources of the municipality.

The municipal manager is seldom present at the municipality, which contributes to the poor control environment and employees not fulfilling their roles and responsibilities. He did not prioritise the implementation of the municipality's action plan, resulting in a lack of urgency to design and implement internal controls.

The municipality used consultants to prepare their financial statements and update supporting schedules. The consultants prepared financial statements based on data that was not credible due to the lack of preventative controls to support financial reporting as well as challenges relating to the financial system. This resulted in a poor set of financial statements being submitted in which a number of errors were identified. In addition, the consultants – instead of municipal leadership – responded to audit findings. The responses to audit findings focused on immediate solutions that would result in an unqualified and/or clean audit opinion rather than a deeper look at the serious problems which prevented the municipality from improving their audit outcome on a sustainable basis.

The audit committee, which is responsible for the review and monitoring of the audit action plan and internal audit plan, did not ensure that these plans were sufficient to address the risks and misstatements identified in prior year audits.

LAINGSBURG in the Central Karoo district has a history of qualified audits and has been plagued by poor governance. This is due to the poor tone set by those charged with governance as the poor outcomes seem to be tolerated without credible action plans being implemented. The location of the municipality has also hampered their ability to attract suitably skilled individuals, which resulted in assurance providers such as the audit committee and municipal public accounts committee not providing the necessary financial oversight and governance. This has resulted in a list of repeat compliance findings reported every year due to the lack of implementation of credible action plans.

The appointment process for the municipal manager was investigated by the Directorate for Priority Crime Investigation (Hawks), which created further instability. This municipality is reliant on the chief financial officer who accounts for the majority of the skills and competence within the finance unit. There is a lack of succession planning and capacity building within the finance unit, which is of great concern.

Given capacity concerns within the finance unit, daily financial disciplines were not evident, which resulted in the municipality being heavily reliant on consultants and having to pay them in excess of R3 million from an already constrained budget.

At **KANNALAND** in the Garden Route district there is a lack of oversight due to instability in the political and administrative positions. Key positions such as those of the chief financial officer and the supply chain management manager have not been filled permanently, with different employees acting in these positions. The instability has not allowed for a culture of good governance to be developed, which contributed to action plans not being developed, implemented or monitored to address all the prior year audit findings and previously reported internal control deficiencies. This has resulted in repeat audit findings.

Combined with the instability in these key positions, there has been no functioning internal audit unit for three consecutive years, rendering the functioning of the audit committee redundant. This meant that the required oversight could not be exercised and consequently risk assessment and monitoring processes have been absent. This has manifested in system challenges that resulted in the municipality not being able to process transactions throughout the year. It also resulted in the municipality submitting their financial statements late for two consecutive years. In addition, the daily and monthly controls were ineffective and did not ensure that recorded transactions were supported by credible audit evidence. Skills and capacity in the finance unit have also not been adequate, which has resulted in the municipality relying heavily on consultants for the preparation of their year-end reconciliations and financial statements.

WHAT DO THE FINANCIAL STATEMENTS SAY?

The financial statements of the municipalities in the province generally correlate with the socio-economic climate within their respective areas as well as our assessment of their financial discipline. The following is a financial statement analysis of three varied municipalities across the province to provide users with valuable insights into some of the challenges that municipalities currently face.

The high-level overview of the financial statements of **SWELLENDAM** confirms our assessment regarding difficulties with revenue collection but disciplined spending. Their disciplined financial management contributed to an unqualified audit opinion with findings. The municipality continued to rely on consultants for financial reporting at a cost of R1,6 million. Their revenue base of R260 million, of which R53 million is from government grants, is relatively small in comparison to some of the other municipalities in the province. Of the revenue raised, R83,4 million was outstanding at year-end. An amount of R63 million, representing 76% of the receivables balance, was provided for as potentially uncollectable due to the socio-economic conditions within the municipality. This affected the municipality’s suppliers as it took 89 days on average to pay them. Despite this challenge, the municipality remained disciplined with their expenditure and working capital management.

The municipality is also prudent in their spending as their operating expenditure grew by only 2% compared to 2017-18 while their expenditure on capital assets of R16 million was 25% less than was budgeted. The municipality spent R13 million to repair and maintain their property, infrastructure and equipment, which represents 4% of their assets’ value. This enabled the realisation of an operating surplus of R48 million and a net surplus of R14 million after taking into account the impairment of their assets.

Their current assets were valued at R102 million, of which R75 million related to cash and cash equivalents, compared to their current liabilities of R48 million. They have maintained this relationship over the past few years, enabling them to have twice as much liquid assets to cover their short-term debt thanks to their disciplined cash management.

Their internal funding prevents them from being exposed to undue financial risks associated with loan funding and finance costs. The general message coming out of the financial statements is one of conformity to norms and standards as evidenced by the disclosure of water and electricity losses of 16% and 10%, respectively, which is within the National Treasury’s prescribed norms.

The financial statements of **CEDERBERG** similarly conformed to our assessment of poor recovery of debt from the community but disciplined spending. Cash reserves, however, are declining year on year, from R18,5 million in 2018 to R7,2 million in 2019. The municipality continues to demonstrate resilience and has maintained their clean audit status. Given the socio-economic conditions, the municipality had difficulty in collecting amounts due to them. In total, R72 million was outstanding for basic services delivered and R28,4 million for rates and taxes. They deemed R58,6 million, which represents 58% of the receivables, to be potentially uncollectable. Furthermore, R70,9 million of the receivables balance was outstanding for more than 90 days; this in relation to the total debtors' value of R100,4 million for basic services and rates and taxes, which is indicative of the fact that the community is not paying amounts due on a timely basis. At year-end, the municipality had only R56,9 million in current assets, which they will need to pay short-term debt of R97,5 million. The municipality takes 149 days on average to pay suppliers, which is far above the norm of 30 days.

These are all indicators of a worsening cash position as a result of the municipality's inability to collect revenue due for services provided as well as the non-collection of property rates. Notwithstanding these challenges, the municipality demonstrated sound financial discipline in spending funds for their intended purpose. This was seen in the construction of a wastewater treatment plant which had stood incomplete for three years due to a lack of funds. While R67,7 million of grant funding had already been spent, the municipality was unable to complete the project due to their inability to raise the necessary funds required given their cash-flow and revenue-collection challenges. The municipality will therefore be reliant on further grant funding to complete the project, but they withstood the temptation to use funds allocated for other programmes to do so.

The municipality is doing well on the management of infrastructure assets as reflected in the water losses of 10% and the electricity losses of 4%, which are well within the set norms. There has also not been any impairment of infrastructure assets in the past two financial years and R13 million was spent on repairing and maintaining such assets.

The financial statements of **BEAUFORT WEST** tell a story that has been told before. That is, a story of a municipality whose ability to continue operating in the future is uncertain. The same red flags identified in the past have again made an appearance, namely short-term debt exceeding liquid assets, water losses exceeding 40%, non-recovery of amounts due to the municipality, and a general lack of financial discipline resulting in a qualified audit opinion.

Payments due to the municipality amounted to R270 million, which was significantly impaired by an amount of R226 million. A large portion are amounts owed to the municipality for more than 90 days. The dire situation becomes even more concerning when looking at the year-end cash balance, which has significantly decreased from R12,7 million in the previous year to R0,5 million in the current year. Comparing this cash balance to the unspent conditional grants of R6,5 million, raises concerns as to whether grant funding was used for its intended purpose as the cash balance is currently insufficient to match the balance of unspent conditional grants. The municipality's overdraft balance is currently R12,9 million, reflecting an increase from R7,8 million in the previous year. Also concerning is the significant drop in the surplus from R58,7 million in the previous year to R0,6 million in the current year.

The main contributor was the decrease in grants and subsidies that was recognised as revenue relating to capital expenditure. In the previous year, R77,7 million was recognised with only R30,1 million being recognised in the current year. This is symptomatic of the municipality's dependency on grant funding to continue operating. The apparent lack of financial discipline around the spending of grant funding adds to the uncertainty over the municipality's ability to continue operating as any future reduction in grant funding will mean that they will be unable to pay employees and suppliers. This, along with the municipality's challenges with collecting outstanding amounts due to them, could have a serious impact on meeting service delivery objectives.

Despite a decrease in long-term borrowings and trade and other payables, it is concerning that the municipality's cash balances were almost depleted to the extent that they have unspent grant funding but no cash reserves to back it up. Consultant expenditure increased from R9,3 million in the previous year to R11,4 million in the current year. Of this amount, R3,9 million related to the use of consultants to prepare financial statements despite the municipality having a finance unit with positions that are mostly filled. Notwithstanding the municipality's cash challenges, they continue to rely on consultants, with very limited transfer of skills or improvement in the audit outcome.

Excessive water consumption by indigent consumers, pipe bursts and field leakages are disclosed as the reasons for the 45% material water losses. A key cause is the municipality's ageing water meters and the lack of maintenance. Repairs and maintenance of infrastructure assets amounted to R7 million compared to R15 million in the previous year. Additionally, a lack of usage monitoring further contributed to reported losses. This is especially concerning for a drought-stricken area such as Beaufort West.

CONCLUDING REMARKS

While the province has shown an improvement, significant concerns remain. These concerns relate to those municipalities where the control environments are not institutionalised, which make them susceptible to possible regressions, and those municipalities where the control environments are dysfunctional, which could lead to a further deterioration in already poor audit outcomes. However, this does not have to be an inevitability as the trajectory can be changed by all role players institutionalising the best practices and addressing the control weaknesses identified above. Municipalities that have institutionalised controls are commended and encouraged to continue on the positive trajectory towards the sustainability of good governance as well as the sharing of their good practices. The assistance of the premier and coordinating departments requires some reflection and mapping of a way forward. We remain committed to supporting all institutions in the drive to embed preventative controls and good governance as a culture in the province.

SCHEDULE OF CONSULTANT COSTS FOR ACCOUNTING, FINANCIAL AND ASSET MANAGEMENT, AND OTHER INTERNAL CONTROL SERVICES RENDERED BY EXTERNAL SERVICE PROVIDERS DURING 2018-19 REPORTING PERIOD

	MUNICIPALITY	AUDITEE TYPE	AUDIT OPINION	FINANCIAL REPORTING - COST (R)	CONTRIBUTIONS FROM OTHER INSTITUTIONS - COST (R)	TOTAL CONSULTANT COST (R)	FINANCE DEPARTMENT SALARY COST (R)	PERCENTAGE OF SALARIES	NUMBER OF CONSULTANTS
1	West Coast District	DM		1 192 590	-	1 192 590	11 073 280	11%	1
2	Bergrivier	LM		4 051 393	-	4 051 393	16 723 706	24%	2
3	Cape Agulhas	LM		1 082 513	-	1 082 513	15 556 941	7%	1
4	Cederberg	LM		2 768 444	-	2 768 444	Data not readily available		1
5	Hessequa	LM		1 383 441	-	1 383 441	20 520 791	7%	2
6	Langeberg	LM		3 503 594	-	3 503 594	20 178 121	17%	1
7	Prince Albert	LM		470 870	-	470 870	4 447 188	11%	1
8	Theewaterskloof	LM		1 088 027	-	1 088 027	28 093 724	4%	2
9	Central Karoo District	DM		1 748 946	-	1 748 946	2 944 761	59%	1
10	Garden Route District	DM		2 624 393	-	2 624 393	20 023 202	13%	1
11	Overberg District	DM		529 005	-	529 005	7 732 213	7%	3
12	Bitou	LM		878 423	-	878 423	18 792 018	5%	1
13	Breede Valley	LM		550 458	-	550 458	19 146 320	3%	1
14	George	LM		147 002	-	147 002	50 872 512	0%	1
15	Knysna	LM		4 043 455	-	4 043 455	32 811 163	12%	1
16	Matzikama	LM		718 031	-	718 031	21 327 061	3%	2
17	Mossel Bay	LM		601 372	-	601 372	27 495 651	2%	1
18	Oudtshoorn	LM		3 033 722	-	3 033 722	25 662 344	12%	1
19	Stellenbosch	LM		1 634 743	-	1 634 743	33 264 022	5%	2
20	Swartland	LM		240 508	-	240 508	26 997 134	1%	4
21	Swellendam	LM		1 553 245	-	1 553 245	18 806 763	8%	1
22	Beaufort West	LM		3 937 015	-	3 937 015	14 723 349	27%	1
23	Laingsburg	LM		3 434 381	-	3 434 381	5 125 894	67%	1
24	Kannaland	LM		1 076 178	-	1 076 178	10 268 121	10%	1
TOTAL				**42 291 748**	**-**	**42 291 748**	**452 586 279**	**9%**	**34**

Audit outcomes	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Audit not finalised at legislated date

MET = metropolitan municipality **DM** = district municipality **LM** = local municipality

NOTES

SECTION 3

Material irregularities

INTRODUCING MATERIAL IRREGULARITIES

The **responsibilities and duties of municipal managers are well defined** in the Municipal Finance Management Act, which are all underpinned by the basic values and principles governing public administration as set out in our country's constitution. It includes the need for high standards of professional ethics, accountability and transparency as well as the promotion of the efficient, economical and effective use of resources.

Our audits have for many years been highlighting a systemic failure in local government to establish the systems, processes and controls required to make the constitutional principles and the requirements of the Municipal Finance Management Act the norm. Not only are **irregularities and the resultant losses, misuse and harm not prevented from happening, it is also not appropriately dealt with when it is identified.** This is evident in the rising irregular expenditure not being dealt with, the lack of action on potential fraud and corruption, and the continued disregard for our findings and recommendations.

The remarks made by Chief Justice Mogoeng Mogoeng in October 2016 at a meeting of the heads of supreme audit institutions were a catalyst for the **changes made to our mandate** through the amendments to the Public Audit Act. The amendments were driven by the Standing Committee on the Auditor-General and received unprecedented support in Parliament.

'…the failure to be disciplined in the way you use public resources, would not only attract consequences, but serious consequences…'

Call it 'the power to follow up on audit recommendations, the power to take remedial action, the power to ensure compliance', but you need to strengthen the pre-existing mechanism to follow up on the recommendations he made. Only then, I would believe, would qualified audit reports come down significantly. When people know that failure to act in line with the legal framework applicable to the use of public money, and the failure to be disciplined in the way you use public resources, would not only attract consequences, but serious consequences... [would audit outcomes improve].

[Audit follow-ups] should not be a loose arrangement dependent on the mercy or reasonableness of the incumbent affected by a negative audit report. People should know in advance that it is a matter of compliance with the Constitution, it is a matter of compliance with a statute, and there are serious consequences if you don't do it. In that way I believe they would be incentivised to do much more than they would otherwise have done absent that provision.

Chief Justice Mogoeng Mogoeng, CBC meeting – October 2016

The amendments provide us with an expanded mandate to:

Refer material irregularities to relevant public bodies for further investigations

Take binding remedial action for failure to implement our recommendations for material irregularities

Issue a certificate of debt for failure to implement the remedial action if financial loss was involved

The amendments to the Public Audit Act became effective on 1 April 2019. These amendments introduced the concept of a material irregularity.

What is a material irregularity?

Material irregularity

Irregularity: Any **non-compliance with**, or contravention of, **legislation, fraud, theft or a breach of a fiduciary duty**

identified during an audit performed under the Public Audit Act that **resulted in or is likely to result in …**

Impact: a **material financial loss**, the **misuse or loss of a material public resource** or **substantial harm to a public sector institution or the general public.**

Municipal managers are familiar with the different elements of a material irregularity, as they are responsible for **preventing irregularities** such as non-compliance, fraud, theft and breaches of fiduciary duty and the impact in terms of the loss or misuse of the money and resources financed by taxpayers. They also have a clear duty to serve and protect the community and the well-being of the municipality they are leading.

The intent of the amendments is **not to take over the functions of the municipal managers**, as their accountability responsibilities are clear in legislation. It was also not an attempt to bring another punitive measure but rather a **complementary mechanism for strengthening financial and performance management**, which in turn will contribute to improved accountability in the public sector. Hence, our extended powers will only be activated if we reported a material irregularity to a municipal manager and they did not take appropriate and timely action to address it.

By identifying material irregularities, we **support municipal managers** by bringing to their attention the irregularities that could have a significant impact on finances, resources and service delivery while also empowering them to timeously take the appropriate steps in terms of legislation. This will lessen the adverse effect of such irregularities on municipalities, set the right tone for accountability, highlight the need for consequences, and encourage a behavioural change at the highest levels. We report the material irregularities in the audit report, which also **enables councils and the municipal public accounts committees to perform their oversight function** – focusing on the most material matters affecting municipalities.

If municipal managers, supported by their political leadership, adhere to their legislated responsibilities and commit to take swift action when we notify them of a material irregularity, there will be **no need for us to use our remedial and referral powers**.

They should focus on **preventing material irregularities**, as it is more effective than having to deal with the impact and consequences thereof. More insights on the prevention of material irregularities are included at the end of this section.

THE DIFFERENCE BETWEEN MATERIAL IRREGULARITIES AND IRREGULAR EXPENDITURE

A material irregularity and irregular expenditure are not the same, as shown below:

Irregular expenditure

Irregular expenditure is all expenditure where there was non-compliance with legislation in the process leading up to the payment.

For example, if the procurement process for the awarding of a construction contract did not comply with legislation on supply chain management, all payments to that contractor will be irregular expenditure.

When irregular expenditure is identified, the municipal manager is required to perform an investigation to determine the impact by considering if the non-compliance resulted in a financial loss, whether there was any fraud involved, and if an official should be held accountable. If there was no loss or fraud, the irregular expenditure will be condoned after the necessary disciplinary action had been taken.

Material irregularity

As with irregular expenditure, a material irregularity also stems from non-compliance with legislation, but it has a broader scope and can be applied to fraud and theft and to a breach of fiduciary duty (which means that an official did not do what the legislation requires and/or did not act in the best interest of the municipality).

Another key difference is that for any non-compliance to be considered a material irregularity, there must already be an indication that the non-compliance resulted in, or is likely to have a material impact in the form of, a material financial loss, the misuse or loss of a material public resource, or substantial harm to a public sector institution or the general public.

The values will differ. Irregular expenditure is the total expenditure. If the material irregularity relates to a financial loss, the value will be the loss. A material irregularity will also not always have a value (for example, substantial harm cannot be quantified).

Example

A lack of a competitive bidding process for the awarding of a contract of R20 million.

The irregular expenditure is all the payments made on the contract to date (e.g. R10 million).

Example

A lack of a competitive bidding process for the awarding of a contract of R20 million resulting in a material financial loss, as the same service could have been delivered at a lower price (e.g. R18 million).

The financial loss is R2 million (what was lost and what can still be lost).

APPROACH TO 2018-19 AUDITS

Irregularities are **identified during our normal audit process** as we audit compliance with key legislation as well as consider governance and control as part of the audit. Our audit processes can also identify possible fraud and theft, which we then report to management for investigation.

However, our audit process **generally does not consider the impact** of the irregularities identified (for example, if a financial loss is likely), as it is not required by the auditing standards. The requirements and processes to follow for a material irregularity as prescribed by the Public Audit Act and the Material Irregularity Regulations introduce additional steps in the audit process, new processes for referrals and remedial action, and the establishment of new structures and additional capacity.

The impact of the expanded mandate on our audit process and organisation as well as the profound implications thereof requires us to **implement the changes in a careful, but progressive manner**. As agreed with the Standing Committee on the Auditor-General, we are phasing in the implementation of our expanded mandate.

The phasing-in allows us to:

- responsibly align the organisational resources with the demand placed on us by the Public Audit Act
- establish relationships with the public bodies to which we will be referring material irregularities
- create the required level of awareness of the Public Audit Act and the Material Irregularity Regulations in the external environment.

For the 2018-19 audits, **we implemented the material irregularity process at a limited number of municipalities** (nine), which we selected based on their audit outcomes and their history of irregular expenditure.

In the first phase of implementation, we focused on identifying material irregularities that relate to **non-compliance that can result in a material financial loss** identified as part of our compliance audit. The reason for this focus is that we already have well-established processes to identify material non-compliance with key legislation and that the recovery of financial losses is of great concern to the country. We will continue with a phased approach over the next few years but will progressively increase the extent of the work we do until it is fully implemented at all municipalities and municipal entities.

WHAT DID WE DO TO IDENTIFY MATERIAL IRREGULARITIES?

The material irregularity process was applied only from 1 April 2019 at the selected municipalities, when the amendments became effective. The auditor-general used the discretion allowed by the Public Audit Act to direct that the audit teams **only consider material irregularities where it continued to have a financial impact in the 2018-19 financial year**. This means that we did not consider non-compliance that took place in prior years except where it continued to financially affect the municipality; for example, if payments are still being made on a contract that was irregularly awarded in prior years, or if a debt owed to the municipality was still in its books in 2018-19.

We also made sure that we applied the definition of a material irregularity correctly by only reporting it if the **non-compliance directly resulted in a financial loss** or there were sufficient indicators that it is likely to result in a financial loss. We considered whether **a financial loss was material** through considering its value, nature and impact. The value of the financial loss had often already been determined by the municipality and disclosed in the financial statements, such as fruitless and wasteful expenditure (what we refer to as a known financial loss). But for some material irregularities, we estimated the potential financial loss to consider if it was material (what we refer to as an estimated financial loss).

The limited time available for finalising the audit, the complexity of some of the matters we dealt with, the difficulties experienced at some of the municipalities to perform the audits, and the time we gave municipal managers to respond to identified material irregularities **affected our ability to finalise most of the audits by 30 November 2019 (or 31 December for the metros)**. We could also not complete the process of notifying municipal managers and assessing their responses to the notification at some of the municipalities before finalising the audit. It is likely that **additional material irregularities will be reported** at the selected municipalities in upcoming audits.

WHAT DID WE DO WHEN WE IDENTIFIED A MATERIAL IRREGULARITY?

When we identified a material irregularity, the municipal manager **was notified** without delay. We gave them 20 working days to respond to the notification by giving us a written submission and evidence on what they have done to address the material irregularity and what their further planned actions are.

We assessed the responses provided and concluded whether their actions (taken or planned) and the outcomes thereof were appropriate in line with their legal obligations. If we found the actions and outcomes to be appropriate, we took no further action and **reported the material irregularity and the taken and planned actions of the municipal manager in the audit report**. This was the case for all the material irregularities identified in 2018-19.

Where we notified municipal managers of a material irregularity but could not finalise the process of receiving and assessing their response before finalising the audit, we reported in the audit report that an **'other' material irregularity** was identified but all the processes had not been finalised by the time of the audit report.

If we would have concluded that appropriate actions had not been taken, the normal process would be to include **recommendations in the audit report** on what the municipal manager should do to address the material irregularity, with a deadline by when these recommendations should be implemented. Alternatively, we would have **referred the material irregularity to a public body for further investigation**.

LEGAL OBLIGATIONS OF MUNICIPAL MANAGER TO ADDRESS AN IRREGULARITY

If a municipal manager is made aware of an irregularity (non-compliance, fraud, theft or a breach of fiduciary duty), the **Municipal Finance Management Act and its regulations typically prescribe** the following steps to be taken:

1. Perform a preliminary investigation to determine the facts and collect information on what caused the transgression, who is responsible, and whether a financial loss was (or will be) suffered

If applicable

2. Prevent any losses or further losses
3. Institute a formal investigation if there are indications of fraud, corruption or other criminal conduct; if confirmed, take further action (e.g. report the matter to the South African Police Service)
4. Recover any financial losses from an external party
5. Take steps against the responsible official/s (which can include a financial misconduct investigation)
6. Recover any financial losses from the responsible official/s

The **policies and procedures** of a municipality typically describe how these steps should be taken and the timing thereof.

WHAT HAPPENS WITH THE IDENTIFIED MATERIAL IRREGULARITIES?

A material irregularity is only **fully resolved** if (1) the loss (or further losses) is prevented and/or any losses incurred have been recovered or all possible steps have been taken to recover the losses; and (2) appropriate steps have been taken against the person or party responsible for the loss.

The **responsibilities for the further steps** to be taken by the municipal manager, mayor and council (including the municipal public accounts committee) to resolve the material irregularities identified in 2018-19 are detailed as follows.

Municipal manager is dealing with the material irregularity

Auditor-General of South Africa and municipal manager

Municipal manager implements the committed actions to address the material irregularity and improves controls to prevent recurrence

Auditor-General of South Africa follows up in the next audit if actions were implemented and if outcomes were reasonable – if not, can result in referral or a recommendation in the audit report

Mayor and council

Mayor monitors progress and supports municipal manager in addressing the material irregularity and improving controls

Council monitors progress and calls municipal manager to account for actions taken and outcomes

If the follow-up in the next audit results in a recommendation in the 2019-20 audit report for the municipal manager to implement specific actions to resolve the material irregularity, it can result in a certificate of debt for the municipal manager by January 2022 as illustrated below.

1 **November 2019**
Report material irregularity in audit report for 2018-19 audit

We are here

2 **August 2020**
Follow up on actions taken by municipal manager and conclude whether actions and/or outcome were appropriate or not

3 **November 2020**
Include recommendations in audit report on how material irregularity should be addressed by a specific date (e.g. within 6 months)

4 **June 2021**
Follow up whether recommendations have been implemented; if not, issue remedial action to municipal manager that must be implemented by a specific date (e.g. within 3 months)

5 **October 2021**
Follow up whether remedial actions have been implemented; if not, issue notice of intention to issue certificate of debt to municipal manager

Request written submission on reasons not to issue certificate of debt within 20 working days

6 **November 2021**
Conclude based on written submission whether certificate of debt process should continue; if it continues, request municipal manager to give oral representation before material irregularity advisory committee on reasons not to issue certificate of debt

7 **December 2021**
Material irregularity advisory committee meets to hear oral representation and recommends course of action to auditor-general

8 **January 2022**
Auditor-general issues certificate of debt to municipal manager

The material irregularities and the progress made in resolving them will be **reported in the audit report of the municipality and in general reports until they have been fully resolved** to enable accountability and oversight.

OUTCOMES FROM THE 2018-19 AUDITS

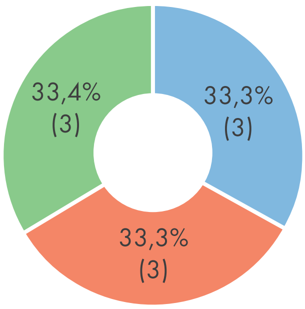
Nine municipalities were identified for implementation of the material irregularity process in 2018-19. The **overall outcomes** were as follows:

6 material irregularities reported

R24 499 866 financial loss

(**R2 421 897** known and **R22 077 969** estimated)

3 (100%) municipal managers are taking appropriate action to resolve material irregularities



Municipalities identified in phase 1	Status	Material irregularities reported
Ngaka Modiri Molema District (NW)		3
City of Tshwane Metro (GP)		2
Ga-Segonyana (NC)		1
Nelson Mandela Bay Metro (EC)		0*
eThekwini Metro (KZN)		0
City of Cape Town Metro (WC)		0
Matjhabeng (FS)		
Mogalakwena (LP)		
Dr JS Moroka (MP)		

* Material irregularities were identified but reported as an 'other' material irregularity in the audit report, as all processes had not been finalised by the time of the audit report

Completed audits – no material irregularities identified

Completed audits – material irregularities identified

Audits outstanding at 31 March 2020

Nature of material irregularities

Payment for **goods or services not received**	Assets **not safeguarded** resulting in **theft/vandalism**	Unfair procurement leading to **overpricing**
33% (2)	50% (3)	17% (1)
R11 418 843	R11 849 379	R1 231 644

SUMMARY OF MATERIAL IRREGULARITIES IDENTIFIED AND REPORTED IN THE AUDIT REPORTS

Municipality	Number of material irregularities	Description	Financial loss	Action being taken by municipal manager
Ngaka Modiri Molema District	3	A failure by the municipality to monitor a contract for construction work to the municipal office building and gate house resulted in a contract extension that included items which had already been paid for as part of the original contract – this resulted in costs that could have been avoided.	To be quantified by municipal manager based on investigation	The municipal manager plans to request access to a report from an investigation commissioned by the provincial treasury on the awarding of the contract and extension to the contractor. If the report is not provided, an independent investigation will be commissioned by the municipal manager by 15 June 2020. Further steps will be taken based on the outcome of the investigation.
		The claims from a supplier of water tankering services were paid without ensuring that the services had actually been rendered and that the claims were based on actual kilometres travelled – this resulted in an overpayment to the supplier.	To be quantified by municipal manager based on investigation	The municipal manager will appoint an independent party in February 2020 to investigate the claims and quantify the financial loss. Further steps will be taken based on the outcome of the investigation.
		Poor safeguarding of assets resulted in a material write-off of assets that could not be located during the year-end asset verification process. The assets are presumed to have been stolen.	R2 421 897	The municipal manager plans a full asset verification process and investigation into the missing assets by 31 March 2020. Further steps will be taken based on the outcome of the investigation by 30 April 2020.
City of Tshwane Metro	2	The municipality did not take all reasonable steps to safeguard the assets at the Annlin reservoir project, resulting in assets being stolen and vandalised on 8 January 2018.	R5 523 136	The municipal manager reported the matter to the South African Police Service and commissioned an investigation by the internal forensic services division to be completed by 30 June 2020. Steps were taken to improve security at the site and a security company is planned to be appointed by 31 March 2020 in order to prevent further losses.

Municipality	Number of material irregularities	Description	Financial loss	Action being taken by municipal manager
City of Tshwane Metro		The municipality did not take all reasonable steps to safeguard the assets at the Baviaanspoort wastewater treatment works, resulting in assets being stolen and vandalised on 10 February 2016.	R3 904 346	The municipal manager reported the matter to the South African Police Service and arrests were made. An investigation by the internal forensic services division was commissioned to be completed by 30 June 2020. Steps were taken to improve security at the site and a security company is planned to be appointed by 31 March 2020 in order to prevent further losses. An insurance company reimbursed R174 716 of the loss.
Ga-Segonyana	1	A contract was awarded on 8 February 2019 to a supplier of protective clothing without following a competitive bidding process. The basis for deviation was impracticality, which was not a valid reason. The prices of the goods were significantly higher than market prices.	To be quantified by municipal manager based on investigation	The municipal manager instituted an investigation into the matter on 3 March 2020. Based on the outcome of the investigation, disciplinary steps will be taken and the financial losses recovered.

Based on the outcomes of the 2018-19 audits, we can make the following **observations**:

- All affected municipal managers are taking appropriate action to address the material irregularities identified. They had already started taking action in some cases by the time we formally notified them of the material irregularity. This demonstrates that municipal managers understand what they are required by legislation to do when they become aware of irregularities and that they are willing and able to take on these responsibilities. It also signals a behavioural change towards responding in a decisive and timely manner to our findings.
- Most of the material irregularities identified were money lost as a result of payments that should not have been made or projects and assets not being safeguarded as required. These material irregularities are not complex issues and could have been prevented through basic controls. The material irregularities resulting from supply chain management non-compliance were also mostly not complex or ambiguous and could have been prevented – or at least detected and dealt with – before they resulted in such material financial losses for the municipality. None of the material irregularities were as a result of human error, but were rather due to poor processes and judgement. There were most definitely indicators of fraud in some of these material irregularities, which have been (or will still be) uncovered by the investigations.

PREVENTING MATERIAL IRREGULARITIES

The system of accountability has reached a point where **municipal managers must invest in preventative controls**. Preventing material irregularities is more effective than having to deal with the consequences thereof – money is lost, costly investigations have to be instituted and officials are subjected to the discomfort and anxieties associated with these processes, which often take a number of years.

Our message has been consistent over the years that a strong control environment and processes are key to achieving objectives, addressing risks, ensuring compliance with legislation, and managing public sector funds to the benefit of citizens. We acknowledge that it takes time to institutionalise good controls, especially in large and complex environments, but municipal managers need to **build their municipalities towards accomplishing this in a deliberate manner**.

We encourage municipal managers to **identify the areas of greatest risk in their institutions and focus on strengthening those areas first** – by applying the 80:20 rule, the greatest impact can be achieved through the lowest effort by focusing on the 20% that will bring 80% of the results.

In the context of material irregularities, the three key areas where municipalities are vulnerable to material financial losses, based on our findings in this first phase of implementation, are **awarding contracts, safeguarding assets, and making payments**. Controls should be implemented to prevent deviations from the procurement process resulting in overpricing, the loss of assets as a result of theft and vandalism, and paying for goods and services not received.

The preventative controls will only operate effectively and consistently if they are built on a **strong control environment** driven by the municipal leadership. Such an environment is characterised by the following:

- A culture of ethical behaviour and commitment to good governance and accountability enabled and inspired by the words and actions of the **leadership** of the municipality.
- **Adequate and sufficiently skilled officials** who know what their responsibilities are towards internal controls, as it is included in their job descriptions and often communicated, while their performance is monitored.
- Comprehensive **policies and procedures** that define principles and processes for officials to follow when they are performing their duties.
- Mechanisms for officials to report any pressure on them to act (for example, make decisions or payments) in a manner that is not in accordance with policies, procedures or codes of ethics. Such **whistleblowing mechanisms** should protect the official and enable swift and appropriate action against the implicated parties.
- **Risk management** through regular risk assessments (including fraud risk) and the development and implementation of mitigating measures, such as internal controls.
- A **combined assurance model** whereby different levels of management, the internal audit unit and the audit committee all work towards strengthening controls through monitoring and oversight.

The **council** can also play an important role in preventing material irregularities through the municipal public accounts committee. As detailed earlier in this section, the committees can use the information we provide on material irregularities in the audit report and general reports to call municipal managers to account on how reported material irregularities are being resolved. However, a more proactive approach by the council geared towards prevention will have an even greater impact. Such an approach should be aimed at identifying risks for material irregularities and requiring assurance from municipal managers that these risks are being mitigated through a strong control environment and the type of preventative activities detailed above. Our briefings to the mayor, council and municipal public accounts committee on, for example, the status of records will be a good source of information on risks and the status of controls. But we also strongly encourage engagement with the chair of the audit committee and the head of the internal audit unit on their perspective, as they have a key responsibility to assess risk and control.

As we continue on our journey to implement the material irregularity process, we hope to see a definite move towards the prevention of material irregularities to the benefit of the financial management, reputation and service delivery of municipalities – and ultimately the lives of the citizens they serve.

NOTES

SECTION 4

Summary of audit outcomes

OVERALL AUDIT OUTCOMES

Overall regression in audit outcomes

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits	TOTAL
2016-17	33	114	72	6	32	0	257
2017-18	18	105	87	12	31	4	257
2018-19	20	91	83	2	33	28	257

EXPENDITURE BUDGET

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2018-19 *R419 BILLION*	3%	51%	23%	< 1%	5%	18%

MOVEMENT from 2017-18

33 Improved 46 Regressed

MOVEMENT from 2016-17

31 Improved 76 Regressed

20 of the 24 outstanding audits reported in 2017-18 were completed by the date of this report; the 4 still outstanding were Masilonyana (FS), Maluti-A-Phofung (FS), Phokwane (NC) and Renosterberg (NC)

CLEAN AUDIT MOVEMENTS

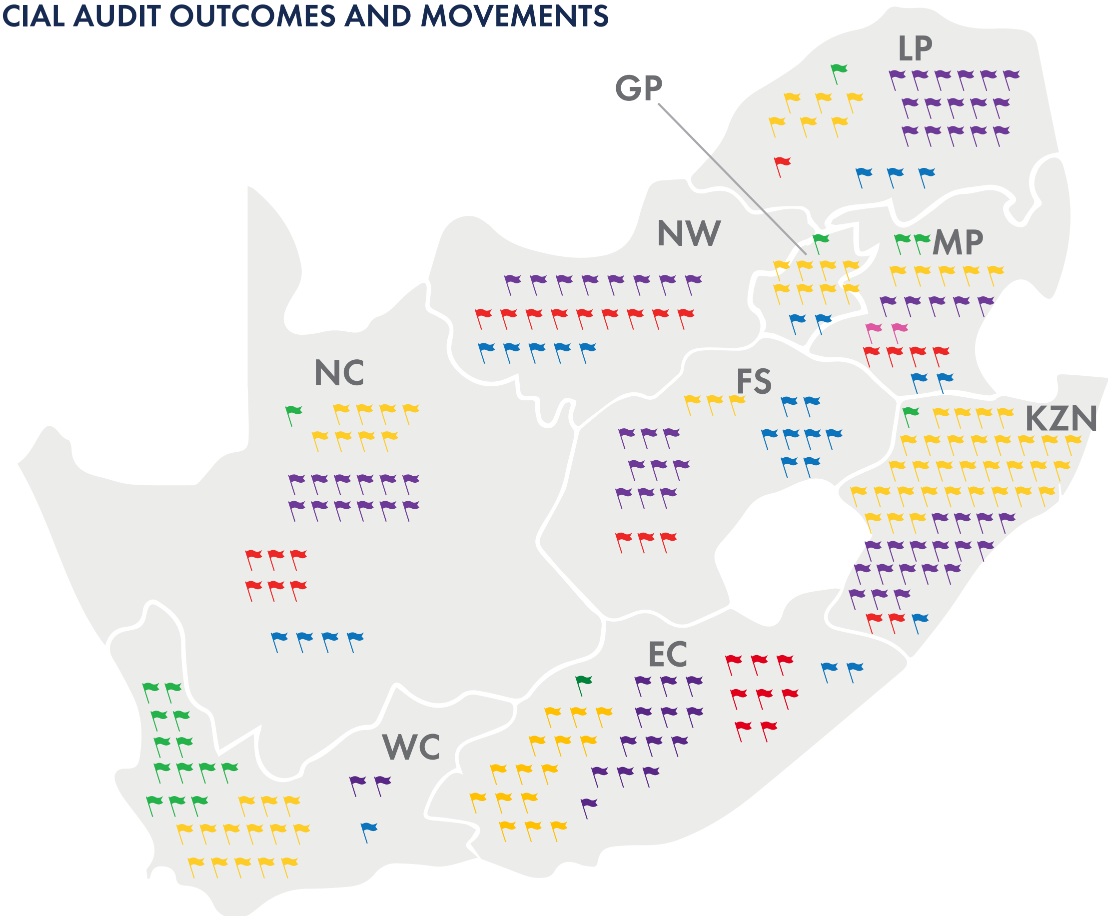
12 > *Remained clean*

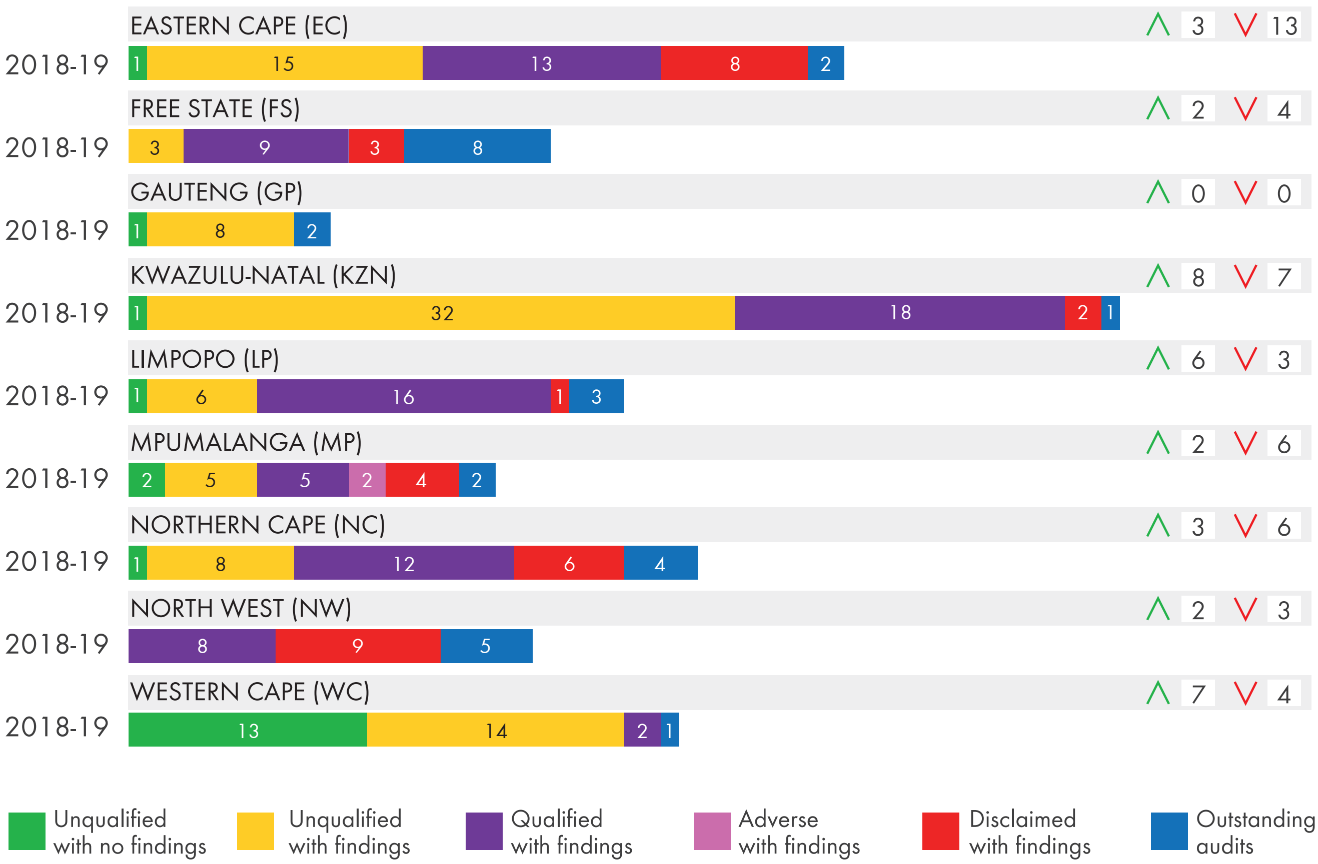
8 New clean audits

6 Regressed

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

PROVINCIAL AUDIT OUTCOMES AND MOVEMENTS





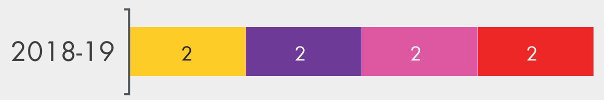
OUTSTANDING AUDITS

Cut-off date for inclusion of the audit outcomes in this report is 31 January 2020

REASONS FOR **28** *OUTSTANDING AUDITS*

Financial statements submitted late – **10 (36%)**
Financial statements not submitted – **6 (21%)**
Material irregularity phased-in audit – **5 (18%)**
Delay in the audit – **5 (18%)**
Auditee delays – **2 (7%)**

RESULTS OF **8** *AUDITS SUBSEQUENTLY FINALISED AS AT 25 MARCH 2020*



AUDITS SUBSEQUENTLY FINALISED AS AT 25 MARCH 2020	MOVEMENT FROM PREVIOUS YEAR'S AUDIT OUTCOME	2018-19 AUDIT OUTCOMES		
		Audit opinion	Performance reports	Compliance with legislation
Nelson Mandela Bay Metro (EC)				
City of Tshwane Metro (GP)				
Inkosi Langalibalele (KZN)				
Thabazimbi (LP)				
Mamusa (NW)				
Naledi (NW)				
Ngaka Modiri Molema District (NW)				
Kannaland (WC)				

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits | Findings

FINANCIAL STATEMENTS

▼ SLIGHT REGRESSION IN QUALITY OF PUBLISHED FINANCIAL STATEMENTS

TARGET	MOVEMENT from previous year	2018-19	2017-18	MOVEMENT over 3 years	2016-17
Timely submission of financial statements (all municipalities)	▶	88% (225)	88% (226)	▼	90% (232)
Quality of financial statements submitted for auditing	▼	18% (43)	20% (47)	▼	23% (54)
Quality of published financial statements	▼	48% (111)	52% (120)	▼	62% (142)

***68 municipalities (30%)** achieved unqualified audit opinions only because they **corrected all misstatements** identified during the audit*

QUALIFICATION AREAS *(on audited financial statements)*	MOVEMENT from previous year	2018-19	2017-18	MOVEMENT over 3 years	2016-17
Property, infrastructure and equipment	▼	34% (79)	29% (67)	▼	25% (58)
Irregular expenditure	▼	33% (76)	25% (58)	▼	22% (51)
Receivables	▼	29% (66)	25% (57)	▼	22% (51)
Payables, accruals and borrowings	▼	28% (64)	26% (60)	▼	18% (41)

PROVINCIAL VIEW

PROVINCE	TIMELY SUBMISSION OF FINANCIAL STATEMENTS (all municipalities)		QUALITY OF FINANCIAL STATEMENTS SUBMITTED FOR AUDITING		QUALITY OF PUBLISHED FINANCIAL STATEMENTS	
	Number	Movement from 2017-18	Number	Movement from 2017-18	Number	Movement from 2017-18
Eastern Cape	38 (97%)	▲	3 (8%)	▼	16 (43%)	▼
Free State	12 (52%)	▼	0 (0%)	▶	3 (20%)	▶
Gauteng	11 (100%)	▶	4 (44%)	▲	9 (100%)	▶
KwaZulu-Natal	54 (100%)	▶	7 (13%)	▼	33 (62%)	▼
Limpopo	26 (96%)	▲	1 (4%)	▲	7 (29%)	▼
Mpumalanga	17 (85%)	▶	3 (17%)	▲	7 (39%)	▼
Northern Cape	26 (84%)	▲	4 (15%)	▲	9 (33%)	▼
North West	12 (55%)	▼	0 (0%)	▶	0 (0%)	▼
Western Cape	29 (97%)	▲	21 (72%)	▼	27 (93%)	▲
Total	225 (88%)	▶	43 (18%)	▼	111 (48%)	▼

EFFECTIVE USE OF CONSULTANTS

Local government spent an estimated **R3,4 billion** on consultancy services in 2018-19.

FINANCIAL REPORTING SERVICES

183 municipalities used consultants for financial reporting services at a cost of **R741 million** (2017-18: R794 million). This amount excludes **R522 million** relating to outstanding audits for which financial statements were received. Of the R741 million, only **R51 million (7%)** was as a result of vacancies in municipal finance units.

Note: *The above costs include financial reporting costs paid by other institutions amounting to* ***R29 million*** *(2017-18: R24 million)*

PROVINCE	EC	FS	GP	KZN	LP	MP	NC	NW	WC
Cost (R million) - completed audits	116	29	29	94	122	95	35	180	41
Cost (R million) - outstanding audits	2	17	312	1	127	3	12	47	1

AUDIT OUTCOMES WHERE CONSULTANTS WERE USED 26 ⋀ 41 ⋁

- Unqualified with no findings
- Unqualified with findings
- Qualified with findings
- Adverse with findings
- Disclaimed with findings

REASONS WHY CONSULTANTS WERE INEFFECTIVE

OTHER AUDITEE INEFFECTIVENESS
45% (70)

LACK OF RECORDS AND DOCUMENTS
29% (46)

POOR PROJECT MANAGEMENT
11% (17)

CONSULTANT DID NOT DELIVER
10% (15)

CONSULTANT APPOINTED TOO LATE
5% (9)

59% (134) OF THE FINANCIAL STATEMENTS SUBMITTED FOR AUDITING INCLUDED MATERIAL MISSTATEMENTS IN THE AREA IN WHICH CONSULTANTS DID WORK

PROVINCE	EC	FS	GP	KZN	LP	MP	NC	NW	WC
Financial statements submitted with material misstatements in areas in which consultants did work	25	12	1	24	18	13	18	16	7

10% (24) of the municipalities did not follow proper procurement procedures when appointing consultants, resulting in irregular expenditure of **R95 million**

Consultants at **21% (5)** of these municipalities were appointed through a contract secured by another municipality without following the prescribed process

ALL SERVICES

208 municipalities used consultants for a variety of services – at **65%,** significant management weaknesses were identified in the following areas:

- **51%** Performance management and monitoring
- **47%** Transfer of skills
- **30%** Planning and appointment processes

PERFORMANCE REPORTS

▼ SLIGHT REGRESSION IN QUALITY OF PUBLISHED PERFORMANCE REPORTS

TARGET	MOVEMENT from previous year	2018-19	2017-18	MOVEMENT over 3 years	2016-17
Performance reports prepared	▲	99% (226)	97% (222)	▲	98% (224)
Quality of performance reports submitted for auditing	►	12% (27)	12% (26)	▲	11% (24)
Quality of published performance reports	▼	33% (75)	37% (82)	▼	40% (89)

***48 municipalities (21%)** had no material findings only because they **corrected all misstatements** identified during the audit*

FINDINGS ON PERFORMANCE REPORTS	MOVEMENT from previous year	2018-19	2017-18	MOVEMENT over 3 years	2016-17
Performance reporting not useful	▲	50% (114)	52% (116)	▲	57% (128)
Achievement reported not reliable	▲	48% (109)	50% (112)	►	48% (108)
No underlying records or planning documents	▼	9% (20)	4% (9)	▼	6% (14)

Most common usefulness findings

28% Not consistent	**24%** Not well defined	**13%** Not verifiable	**13%** Not measurable

PROVINCIAL VIEW

PROVINCE	PERFORMANCE REPORTS PREPARED		QUALITY OF PERFORMANCE REPORTS SUBMITTED FOR AUDITING		QUALITY OF PUBLISHED PERFORMANCE REPORTS	
	Number	Movement from 2017-18	Number	Movement from 2017-18	Number	Movement from 2017-18
Eastern Cape	37 (100%)	►	2 (5%)	►	7 (19%)	▼
Free State	15 (100%)	►	0 (0%)	►	2 (13%)	▲
Gauteng	9 (100%)	►	1 (11%)	▼	1 (11%)	▼
KwaZulu-Natal	53 (100%)	►	9 (17%)	▲	23 (43%)	▲
Limpopo	24 (100%)	►	1 (4%)	►	6 (25%)	▲
Mpumalanga	18 (100%)	►	2 (11%)	►	7 (39%)	▼
Northern Cape	24 (89%)	▲	1 (4%)	▲	6 (25%)	▼
North West	17 (100%)	▲	0 (0%)	►	0 (0%)	▼
Western Cape	29 (100%)	►	11 (38%)	▼	23 (79%)	▼
Total	226 (99%)	▲	27 (12%)	►	75 (33%)	▼

COMPLIANCE WITH KEY LEGISLATION

▲ SLIGHT DECREASE IN NON-COMPLIANCE FROM **92% (210)** TO **91% (209)**

MOST COMMON NON-COMPLIANCE AREAS	MOVEMENT from previous year	2018-19	2017-18	MOVEMENT over 3 years	2016-17
Quality of financial statements	▼	81% (186)	79% (182)	▼	76% (174)
Procurement and contract management	▲	79% (181)	81% (186)	▼	71% (163)
Prevention of unauthorised, irregular and fruitless and wasteful expenditure	▼	75% (171)	73% (168)	▼	68% (155)
Effecting consequences	▼	61% (139)	60% (137)	▼	53% (122)
Expenditure management	▲	53% (122)	56% (128)	▲	54% (123)

OTHER NOTABLE NON-COMPLIANCE AREAS	MOVEMENT	2018-19	MOST COMMON FINDINGS PER AREA
Asset management	▲	39% (89)	Ineffective system of internal control for assets – 28% (65)
Strategic planning and performance management	▲	39% (90)	Performance management systems and related controls not maintained or inadequate – 23% (53)
Human resource management	▲	34% (77)	Policies and procedures not in place to monitor, measure and evaluate staff performance – 23% (52)
Revenue management	▼	32% (73)	Ineffective system of internal control for revenue – 26% (60)
Annual financial statements and annual report	▼	21% (49)	Oversight report not adopted by council within 2 months of annual report tabling – 8% (18)

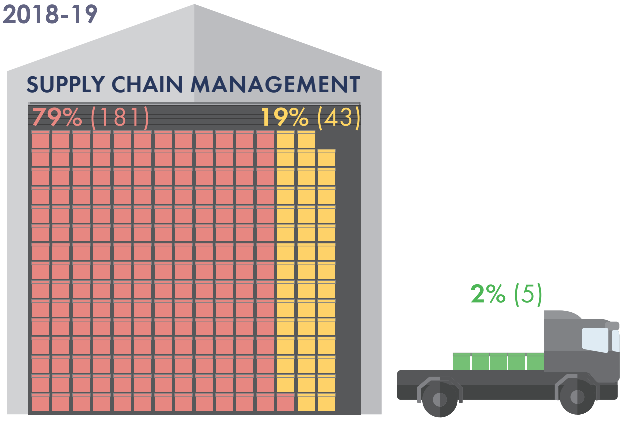
PROVINCIAL VIEW

MUNICIPALITIES WITH NO FINDINGS ON COMPLIANCE

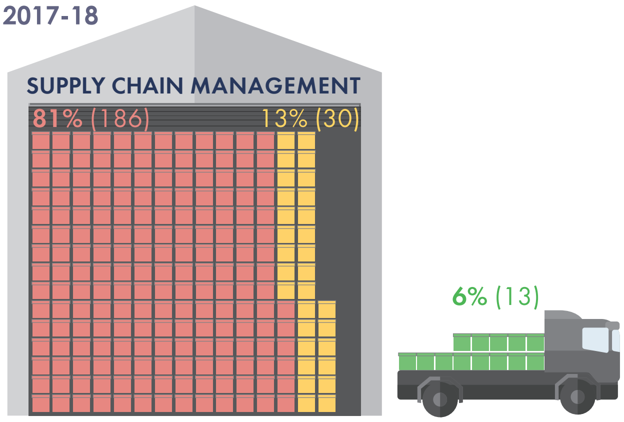
	EC	FS	GP	KZN	LP	MP	NC	NW	WC
NUMBER	3% (1)	0% (0)	11% (1)	2% (1)	4% (1)	11% (2)	4% (1)	0% (0)	45% (13)
MOVEMENT from 2017-18	▼	►	►	▼	▲	▲	►	►	▲

Total 9% (20) ▲

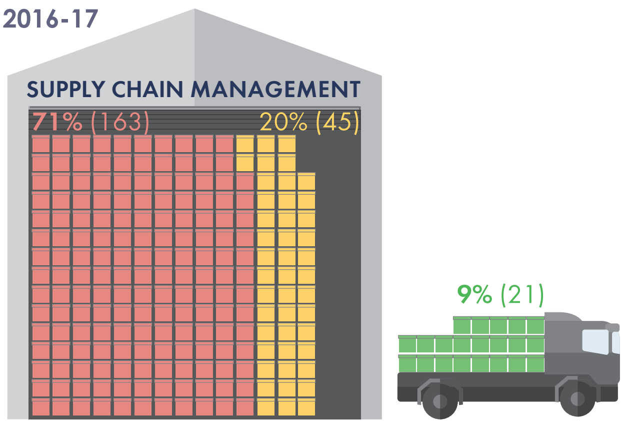
2018-19



2017-18



2016-17



With no findings With findings With material findings

Not able to audit procurement of **R361 million** due to **missing or incomplete information** at 31 municipalities (14%)

Highest contributors **(70% of rand value)** were:

- **Dr Ruth S Mompati District (NW) – R67 million:** Poor record management relating to various contracts due to instability in key positions.
- **Msukaligwa (MP) – R55 million:** Not all supporting documents were provided for auditing due to poor record management and inadequate controls.
- **Lekwa (MP) – R47 million:** All tender documents were kept in the municipal manager's office and could not be submitted for audit purposes within the agreed turnaround time. These submission challenges persisted even after discussions with the municipal manager in audit steering committee meetings, in which she committed that officials must retrieve and submit the requested tender documents to her office. Some tender documents were subsequently submitted, but these could not be audited because they did not contain all the required information such as scoring sheets and advertisements.
- **uMzinyathi District (KZN) – R42 million:** As nine bidding documents were not provided for auditing, the bidding / SCM process could not be tested – more than 80% of the expenditure related to the provision of water and sanitation in the district.
- **Chief Albert Luthuli (MP) – R40 million:** The municipality submitted the wrong documents or could not submit supporting documents for transactions relating to quotations and tenders selected from the awards register for auditing, due to – amongst others – the incorrect capturing of details in the awards register.

AWARDS TO EMPLOYEES, COUNCILLORS, CLOSE FAMILY MEMBERS AND OTHER STATE OFFICIALS

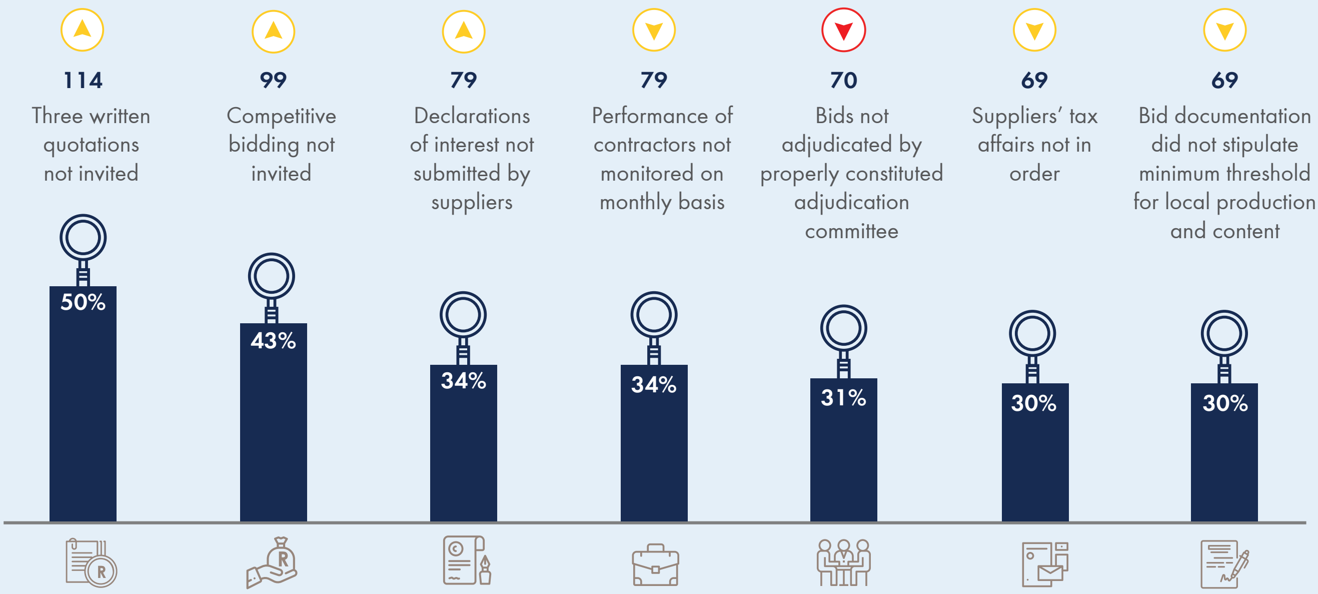
FINDINGS	MOVEMENT FROM PREVIOUS YEAR	MOVEMENT FROM 2016-17	NUMBER OF MUNICIPALITIES WITH AWARDS	AMOUNT
Prohibited awards to other state officials	▼	▼	62% (141)	R1 282 million
Prohibited awards to employees and councillors	▼	▼	17% (40)	R30 million
At 11 municipalities (5%), awards were made to councillors				
Awards to close family members of employees	►	▼	34% (77)	R474 million
At 21 municipalities (9%), awards to close family members were not disclosed in the financial statements as required				

UNCOMPETITIVE OR UNFAIR PROCUREMENT PROCESSES AND CONTRACT MANAGEMENT

Findings on **uncompetitive and unfair procurement processes** at **90%** of the municipalities, of which 76% was material non-compliance. This is a slight regression from 88% in the previous year and a regression from 80% in 2016-17.

Findings on **contract management** at **49%** of the municipalities, of which 40% was material non-compliance. This is a slight regression from 48% in the previous year and a regression from 42% in 2016-17.

Most common findings were the following:



At **42 municipalities (18%)**, goods and services were procured through contracts secured by other organs of state without complying with prescribed requirements.

The aim of the Preferential Procurement Regulations is to support socio-economic transformation. The public sector should lead by example to achieve this goal, but the preference point system was incorrectly applied or not applied at all.
At **65 municipalities (28%)**, the preference point system was found to be incorrectly applied or not applied.

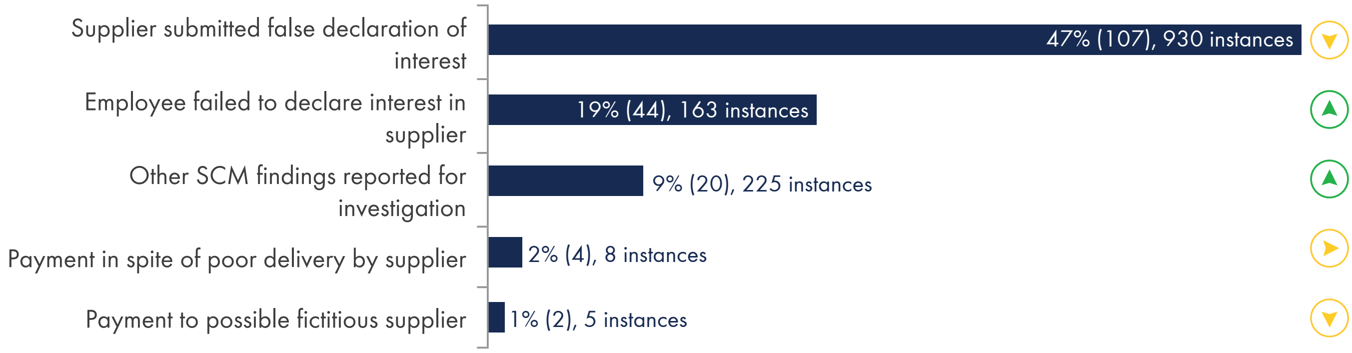
LOCAL PROCUREMENT

Municipalities are required to procure certain commodities from local producers; **78 municipalities (54%)** out of 144 where we audited local content failed to comply with regulation on promotion of local producers on awards amounting to **R731 million**

FALSE DECLARATIONS BY SUPPLIERS AND NON-DISCLOSURE BY EMPLOYEES

FINDINGS	MOVEMENT FROM PREVIOUS YEAR	MOVEMENT FROM 2016-17	NUMBER OF MUNICIPALITIES	NUMBER OF SUPPLIERS/ EMPLOYEES	AMOUNT
Suppliers owned or managed by **employees of another state institution** made false declarations	▲	▲	31% (71)	533	R481 million
Suppliers owned or managed by **employees and councillors** of the municipality made false declarations	▼	▲	6% (14)	44	R13 million
Suppliers owned or managed by **close family members of employees** of the municipality made false declarations	▲	▲	12% (28)	112	R67 million
Employees of the municipality **failed to declare their own interest** either as part of the procurement processes or through annual declarations	▲	▼	5% (11)	27	R2 million
Employees of the municipality **failed to declare their family members' interest**	▲	▲	10% (23)	88	R81 million

FINDINGS REPORTED FOR INVESTIGATION AT 121 MUNICIPALITIES (53%) – AN IMPROVEMENT FROM 62% IN 2017-18

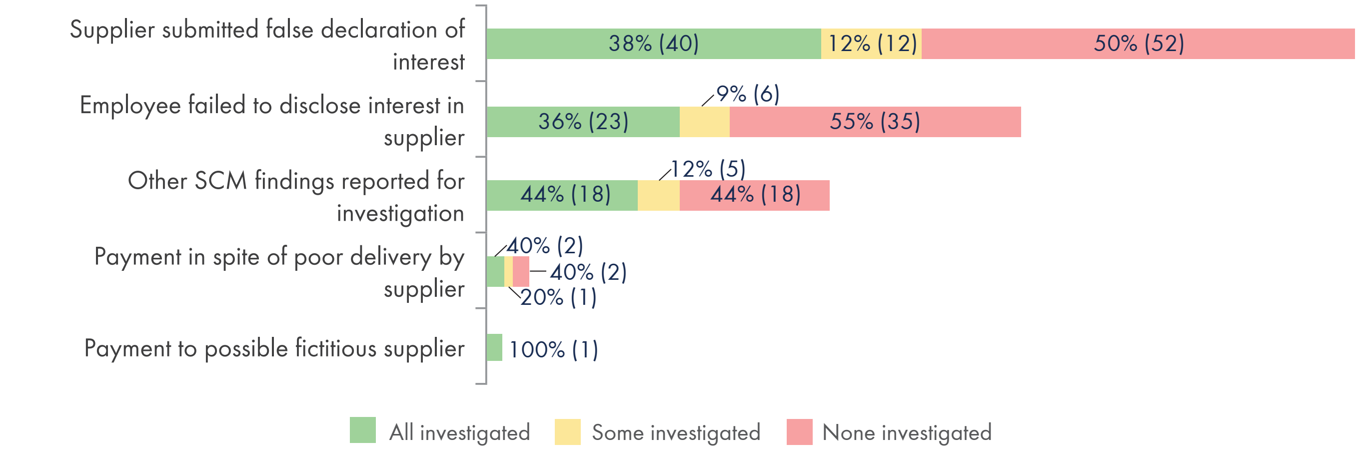


88 (62%) of the 143 municipalities that had such findings in 2017-18 had similar findings in 2018-19

FOLLOW-UP OF SUPPLY CHAIN MANAGEMENT FINDINGS REPORTED FOR INVESTIGATION AT 143 MUNICIPALITIES IN PREVIOUS YEAR

54 (38%) of these municipalities investigated all the findings we reported, **26 (18%)** investigated some of the findings, and **63 (44%)** investigated none of the findings

49 (61%) of the **80** municipalities that investigated all or some findings, satisfactorily resolved these investigations, but the remaining **39%** did not (for example, the investigation recommended that contracts in which employees failed to declare their interest be cancelled, but the municipality did not do so)



Note: *The entire analysis excludes the outstanding audits unless otherwise indicated (*)*	**Irregular** *Non-compliance with legislation in process leading to expenditure*	**Unauthorised** *Expenditure more than budget or not in accordance with grant conditions*	**Fruitless and wasteful** *Expenditure made in vain – could have been avoided if reasonable care was taken*
How much was disclosed in 2018-19?	**R21,46 billion at 220 municipalities (96%)** 29% increase from R16,63 billion in 2017-18 * Irregular expenditure of outstanding audits based on unaudited financial statements as well as audits subsequently finalised – **R10,60 billion (2017-18: R7,75 billion)** * The combined irregular expenditure for both completed and outstanding audits is R32,06 billion	**R11,98 billion at 147 municipalities (64%)** 35% increase from R8,88 billion in 2017-18 * Unauthorised expenditure of outstanding audits based on unaudited financial statements as well as audits subsequently finalised – **R3,93 billion (2017-18: R5,76 billion)** * The combined unauthorised expenditure for both completed and outstanding audits is R15,91 billion	**R2,07 billion at 200 municipalities (87%)** 101% increase from R1,03 billion in 2017-18 * Fruitless and wasteful expenditure of outstanding audits based on unaudited financial statements as well as audits subsequently finalised – **R1,05 billion (2017-18: R0,78 billion)** * The combined fruitless and wasteful expenditure for both completed and outstanding audits is R3,12 billion
Is all of it 2018-19 expenditure?	**No** R6,55 billion (31%) was expenditure in prior years only uncovered and disclosed in 2018-19 R14,91 billion (69%) was expenses in 2018-19, which included payments made on ongoing contracts irregularly awarded in prior years – **R4,33 billion** (29%); and **R10,58 billion** (71%) representing non-compliance in 2018-19	**Yes**	**No** R0,32 billion (16%) was expenditure in prior years only uncovered and disclosed in 2018-19 R1,75 billion (84%) was expenses in 2018-19
How much of the 2018-19 budget does it represent?	4%	3%	1%
Is this the total amount?	**No** 126 municipalities (55%) were qualified on the completeness of their disclosure and/or did not know the total amount and were still investigating to determine the total amount We could also not audit procurement processes for contracts valued at R0,36 billion due to missing or incomplete documentation – it is not known whether any part of this amount might represent irregular expenditure	**No** 26 municipalities (11%) were qualified on the completeness of their disclosure	**No** 12 municipalities (5%) were qualified on the completeness of their disclosure

	Irregular	Unauthorised	Fruitless and wasteful
What was main cause?	**Non-compliance with supply chain management legislation (93%)** – related to: • Procurement without following a competitive bidding or quotation process – R5,47 billion (27%) • Non-compliance with procurement process requirements – R12,34 billion (62%) • Inadequate contract management – R2,16 billion (11%)	**Overspending of budget (99%)** – R11,87 billion: • R5,03 billion (42%) related to actual payments in excess of budget • R6,84 billion (58%) related to non-cash items, representing the poor estimation of, for example, asset impairments	**Penalties and interest** on overdue accounts and late payments **(86%)** – R1,78 billion **Litigation and claims (< 1%) –** < R0,01 billion **Other (14%) –** R0,29 billion The main causes are included in the top 10 contributor table
Did the municipalities detect this expenditure?	**69% was identified by municipalities** and the remainder in the audit process Many municipalities put processes in place to fully uncover irregularities of prior years – partly to address prior year qualifications on irregular expenditure **(R1,28 billion)** but also to correct and address past irregularities	**91% was identified by municipalities** and the remainder in the audit process	**88% was identified by municipalities** and the remainder in the audit process
Does it mean this money was wasted?	**Possibly** – it can only be determined through a council investigation Goods and services were received for R16,86 billion (84%) of the expenditure related to supply chain management, but were not received for R0,06 billion (< 1%), while we did not audit the remaining 16% We cannot confirm if value for money was received for all of these goods and services	**No**	**Yes**
How much of the current and prior year expenditure has not yet been dealt with (what is the closing balance)?	**R65,59 billion**	**R46,20 billion**	**R4,92 billion**

TOP 10 CONTRIBUTORS – IRREGULAR EXPENDITURE

All of these municipalities incurred irregular expenditure **for the past 3 years** except George

Municipality	Disclosed (R billion)	Incurred in 2018-19 (R billion)	Main non-compliance	Key projects / contracts affected (R billion)	Grants * affected (R billion)
eThekwini Metro (KZN)	R2,34	R1,36 (58%)	54% related to non-compliance with procurement process requirements	Construction of ablution facilities at informal settlements and schools, and development of revenue management system	USDG (amount is unknown due to limitation)
OR Tambo District (EC)	R0,98	R0,98 (100%), of which R0,41 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	96% related to non-compliance with procurement process requirements	Water and sanitation related services	R0,55 (MIG)
City of Cape Town Metro (WC)	R0,95	R0,36 (38%)	69% related to procurement without following competitive bidding or quotation processes	Legal services procurement – R0,24	
Rustenburg (NW)	R0,92	R0,42 (45%), of which R0,15 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	73% related to non-compliance with procurement process requirements	Rustenburg Rapid Transport project	R0,05 (PTNG)
Mangaung Metro (FS)	R0,84	R0,84 (100%), of which R0,01 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	41% related to non-compliance with non-procurement legislation such as the Division of Revenue Act, while 33% related to non-compliance with legislation on contracts Non-compliance with Division of Revenue Act was mainly due to conditional grants that were not cash-backed	Mainly related to water services and infrastructure projects, such as Vista Park 2 & 3 development and realignment of bulk water and sewer projects	R0,24 (USDG) R0,06 (PTNG) R0,04 (MDG)
City of Johannesburg Metro (GP)	R0,82	R0,82 (100%), of which R0,64 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	100% related to procurement without following competitive bidding or quotation processes	Legacy information technology contracts – R0,13 Fleet management contracts – R0,33	
JB Marks (NW)	R0,68	R0,18 (27%), of which R0,07 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	74% related to non-compliance with procurement process requirements	Water services related infrastructure projects, such as bulk water supply in Boikhutso	R0,01 (MIG) R0,02 (WSIG)
George (WC)	R0,62	R0,26 (42%), of which R0,26 represents irregular expenditure incurred on ongoing multi-year contracts awarded in prior years	100% related to non-compliance with procurement process requirements		

Municipality	Disclosed (R billion)	Incurred in 2018-19 (R billion)	Main non-compliance	Key projects / contracts affected (R billion)	Grants * affected (R billion)
Mopani District (LP)	R0,51	R0,20 (39%)	100% related to non-compliance with procurement process requirements	Water and sanitation related projects	
uMkhanyakude District (KZN)	R0,49	R0,08 (17%)	79% related to non-compliance with legislation on contracts	Various contracts ranging from catering of events to water projects	MIG & WSIG (R0,29)
Total for top 10	R9,15	This constitutes **43% of the total irregular expenditure disclosed in 2018-19** R4,75 billion (52%) of the top 10 value resulted from non-compliance with procurement process requirements, while R2,02 billion (22%) related to procurement without following competitive bidding or quotation processes Excluded from these top contributors is irregular expenditure of Nelson Mandela Bay Metro (EC), City of Tshwane Metro (GP), Ngaka Modiri Molema District (NW) and Mogalakwena (LP) amounting to R4,17 billion, R2,88 billion, R1,56 billion and R0,55, respectively – the amounts are based on either unaudited financial statements or audited financial statements of audits completed after the cut-off date of this report			

*** MDG – municipal disaster grant**

*** MIG – municipal infrastructure grant**

*** PTNG – public transport network grant**

*** USDG – urban settlements development grant**

*** WSIG – water services infrastructure grant**

TOP 10 CONTRIBUTORS – UNAUTHORISED EXPENDITURE

All of these municipalities incurred unauthorised expenditure **for the past 3 years** except Rustenburg, Vhembe District and Bitou

Municipality	Disclosed (R billion)	Nature
Mangaung Metro (FS)	R1,36	Overspending of budget R0,43 billion (43%) related to non-cash items
Rustenburg (NW)	R1,04	Overspending of budget R0,43 billion (42%) related to non-cash items
Setsoto (FS)	R0,62	Overspending of budget R0,56 billion (90%) related to non-cash items
Vhembe District (LP)	R0,57	Overspending of budget R0,28 billion (50%) related to non-cash items
Emalahleni (MP)	R0,52	Overspending of budget R0,50 billion (97%) related to non-cash items
City of Johannesburg Metro (GP)	R0,48	Overspending of budget Almost 100% related to non-cash items
Mnquma (EC)	R0,42	Overspending of budget All related to non-cash items
City of Mbombela (MP)	R0,27	Overspending of budget R0,08 billion (29%) related to non-cash items
Mkhondo (MP)	R0,26	Overspending of budget None related to non-cash items
Bitou (WC)	R0,25	Overspending of budget All related to non-cash items
Total for top 10	R5,79	This constitutes **48% of the total unauthorised expenditure** Excluded from these top contributors is unauthorised expenditure of Matjhabeng (FS), City of Tshwane Metro (GP), Polokwane (LP) and Govan Mbeki (MP) amounting to R1,54 billion, R0,45 billion, R0,44 billion and R0,29 billion, respectively – the amounts are based on either unaudited financial statements or audited financial statements of audits completed after the cut-off date of this report

TOP 10 CONTRIBUTORS – FRUITLESS AND WASTEFUL EXPENDITURE

All of these municipalities incurred fruitless and wasteful expenditure **for the past 3 years** except Ditsobotla

Municipality	Disclosed (R billion)	Nature
Emalahleni (MP)	R0,40	Nearly 100% related to interest and penalties, which included Eskom interest of R0,39 billion and water boards interest of R0,01 billion
Ditsobotla (NW)	R0,15	All related to interest and penalties, which included Eskom interest of R0,06 billion
Lekwa (MP)	R0,12	All related to interest and penalties, which included Eskom interest of R0,11 billion
City of Johannesburg Metro (GP)	R0,11	Mostly related to information and communication technology licences not utilised and discontinued projects R600 000 related to Eskom interest
Ngwathe (FS)	R0,11	Nearly 100% related to interest and penalties, which included Eskom interest of R0,10 billion and water boards interest of R0,01 billion
Mopani District (LP)	R0,10	All related to interest and penalties, which included water boards interest of R0,10 billion and Eskom interest of R64 000
City of Matlosana (NW)	R0,07	All related to interest and penalties, which included Eskom interest of R0,04 billion and water boards interest of R0,03 billion
Rand West City (GP)	R0,05	Mostly related to interest and penalties, which included Eskom interest of R0,02 billion and water boards interest of R340 353
Modimolle-Mookgophong (LP)	R0,05	All related to interest and penalties, which included Eskom interest of almost R0,05 billion
Thaba Chweu (MP)	R0,04	All related to interest and penalties, which included Eskom interest of R0,04 billion
Total for top 10	R1,21	This constitutes **58% of the total fruitless and wasteful expenditure** R0,81 billion (67%) of the top 10 value related to Eskom interest and R0,15 billion (12%) to water boards interest Excluded from these top contributors is fruitless and wasteful expenditure of Emfuleni (GP), Matjhabeng (FS), Govan Mbeki (MP), City of Tshwane Metro (GP) and Kopanong (FS) amounting to R0,36 billion, R0,28 billion, R0,16 billion, R0,10 billion and R0,04 billion, respectively – the amounts are based on either unaudited financial statements or audited financial statements of audits completed after the cut-off date of this report

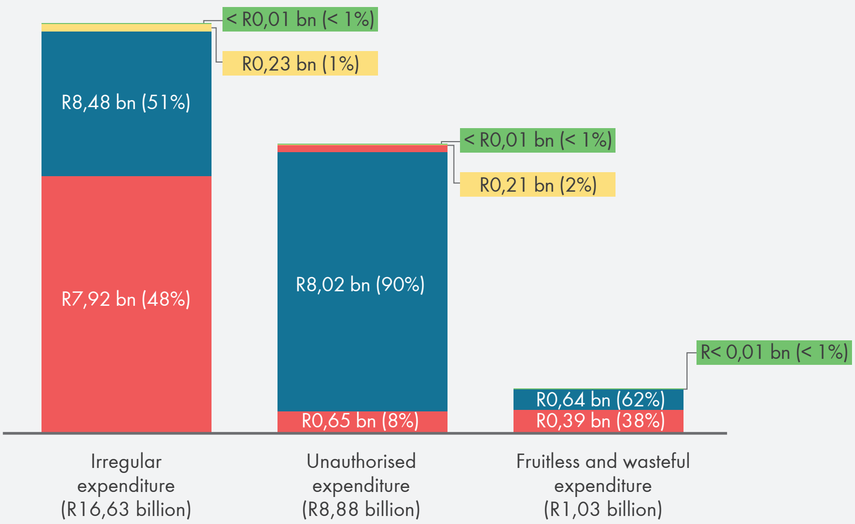
INVESTIGATION AND FOLLOW-UP OF PRIOR YEAR UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE

Investigations by auditees of all prior year instances slightly regressed from **39%** to **37%**

UIFW disclosed must be investigated to determine its impact and who is responsible. Based on the outcome of the investigation, the next steps can include condonement/authorisation, recovery, or write-off. It may also include the cancellation of contracts irregularly awarded.

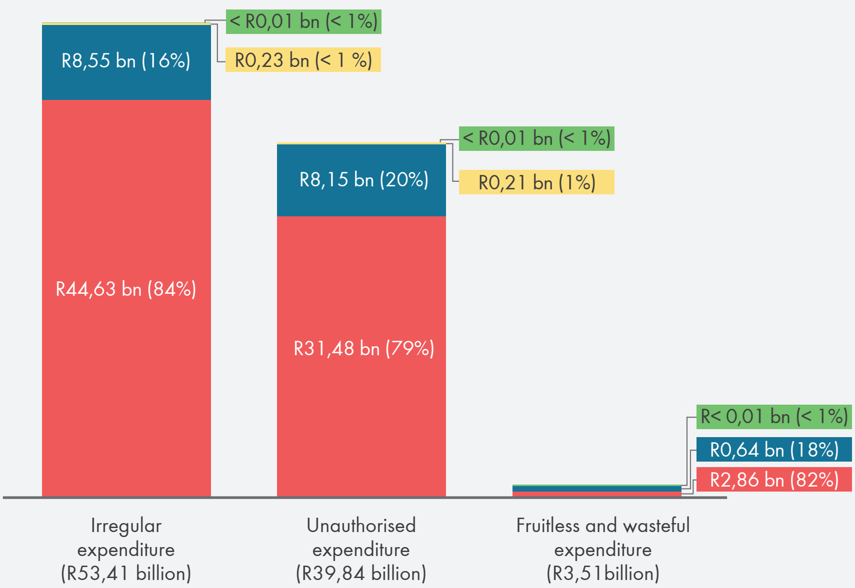
Sufficient steps were not taken to recover, write off, approve or condone UIFW. As a result, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R65,59 billion, while that of unauthorised expenditure was R46,20 billion and that of fruitless and wasteful expenditure was R4,92 billion.

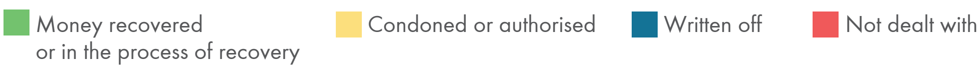
HOW HAS THE COUNCIL DEALT WITH UIFW INCURRED IN 2017-18?



HOW HAS THE COUNCIL DEALT WITH ALL PRIOR YEAR UIFW TO DATE?

Note: *Figures below are expressed as percentage of previous year closing balance*





GROWING BALANCE OF IRREGULAR EXPENDITURE NOT DEALT WITH

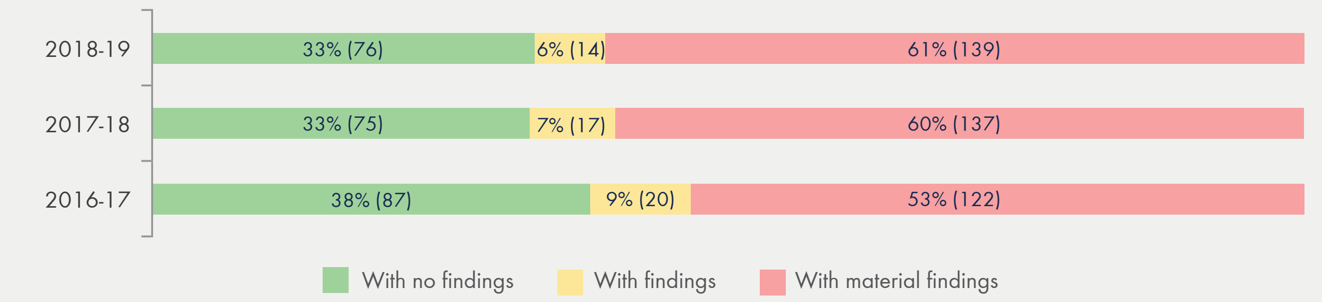
Top 5 contributors to accumulated irregular expenditure (constitutes 26% of R65,59 billion), which also **did not investigate all instances** of prior year irregular expenditure:

- Rustenburg (NW) – R5,13 billion
- City of Johannesburg Metro (GP) – R3,51 billion
- City of Matlosana (NW) – R3,00 billion
- Buffalo City Metro (EC) – R2,78 billion
- uMkhanyakude District (KZN) – R2,33 billion

FRAUD AND LACK OF CONSEQUENCES

Slight increase in material non-compliance with legislation on implementing consequences

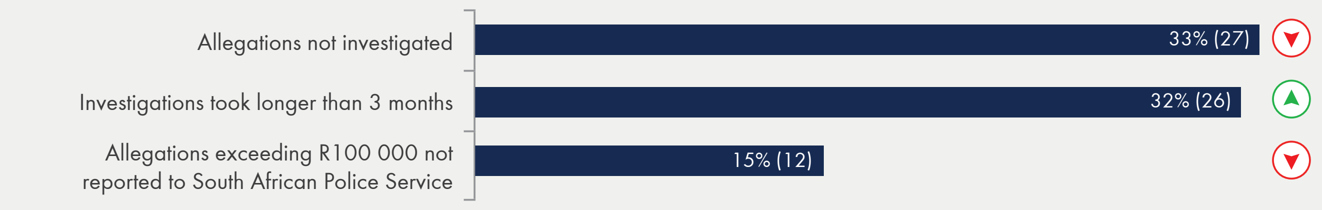
NON-COMPLIANCE WITH LEGISLATION ON IMPLEMENTING CONSEQUENCES



Most common findings were the following:

- Irregular expenditure identified in previous year was not investigated at **125 municipalities (55%)**
- Fruitless and wasteful expenditure identified in previous year was not investigated at **116 municipalities (51%)**
- Unauthorised expenditure identified in previous year was not investigated at **111 municipalities (48%)**

INADEQUATE FOLLOW-UP OF ALLEGATIONS OF FINANCIAL AND SUPPLY CHAIN MANAGEMENT MISCONDUCT AND FRAUD – TESTED AT 82 MUNICIPALITIES



Unauthorised, irregular and fruitless and wasteful expenditure (UIFW) not followed up and dealt with – refer to section on UIFW

Supply chain management (SCM) findings we reported to management for investigation not followed up – refer to section on SCM

ILLUSTRATIVE EXAMPLES

Strong preventative controls reduce the risk of fraud. Investing in preventative controls is more effective than having to deal with the consequences thereof, including costly and lengthy investigations, court cases and financial loss. This is demonstrated through the examples that follow.

APPOINTMENT OF ADVISORY PANEL FOR IMPLEMENTATION OF SECURITY OF REVENUE PROJECT

RESPONSIBLE MUNICIPALITY: City of Tshwane Metro

AIM

Appointment of service provider to panel for financial and legal advisory services through open tender process in 2012 for implementation of security of revenue project

FINDINGS

Panel member appointed to advisory panel was used to implement actual technology needed for technology project instead of for original purpose (advisory services)

Procurement process contravened following prescripts:

- Municipal Finance Management Act (section 112) and Constitution (section 217) requiring tender process to be fair, transparent, competitive and cost-effective
- Supply chain management regulation 27 dealing with ins and outs of bid specification processes
- Supply chain management regulations 28 and 29 dealing with composition and functions of bid evaluation committee and bid adjudication committee
- Municipal Finance Management Act [sections 33 and 120(6)(c)] and public-private partnership regulation 4 relating to need and mechanisms for conducting feasibility study and public participation
- Public Audit Act [section 15(a)] requiring proper retention of appropriate documentation
- Supply chain management regulation 36 relating to prescribed deviation process – use of deviation led to appointment of alternative service provider, which resulted in irregular expenditure

IMPACT

- **Irregular expenditure of approximately R2,72 billion disclosed during 2014-15 to 2017-18 financial years**
- **High Court of South Africa declared contract with service provider as constitutionally invalid and unlawful in October 2017**

REASONS

Management did not exercise oversight responsibility by:

- Implementing adequate record keeping of procurement documentation for audit purposes
- Ensuring compliance with above prescripts
- Planning properly to ensure viability of project, as feasibility study was not conducted

CURRENT STATUS

Metro has since instituted investigation into procurement process followed in awarding service provider contract to implement technology project. Investigation was concluded in April 2019 and recommended that the council recover irregular expenditure incurred from the service provider, erstwhile city manager and chief financial officer.

APPOINTMENT OF CONTRACTOR TO UPGRADE SUBSTATION AND ASSOCIATED EQUIPMENT

RESPONSIBLE MUNICIPAL ENTITY: City Power

AIM Replace existing substation and construct new substation

TIMELINE

FEBRUARY 2015:
City Power appoints supplier (main contractor) through open tender process for substation project for period of three years at a cost of R126 million (excluding VAT)

APRIL 2015:
Consulting engineering supplier (consultant) appointed to project

APRIL 2017:
Community stops construction work, locks gates and instructs contractors to vacate project site, by which time main contractor had already been paid R64 million

2016-17 AUDIT CYCLE:
AGSA selects project for auditing during audit planning process

MAY 2017:
City of Johannesburg Metro institutes investigation into substation project

AUGUST 2017:
Two arrests made for alleged fraud and corruption but National Prosecuting Authority withdraws case, for reasons unknown to AGSA

NOVEMBER 2017:
City Power cancels contract with main contractor

FEBRUARY 2018:
Investigation finalised

2017-18 AUDIT PROCESS:
Project had not resumed

MARCH 2019:
City Power dismisses project manager for gross misconduct

JUNE 2019:
Sub-contractors of main contractor appointed to complete project in accordance with terms of engineering construction contract

FINDINGS

Investigation found:

- Main contractor submitted fraudulent bank guarantee in relation to advance payment made to them by City Power
- City Power official amended consultant's contract by removing clause requiring work completion certificates to be signed by consultant as confirmation of delivery of goods and services
- City Power official also signed off on work completion certificates and captured amounts due on the system for payment

Procurement process contravened following prescripts:

- Constitution (section 217) requiring tender process to be fair, transparent, competitive and cost-effective
- Municipal Finance Management Act [section 62(1)(d)] dealing with responsibilities of municipal entity to prevent unauthorised, irregular or fruitless and wasteful expenditure by ensuring that payments are made for goods and services received
- Public Audit Act [section 15(a)] requiring proper retention of appropriate documentation

REASONS

Management did not exercise oversight responsibility for:

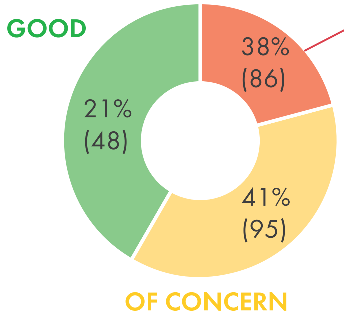
- Adequate record keeping of procurement documentation for audit purposes
- Ensuring compliance with above prescripts
- Adequate project and contract management over main contractor
- Ensuring payments were duly approved by City Power in accordance with original terms and with project manager's sign-off
- Adequate supervision and segregation of duties for certification of work completion certificates and generating purchase orders for payment
- Appropriate consequence management

CURRENT STATUS

- During 2018-19 audit process, City Power was required to disclose fruitless and wasteful expenditure of R28 million for payments made to main contractor
- Main contractor has taken City Power to court over unpaid claims – legal process is pending

FINANCIAL HEALTH

CONTINUED REGRESSION IN FINANCIAL HEALTH



INTERVENTION REQUIRED

This means the municipality:

- is in a vulnerable financial position and might be unable to continue operating and/or
- received a disclaimed or adverse opinion, which means the financial statements were not reliable enough for analysis [**35 (15%)** municipalities]

VULNERABLE FINANCIAL POSITION

31% (72)
30% (68)

Fruitless and wasteful expenditure of **R1,47 billion** incurred in current year by those in vulnerable financial position

2018–19 | 2017–18

SUSTAINABILITY INDICATORS

NET CURRENT LIABILITY POSITION

39% (76)
37% (65)

DEFICIT (expenditure exceeded revenue)

34% (65)
32% (57)

Consolidated deficit of R6,29 billion

Major contributors from:

Free State – R1,57 billion (25%)
Gauteng – R1,10 billion (17%)
North West – R0,98 billion (16%)

78% (51) of municipalities with **deficits** also incurred unauthorised expenditure of **R7,30 billion**

CREDITORS GREATER THAN AVAILABLE CASH AT YEAR-END

51% (98)
51% (90)

Total creditors: **R53,52 billion**
Cash available at year-end: **R43,20 billion**

Highest percentages incurred by:

Magareng (Northern Cape) – **54923%**
Musina (Limpopo) – **37667%**
Tswaing (North West) – **21179%**

CURRENT LIABILITIES GREATER THAN 10% OF NEXT YEAR'S BUDGETED RESOURCES

97% (188)
94% (167)

The **next year's budget will pay for expenditure of the previous year(s)** – at **26% of municipalities** it will be more than half of their budgets

CREDITOR PAYMENTS

CREDITOR-PAYMENT PERIOD > 30 DAYS

89% (173)
85% (152)

CREDITOR-PAYMENT PERIOD > 90 DAYS

49% (96)
45% (80)

AVERAGE CREDITOR-PAYMENT PERIOD

180 DAYS
146 DAYS

*ESKOM ARREARS **

R18,91 billion outstanding as at 30 June 2019 with R11,31 billion in arrears #

 # R0,15 billion was not aged by municipalities

*WATER BOARDS ARREARS **

R9,74 billion outstanding as at 30 June 2019 with R6,24 billion in arrears #

 # R1,37 billion was not aged by municipalities

** These amounts have been taken from municipalities' financial statements, some of which are misstated*

REVENUE AND DEBT MANAGEMENT INDICATORS

BREAKDOWN OF REVENUE

Municipal revenue was R324 billion:

- **R226 billion (70%)** own revenue
- **R55 billion (17%)** equitable share
- **R43 billion (13%)** other conditional grants

MORE THAN 10% OF DEBT IRRECOVERABLE

93% (181)
90% (161)

An average of **59%** of municipal debt was not recoverable – at **55 municipalities** more than **80%** could not be recovered

DEBT-COLLECTION PERIOD > 90 DAYS

51% (99)
53% (94)

AVERAGE DEBT-COLLECTION PERIOD

181 DAYS
157 DAYS

EXPENDITURE

- Salaries and wages (including councillor remuneration) was **R91,30 billion,** which represents 40% of own revenue and 166% of equitable share
- The value of infrastructure assets municipalities should maintain and safeguard is **R317,68 billion** but the expenditure on maintenance was only **R8,5 billion**

PROVINCIAL VIEW – FINANCIAL HEALTH

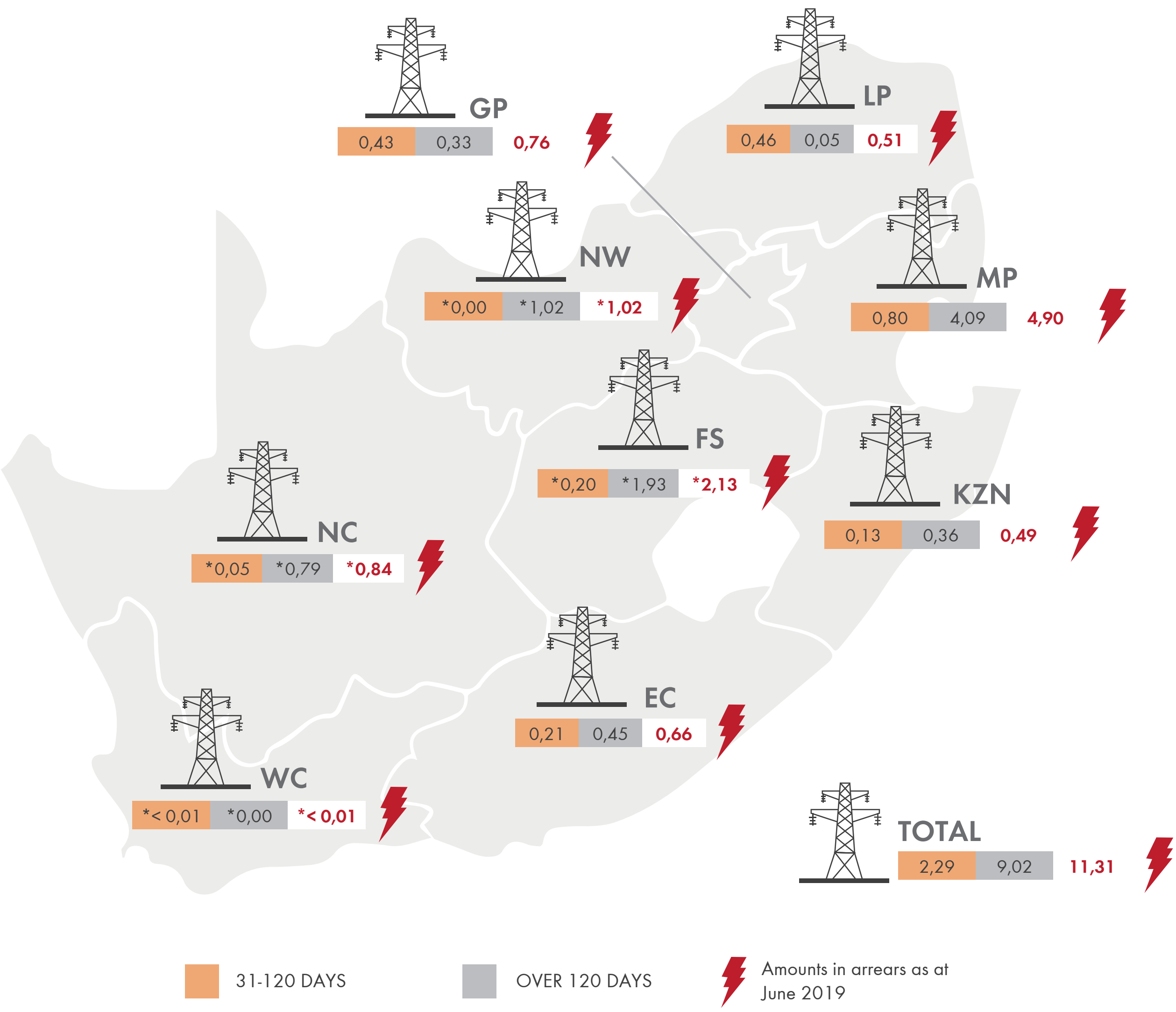
PROVINCE	OVERALL ASSESSMENT *			MOVEMENT FROM PREVIOUS YEAR	VULNERABLE POSITION *	
	Good	Of concern	Intervention required			
Eastern Cape	19% (7)	43% (16)	38% (14)	▼	27% (10)	▲
Free State	0% (0)	13% (2)	87% (13)	▼	80% (12)	▲
Gauteng	12% (1)	44% (4)	44% (4)	▼	44% (4)	▶
KwaZulu-Natal	15% (8)	68% (36)	17% (9)	▼	15% (8)	▼
Limpopo	8% (2)	79% (19)	13% (3)	▲	13% (3)	▲
Mpumalanga	28% (5)	17% (3)	55% (10)	▼	39% (7)	▼
Northern Cape	11% (3)	26% (7)	63% (17)	▲	56% (15)	▲
North West	6% (1)	12% (2)	82% (14)	▼	65% (11)	▼
Western Cape	72% (21)	21% (6)	7% (2)	▼	7% (2)	▼
TOTAL	21% (48)	41% (95)	38% (86)	▼	31% (72)	▼

** Includes municipalities with disclaimed/adverse opinions*

PROVINCE	INDICATORS #					
	Creditor-payment period > 30 days		More than 10% of debt irrecoverable		Deficit (expenditure exceeded revenue)	
Eastern Cape	83% (24)	▼	100% (29)	▼	38% (11)	▼
Free State	92% (11)	▶	100% (12)	▶	58% (7)	▼
Gauteng	89% (8)	▶	100% (9)	▶	44% (4)	▶
KwaZulu-Natal	90% (46)	▼	100% (51)	▼	27% (14)	▼
Limpopo	96% (22)	▼	96% (22)	▼	22% (5)	▲
Mpumalanga	92% (11)	▼	83% (10)	▶	42% (5)	▶
Northern Cape	100% (21)	▼	76% (16)	▼	57% (12)	▲
North West	100% (8)	▼	88% (7)	▼	75% (6)	▼
Western Cape	76% (22)	▶	86% (25)	▼	3% (1)	▲
TOTAL	89% (173)	▼	93% (181)	▼	34% (65)	▼

 # Excludes municipalities with disclaimed/adverse opinions

IMPACT OF FINANCIAL HEALTH ON PAYMENT OF UTILITIES – ESKOM (R BILLION)

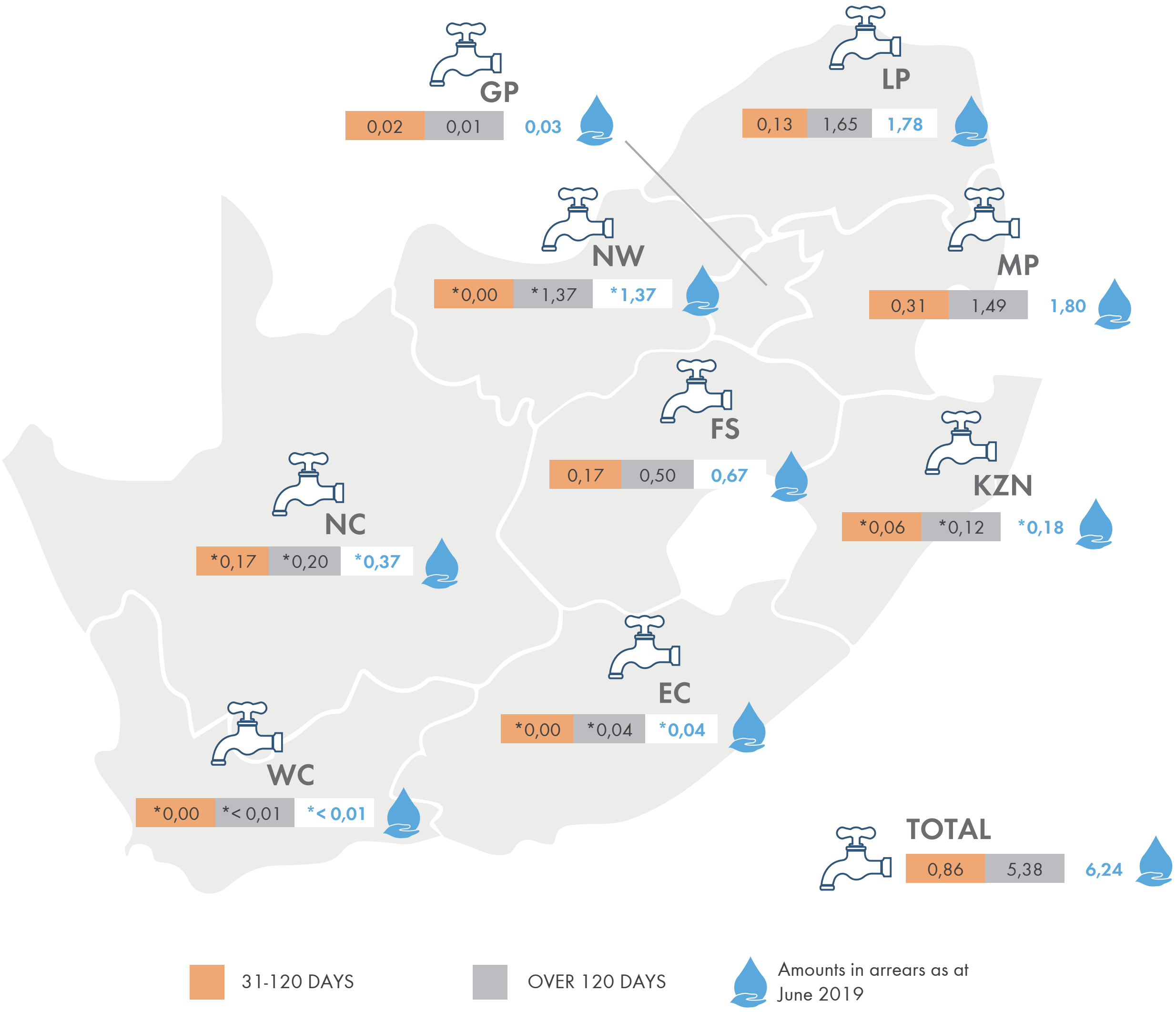


*Ageing could not be determined completely on all completed audits

TOP 3 CONTRIBUTORS TO OUTSTANDING AMOUNTS IN ARREARS (R BILLION)

Municipality	31 – 120 days	Over 120 days	Amounts in arrears as at June 2019
Emalahleni (MP)	0,33	2,44	2,77
Ngwathe (FS)	0,07	0,97	1,04
Lekwa (MP)	0,12	0,68	0,80

IMPACT OF FINANCIAL HEALTH ON PAYMENT OF UTILITIES – WATER BOARDS (R BILLION)



*Ageing could not be determined completely on all completed audits

TOP 3 CONTRIBUTORS TO OUTSTANDING AMOUNTS IN ARREARS (R BILLION)

Municipality	31 – 120 days	Over 120 days	Amounts in arrears as at June 2019
Mopani (LP)	0,09	0,84	0,93
Vhembe (LP)	0,02	0,81	0,83
Msukaligwa (MP)	0,14	0,54	0,68

MANAGEMENT OF INFRASTRUCTURE GRANTS

Compliance with Division of Revenue Act slightly increased to **85%**

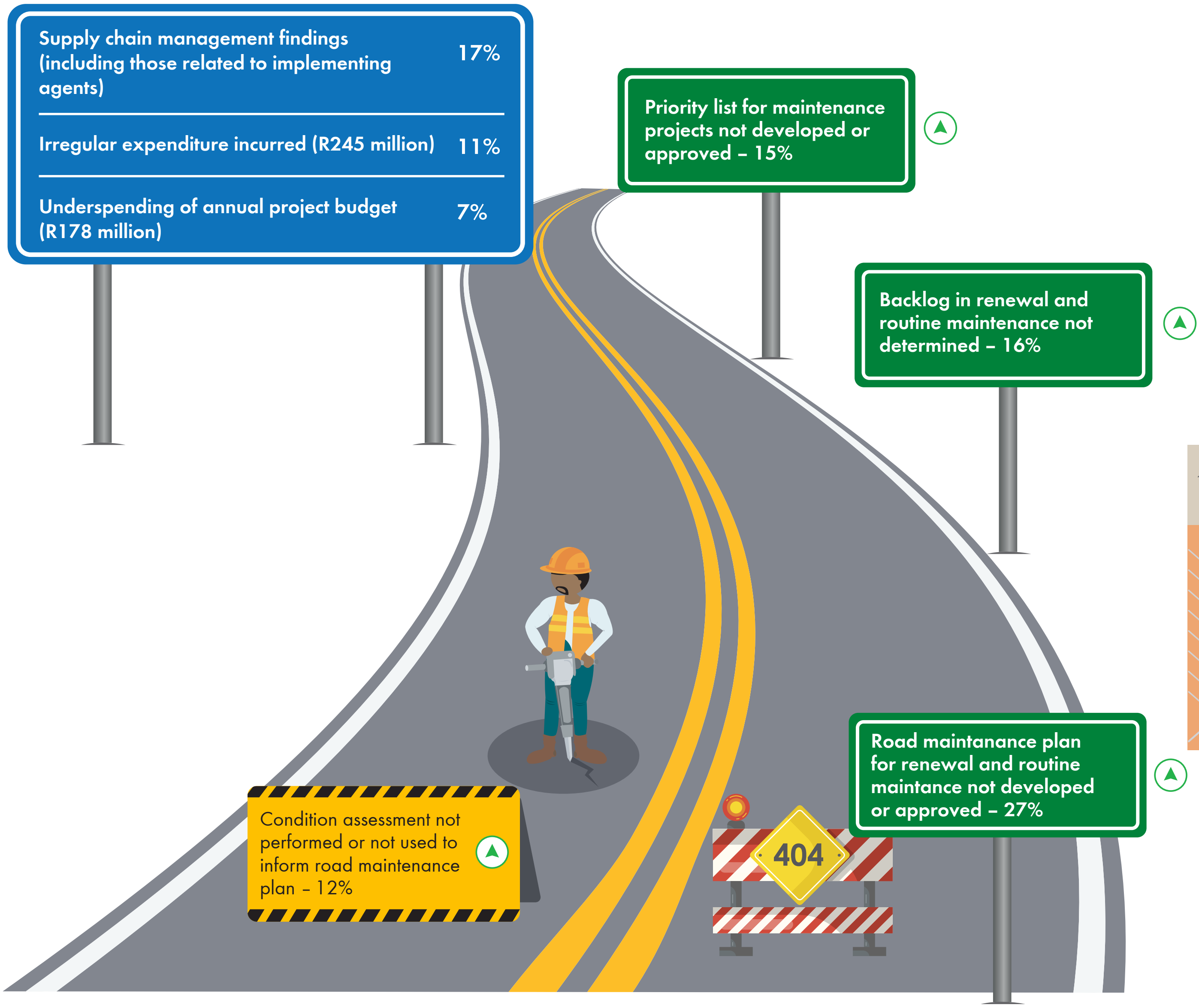
FUNDING	MUNICIPAL INFRASTRUCTURE GRANT (MIG) *193 municipalities*	PUBLIC TRANSPORT NETWORK GRANT (PTNG) *10 municipalities*	URBAN SETTLEMENTS DEVELOPMENT GRANT (USDG) *6 metros*	REGIONAL BULK INFRASTRUCTURE GRANT (RBIG) *26 municipalities*	WATER SERVICES INFRASTRUCTURE GRANT (WSIG) *87 municipalities*
Available to spend *(percentage of funds spent)*	R13,23 billion (94%)	R5,31 billion (74%)	R8,82 billion (95%)	R1,89 billion (71%)	R4,09 billion (76%)
Underspending by more than 10%	43 municipalities (22%)	7 municipalities (70%)	2 metros (33%)	12 municipalities (46%)	41 municipalities (47%)
Used for intended purpose	175 municipalities (91%)	8 municipalities (80%)	5 metros (83%)	25 municipalities (96%)	80 municipalities (92%)

FINDINGS *(per audited project funded by grant)*	MUNICIPAL INFRASTRUCTURE GRANT (MIG) *341 projects*	PUBLIC TRANSPORT NETWORK GRANT (PTNG) *15 projects*	URBAN SETTLEMENTS DEVELOPMENT GRANT (USDG) *18 projects*	REGIONAL BULK INFRASTRUCTURE GRANT (RBIG) *32 projects*	WATER SERVICES INFRASTRUCTURE GRANT (WSIG) *101 projects*
Planned completion date for project not achieved and/or project stage of completion not assessed	75 (22%)	5 (33%)	10 (56%)	7 (22%)	26 (26%)
Supply chain management findings	59 (17%)	3 (20%)	3 (17%)	8 (25%)	28 (28%)

ROAD INFRASTRUCTURE – 171 municipalities responsible for road infrastructure

PROJECT-RELATED FINDINGS – 233 PROJECTS AUDITED

FINDINGS ON MAINTENANCE OF ROAD INFRASTRUCTURE



Performance reporting and other service delivery concerns on one or more projects audited	Number of municipalities with findings or concerns
Targets not achieved	29% (50)
Targets not reliable	23% (40)
Targets not measurable	9% (15)
Targets not relevant	4% (7)

WATER INFRASTRUCTURE AND EXTENT OF WATER LOSSES – 122 municipalities responsible for water infrastructure

PROJECT-RELATED FINDINGS – 155 PROJECTS AUDITED

FINDINGS

Findings	Projects with findings
Supply chain management findings	18%
Irregular expenditure incurred (R248 million)	12%
Underspending of annual project budget (R293 million)	11%

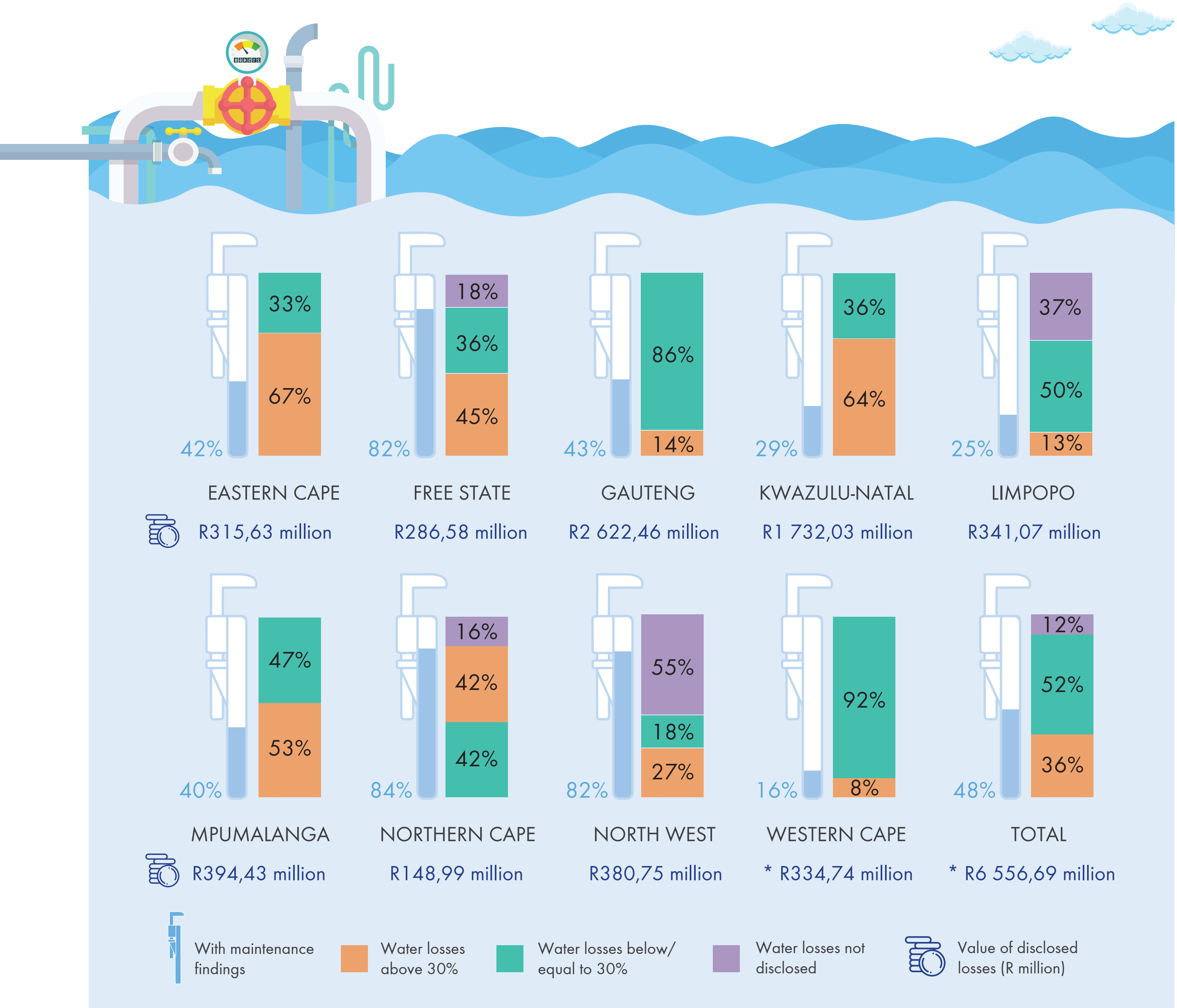
FINDINGS ON MAINTENANCE OF WATER INFRASTRUCTURE

Finding	%
Policy on routine maintenance of water infrastructure not developed or approved	41% ▲
Standard procedures on condition assessments of water infrastructure not established	36% ▲
No condition assessments of water infrastructure to inform routine water infrastructure maintenance plan	33% ▼
No environmental policy, strategy or documented processes established for identifying or monitoring environmental risks relating to water provision	21%*

** This is a new finding and therefore no comparatives are available*

MAINTENANCE WEAKNESSES AND WATER LOSSES

According to Circular 71 issued by the National Treasury, the purpose of the water losses indicator/ratio is to determine the percentage loss of potential revenue from water services through kilolitres of water purchased but not sold as a result of losses through theft (illegal connections), no or incorrect metering, or wastage as a result of deteriorating water infrastructure. The acceptable norm is water losses between 15% and 30%. If the ratio exceeds the norm, it could indicate challenges such as ageing water infrastructure or poor management by the municipality.

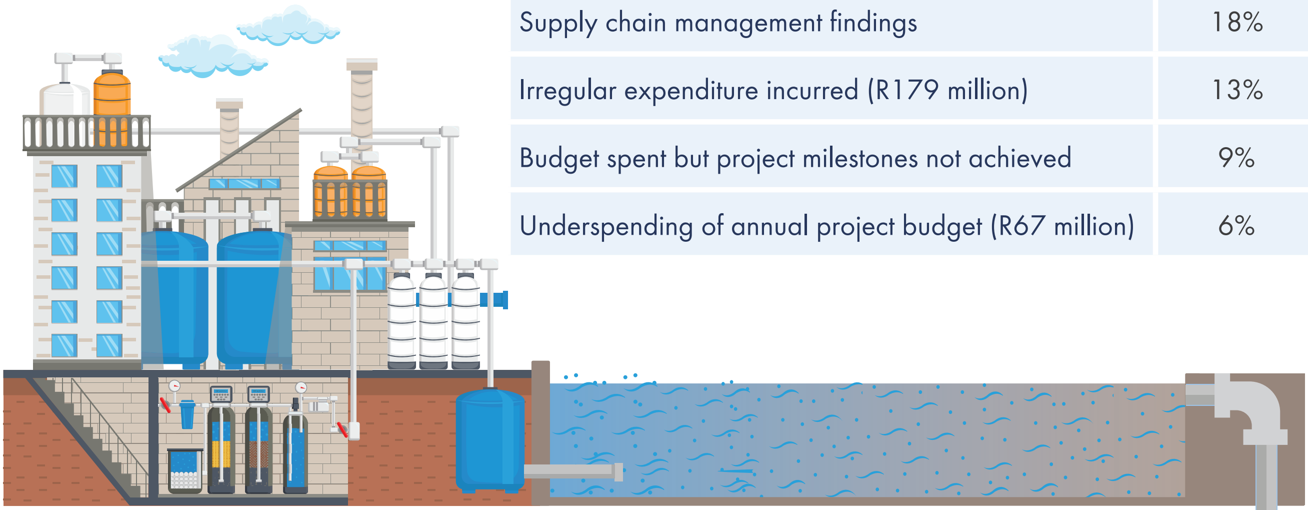


* *Some municipalities disclosed water losses in kilolitres instead of in rand value*

Performance reporting and other service delivery concerns on one or more projects audited	Number of municipalities with findings or concerns
Targets not achieved	35% (43)
Targets not reliable	33% (40)
Targets not measurable	19% (23)
Targets not relevant	8% (10)

SANITATION INFRASTRUCTURE – 119 municipalities responsible for sanitation infrastructure

PROJECT-RELATED FINDINGS – 115 PROJECTS AUDITED



FINDINGS	Projects with findings
Supply chain management findings	18%
Irregular expenditure incurred (R179 million)	13%
Budget spent but project milestones not achieved	9%
Underspending of annual project budget (R67 million)	6%

FINDINGS ON MAINTENANCE OF SANITATION INFRASTRUCTURE

Policy on routine maintenance of sanitation infrastructure not developed or approved 41%

No condition assessments of sanitation infrastructure to inform sanitation infrastructure maintenance plan 35%

Standard procedures on condition assessments of sanitation infrastructure not established 34%

No environmental policy, strategy or documented processes established for identifying or monitoring environmental risks relating to wastewater management 27%*

** This is a new finding and therefore no comparatives are available*

Performance reporting and other service delivery concerns on one or more projects audited	Number of municipalities with findings or concerns
Targets not achieved	36% (43)
Targets not reliable	35% (42)
Targets not measurable	18% (21)
Targets not relevant	9% (11)

EXAMPLES OF INFRASTRUCTURE DEVELOPMENT AND MAINTENANCE FAILURES

Shortcomings in the development and maintenance of infrastructure are symptoms of a larger problem that municipalities have with managing finances, performance and projects and taking accountability for outcomes. This is demonstrated through the examples that follow.

REHABILITATION OF TOP TOWN ACCESS ROADS

RESPONSIBLE MUNICIPALITY: JOZINI (KZN)

COST: R13,03 million funded through municipal infrastructure grant

AIM Improve and upgrade road network through construction and rehabilitation of 4,45 km of gravel roads to paved roads with sidewalks and drainage

TIMELINE

- **JUNE 2011** *Project commences*
- **17 JULY 2012** *Planned completion date*
- **26 APRIL 2019** *Municipality signs certificate that project has been completed*
- **OCTOBER 2019** *Audit team finds that project has not been completed*

FINDINGS

- Only 38% of road kilometres completed
- Only 50% to 80% of road width (tested at various points on different roads) constructed
- No sidewalks constructed
- Some roads were without drains to discharge rain water

Road 6 incomplete

Road 7A not upgraded

IMPACT

- Poor condition will compromise long-term functionality of roads
- Safety of road users not guaranteed

REASONS

PROJECT PLANNING

- Scope of work and project deliverables not adequately defined (e.g. survey not undertaken to determine location and extent of road reserve)
- Existing items of infrastructure below road surface (leaking potable supply and sewer network) not determined

PROJECT MANAGEMENT

- Due diligence not exercised in approving payment certificates as precondition for payment to ensure that construction took place as per agreed specifications

CONTRACT MANAGEMENT

- Contractor not paid within agreed time, negatively affecting contractor's cash flow
- Remedial action clauses in service level agreement not enforced for poor performance by contractor

CONSTRUCTION OF HOUSING UNITS IN PEELTON

RESPONSIBLE MUNICIPALITY: Buffalo City Metro (EC)

COST: R33,70 million (Nkqonkqweni) + **R48,25 million** (Majali) funded through human settlements development grant

AIM Provide adequate housing to people living in Peelton by building 268 houses in Nkqonkqweni and 385 in Majali

TIMELINE

2015
Project commences

15 MONTHS LATER
Planned completion date

4 YEARS LATER
Project significantly delayed and still ongoing

FINDINGS

- Construction of housing units delayed by approximately four years with project still only 83% to 85% complete
- Actual project expenditure exceeded: R4,22 million more than approved contract value had been spent at Nkqonkqweni by October 2019

IMPACT

- Not all housing units were occupied upon completion, as some beneficiaries no longer needed the houses or others had since passed on
- Unoccupied houses were vandalised

Incomplete houses vandalised

REASONS

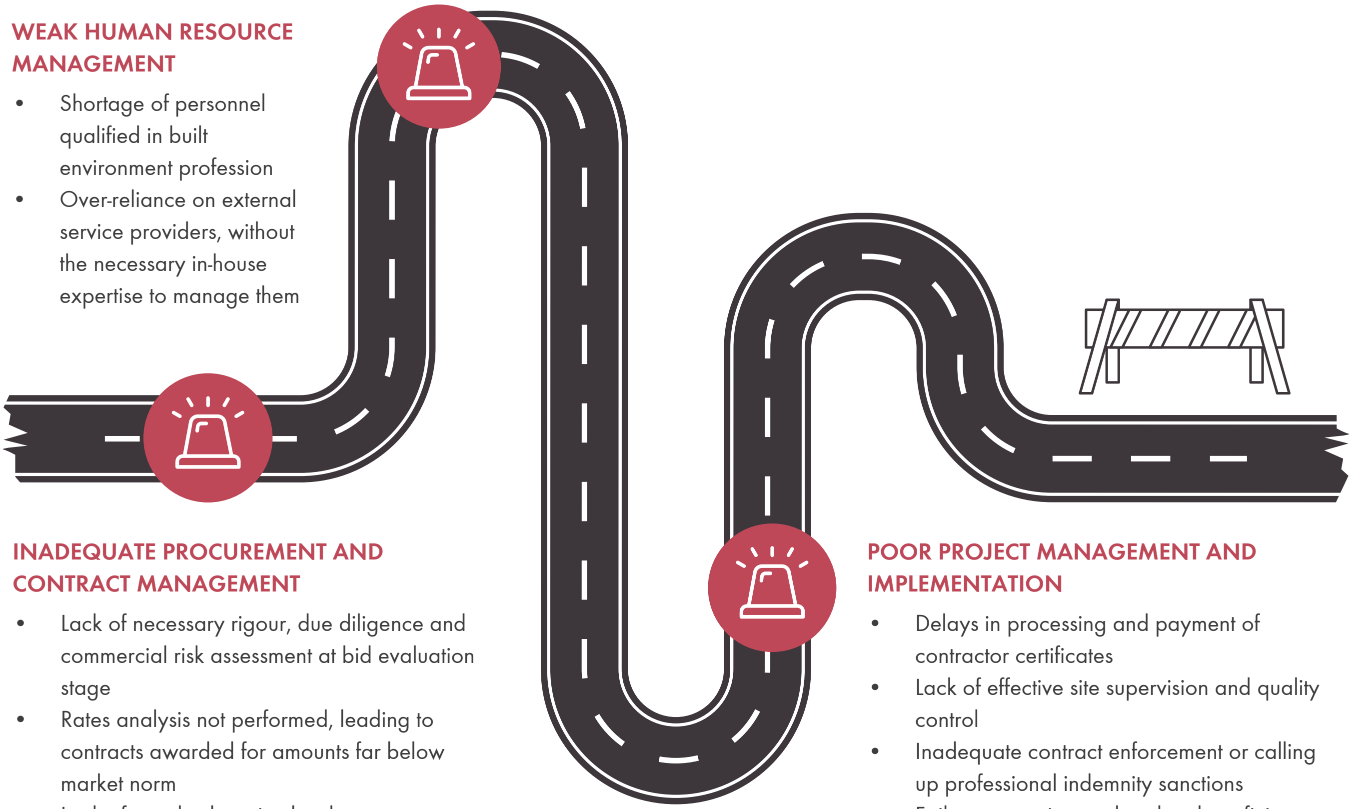
PROJECT MANAGEMENT

- Slow performance, limited capacity and over-commitment of contractor
- Contractor entered into cession agreement to sub-contract work to another contractor

CONTRACT MANAGEMENT

- Contractor not paid within agreed time, leading to contractor eventually abandoning project

TRANSVERSAL FACTORS CONTRIBUTING TO INFRASTRUCTURE PROJECT FAILURES



WEAK HUMAN RESOURCE MANAGEMENT

- Shortage of personnel qualified in built environment profession
- Over-reliance on external service providers, without the necessary in-house expertise to manage them

INADEQUATE PROCUREMENT AND CONTRACT MANAGEMENT

- Lack of necessary rigour, due diligence and commercial risk assessment at bid evaluation stage
- Rates analysis not performed, leading to contracts awarded for amounts far below market norm
- Lack of standard service level agreements

POOR PROJECT MANAGEMENT AND IMPLEMENTATION

- Delays in processing and payment of contractor certificates
- Lack of effective site supervision and quality control
- Inadequate contract enforcement or calling up professional indemnity sanctions
- Failure to monitor and update beneficiary list, resulting in unoccupied houses being vandalised

INTERNAL CONTROL

▼ Regression in overall status of internal control

OVERALL STATUS OF INTERNAL CONTROL

Year	Good	Of concern	Intervention required	Movement
2018-19	19% (44)	42% (96)	39% (89)	▼
2017-18	18% (42)	49% (112)	33% (75)	
2016-17	23% (53)	46% (106)	31% (70)	▼

DRIVERS OF INTERNAL CONTROL

	Good	Of concern	Intervention required	Movement from 2017-18	Movement from 2016-17
Leadership	21% (49)	38% (86)	41% (94)	▼	▼
Financial and performance management	12% (28)	41% (94)	47% (107)	▼	▼
Governance	29% (66)	39% (89)	32% (74)	▼	▼

Good internal control is the key to ensuring that municipalities deliver on their priorities in an effective, efficient and economical manner

It will also ensure that municipalities produce quality financial statements and performance reports, and comply with applicable legislation

BASIC CONTROLS

	Good	Of concern	Intervention required	Movement from 2017-18	Movement from 2016-17
Effective leadership	38% (86)	35% (81)	27% (62)	▼	▼
Audit action plans	12% (28)	46% (104)	42% (97)	▼	▼
Proper record keeping	16% (36)	38% (88)	46% (105)	▼	▼
Daily and monthly controls	18% (42)	32% (74)	50% (113)	▼	▼
Review and monitor compliance	6% (13)	35% (80)	59% (136)	▼	▼
Human resource management	27% (62)	42% (96)	31% (71)	▼	▼

Analysis shows 6 of the 7 basic controls that should receive specific attention to improve and sustain audit outcomes

Refer to information technology (IT) controls section for IT governance controls

Good | Of concern | Intervention required

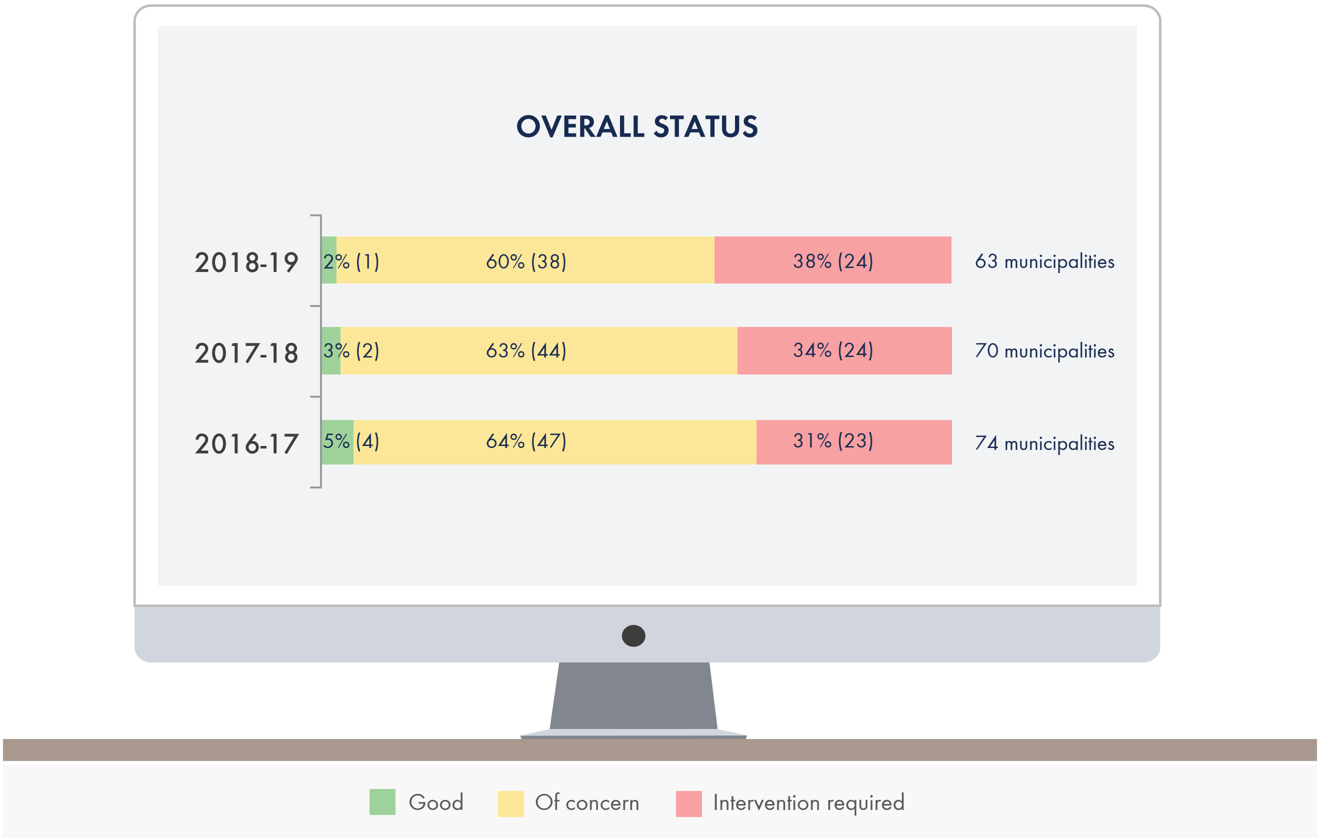
PROGRESS MADE IN IMPROVING DRIVERS OF INTERNAL CONTROL

IN LOCAL GOVERNMENT OVER THREE YEARS

Municipalities must invest in preventative controls to strengthen their control environment

Province	Leadership	Financial and performance management	Governance
Eastern Cape	▼	▼	▼
Free State	▼	▼	▼
Gauteng	▼	▼	▼
KwaZulu-Natal	▼	▼	▼
Limpopo	▲	▲	▲
Mpumalanga	▼	▼	▼
Northern Cape	▼	▼	▲
North West	▼	►	▼
Western Cape	▼	▼	▼
Total	▼	▼	▼

Information systems in the public sector are used to record and process data, and to report on financial and business information. Various stakeholders (including executives and oversight committees) rely on that information to make critical decisions.



STATUS OF GENERAL CONTROLS

IT general controls provide assurance to stakeholders as to whether they can rely on the IT systems used to record and process financial and business transactions. A weak control environment makes those systems susceptible to unauthorised manipulation of financial data and/or transactions, and increases the risk of fraud.

63 of the 211 municipalities where we audited general controls are highly dependent on IT systems for many of their core financial and business processes. The control environment of those municipalities has continued to deteriorate over the years.

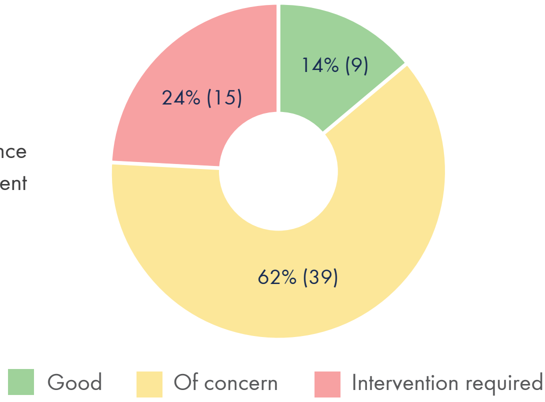
EFFECTIVENESS OF INFORMATION TECHNOLOGY GOVERNANCE

(63 municipalities highly dependent on IT systems for core financial and business processes)

IT governance is a set of organisational processes that ensures executive oversight of IT spending in relation to value for money; the effectiveness of IT risk management; and the allocation of adequate IT resources to deliver on business goals.

The accounting officer, internal auditors and audit committee are generally accountable for effective IT governance processes at municipalities.

Overall IT governance assessment



FINDINGS

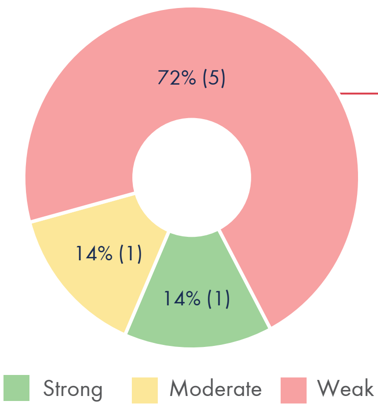
- IT governance framework: No IT governance framework or effective IT governance processes (33%)
- Benefits delivery: Project benefits realisation (e.g. IT spend on infrastructure, software, external service providers and system developments) not identified and/or monitored (47%)
- Risk management: Internal auditors did not perform IT audits and/or provide proactive assurance on IT projects as part of internal system of control (43%)
- Resources optimisation: IT resource structures inadequate to deliver and support current and future business needs (25%)

CYBERSECURITY

CYBERSECURITY POSTURE (STRENGTH)

(7 municipalities where IT security reviews were performed)

IT security controls

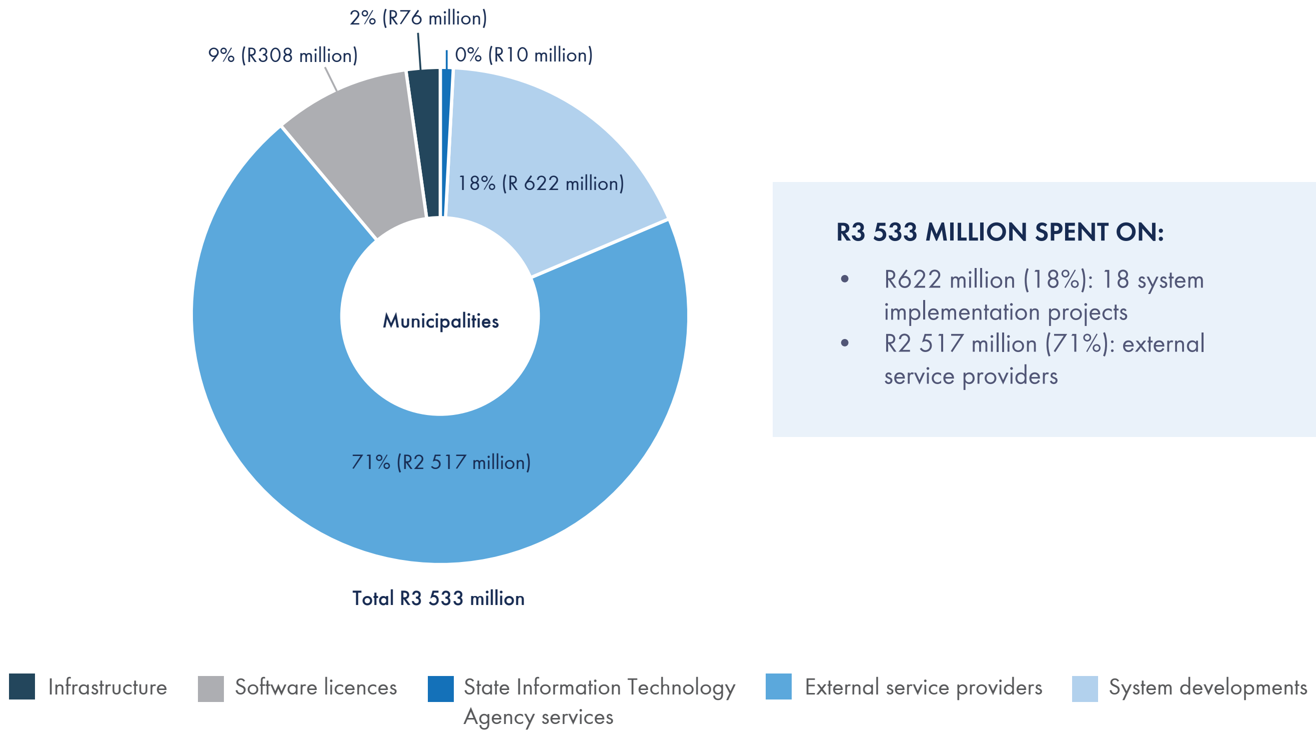


Includes City of Johannesburg Metro and Sol Plaatje whose systems were hacked

Cybersecurity is ranked the number one business risk facing companies in South Africa and globally (according to the Allianz Global Corporate & Speciality risk barometer published in 2020). Similarly, municipalities are facing a growing number of cyber challenges, including larger and more expensive data breaches, an increase in ransomware and business email compromise (spoofing) incidents, as well as the prospect of litigation after a major security breach.

EXPENDITURE ON INFORMATION TECHNOLOGY

(63 municipalities highly dependent on IT systems for core financial and business processes)



R3 533 MILLION SPENT ON:

- R622 million (18%): 18 system implementation projects
- R2 517 million (71%): external service providers

FINDINGS AT 18 PROJECTS AUDITED

Municipalities paid for systems not in use or not fully utilised:

- Amathole District (EC): R111 million spent on system implementation not used and current contract has expired
- Newcastle (KZN) and Harry Gwala District (KZN): R8 million and R941 250 spent, respectively, on system implementation not utilised

Msunduzi (KZN):

- Project with contract amount of R129 million not used due to defects that had to be resolved by service provider; municipality is disputing R54 million of the amount spent

The metros, Mangaung (FS), eThekwini (KZN), City of Johannesburg (GP), City of Ekurhuleni (GP), Buffalo City (EC): Payments were made on contracts but municipalities did not derive value for money; for example:

- City of Ekurhuleni (project with contract value of R100 million): Only one out of five modules implemented, but 70% of budget already spent
- Buffalo City (contract to the value of R14 million): Fully paid for system implementation not utilised and not all modules implemented

The metros, Mangaung, City of Johannesburg, City of Ekurhuleni, Buffalo City: Paid for software licences not used or did not have process to ensure control over utilisation of software licences; for example:

- City of Johannesburg: Paid R45 million for software licences not utilised

The national Department of Cooperative Governance (DCoG) and the Municipal Infrastructure Support Agent (Misa) have an important support and oversight role to play in local government as part of the Medium-Term Strategic Framework's outcome 9 (a responsive, accountable, effective and efficient developmental local government system).

NATIONAL PRIORITY SUPPORT INITIATIVES

In 2014, the back-to-basics (B2B) initiative was launched to improve service delivery. The B2B programme, aimed at building functional municipalities, assisted in identifying and agreeing on critical and priority challenges. In May 2018, DCoG identified 87 priority dysfunctional or distressed municipalities for specific support interventions based on their regressing audit outcomes, reduced revenue, and use of grants or reserves for operational expenditure.

Provinces not providing the required support to municipalities

FINDINGS	PROVINCE								
	EC	FS	GP	KZN	LP	MP	NC	NW	WC
Number of dysfunctional/ distressed municipalities per province	14	7	6	18	13	4	8	10	7
Outstanding audits included in the 87 dysfunctional municipalities per province	1	5	1	1	1	1	2	1	1
Municipal support plans not developed for all municipalities	No finding	Finding	No finding	No finding	No finding	No finding	Finding	Finding	Finding
Municipal support plans not adequately drafted to address key challenges at all municipalities	No finding	No finding	No finding	No finding	No finding	No finding	No finding	Finding	No finding
Support initiatives not implemented at all municipalities	Finding	No finding	No finding	No finding	No finding	No finding	No finding	No finding	No finding
B2B multi-sectoral provincial task teams not established	No finding	No finding	No finding	Finding	No finding	No finding	No finding	No finding	No finding
Municipalities not supported in development of community engagement plans and processes/ Limitation to determine whether support was provided	Finding	No finding	No finding	No finding	No finding	No finding	No finding	Finding	No finding

Finding No finding

The lack of support and support plans resulted in the specific roles and responsibilities of the various role players, deliverables and time frames not being clearly defined, making it difficult to identify and address key matters. The inability to adequately implement support initiatives at the identified municipalities hampered progress towards clean administration and improved service delivery.

The overall regression in audit outcomes stresses the necessity for improved support interventions. To obtain sustainable outcomes with the desired impact in the long term, support should be enhanced and take the form of a preventative control in the place of the current reactive support approach.

MISA'S SUPPORT INITIATIVES

Misa identified 85 municipalities requiring support due to service or infrastructure delivery challenges. Misa purchased an asset management system (the municipal infrastructure performance management information system) during 2013-14 at a cost of R34 million. It is encouraging that the number of municipalities not using Misa's system decreased from 80 in 2017-18 to 35 in 2018-19.

Municipalities not using Misa's asset management system

Gauteng is excluded from the analysis below: while the province did not use Misa's system, it also did not have any qualifications on assets.

FINDINGS	YEAR	TOTAL	PROVINCE							
			EC	FS	KZN	LP	MP	NC	NW	WC
Number of municipalities not using Misa's system to encourage infrastructure maintenance and asset management	**2017-18**	**80**	19	5	7	10	8	20	8	3
	2018-19	**35**	3	2	3	2	1	20	1	3
Audit outcomes	**2018-19**	**35**	2, 1	1, 1	1, 2	2	1	4, 10, 6	1	1, 2
Number of municipalities not using Misa's system with qualification on assets	**2018-19**	**21**	2	2	3	2	0	10	1	1
Number of municipalities that moved to Misa's system but still had asset qualification areas	**2018-19**	**21**	6	3	2	3	3		4	

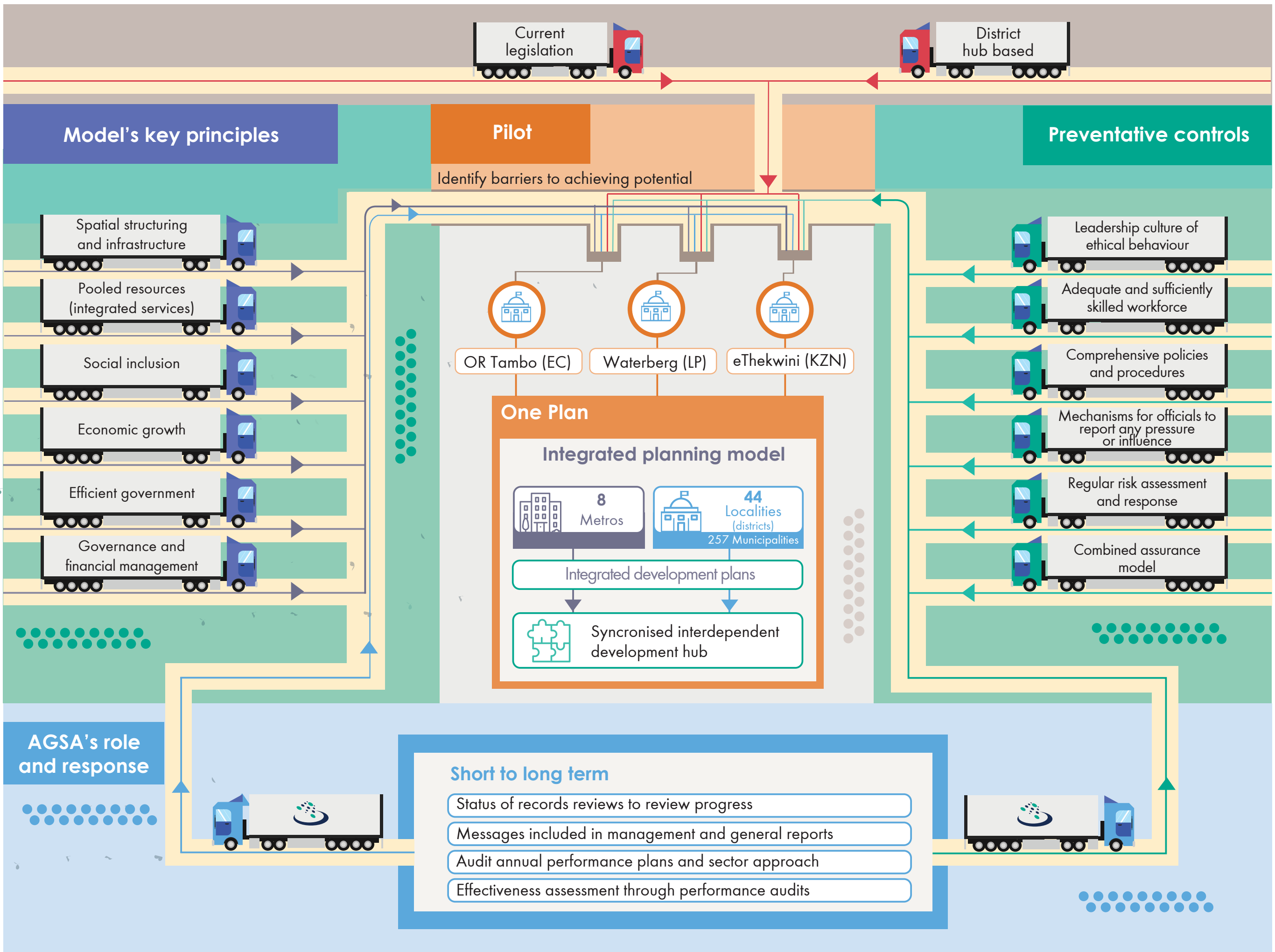
Unqualified with no findings — Unqualified with findings — Qualified with findings — Adverse with findings — Disclaimed with findings

Although more municipalities started using Misa's system, this did not translate into direct improvements in the audit outcomes as evident in the number of municipalities that moved to the system but still had qualifications on assets. This will necessitate municipalities to strengthen the effective use of the system, where necessary, to systematically monitor the planning, development, maintenance and management of municipal infrastructure. Furthermore, the system should be implemented in a manner that is linked to its intended objectives and the achievement of the envisaged goals.

DISTRICT DEVELOPMENT MODEL

In response to earlier initiatives such as B2B proving not to be as successful, the district coordinated development model was launched in 2019 to improve service delivery through breaking down silos in government, synchronising planning by all spheres of government, and moving closer to citizens and civil society, with the ultimate aim of eradicating poverty, unemployment and inequalities.

Overview of the district coordinated development model



The high-level principles of the model were extracted from the concept note *'Towards a district coordinated development model'* dated September 2019

It is envisaged that the model will strengthen cooperative governance and lead to the implementation of well-coordinated and coherent national programmes. The envisioned 'One Plan' is a potential game changer in various areas of government. However, the success of the model will depend on a system that includes the proactive monitoring of key municipal actions and the reporting of poor performance, irregularities and deficiencies to structures with the power and will to enforce corrective action.

Our expected role and response will be anchored around existing processes within our mandate, including auditing, status of records reviews, messaging and stakeholder engagements. As depicted in the graphic, our preventative controls approach is going to be a key ingredient in supporting government to achieve the envisaged goals of the model. The implementation of these controls should assist government and the district hubs to tighten the levels of accountability.

ASSURANCE PROVIDERS

▼ SLIGHT REGRESSION IN ASSURANCE PROVIDED BY ROLE PLAYERS

ASSURANCE PROVIDED BY MANAGEMENT / LEADERSHIP

	Provides assurance	Provides some assurance	Provides limited/no assurance	Not established	Movement from 2017-18	Movement from 2016-17
Senior management	5%	49%	46%		▼	▼
Municipal managers	7%	58%	35%		▼	▼
Mayors	25%	50%	25%		▼	▼

INTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT

	Provides assurance	Provides some assurance	Provides limited/no assurance	Not established	Movement from 2017-18	Movement from 2016-17
Internal audit units	25%	53%	20%	2%	▼	▼
Audit committees	31%	50%	18%	1%	▼	▼
COORDINATING/MONITORING DEPARTMENTS	4%	66%	30%		▼	▲
Treasuries		78%	22%		▼	▼
Offices of the premier	11%	56%	33%		▶	▲
Cooperative governance departments		67%	33%		▶	▲

EXTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT

	Provides assurance	Provides some assurance	Provides limited/no assurance	Not established	Movement from 2017-18	Movement from 2016-17
Municipal councils	26%	47%	27%		▶	▼
Municipal public accounts committees	27%	41%	32%		▼	▼
Portfolio committees on local government		44%	56%		▼	▼

Provides assurance | Provides some assurance | Provides limited/no assurance | Not established

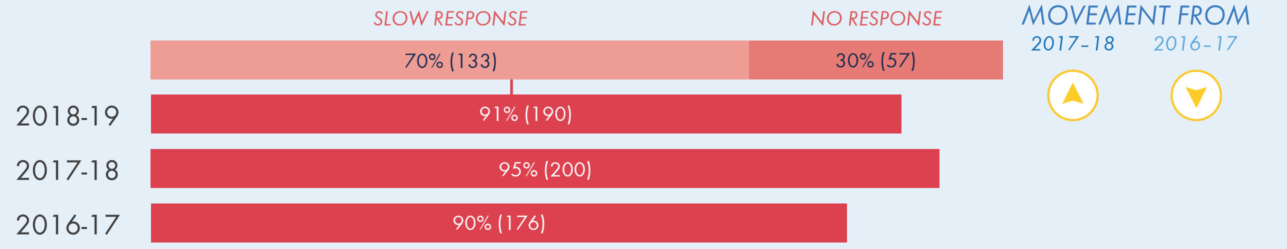
FINDINGS	INTERNAL AUDIT UNITS		AUDIT COMMITTEES	
Fully compliant with legislation	81% (174)	▲	84% (183)	▲
Evaluates reliability of financial information	92% (198)	▲	93% (201)	▲
Evaluates reliability of performance information	88% (189)	▲	88% (190)	▼
Evaluates compliance with key legislation	88% (189)	▶	89% (194)	▼
Interacts with executive authority	N/A		92% (199)	▶
Positive impact on audit outcomes	36% (78)	▲	53% (114)	▶

Internal audit units and audit committees were established and performed the functions required by legislation. However, these assurance providers did not have a positive impact on the audit outcomes and the assurance provided was low. The main reason was that their recommendations were not implemented and at some municipalities the quality of the work performed was not at the required level.

ROOT CAUSES OF LIMITED IMPROVEMENT

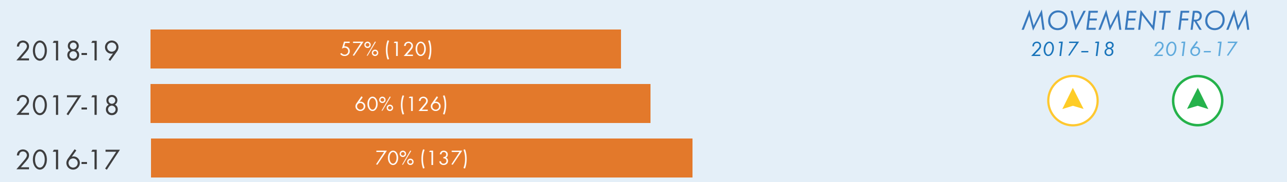
SLOW OR NO RESPONSE IN IMPROVING INTERNAL CONTROLS AND ADDRESSING RISK AREAS

No response most evident in North West (14 municipalities), Limpopo (10 municipalities) and Free State (10 municipalities)



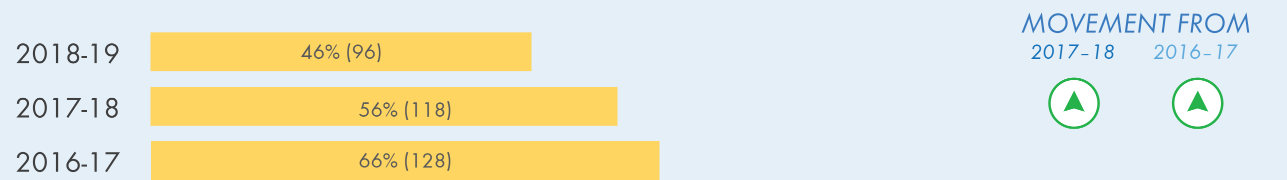
INADEQUATE CONSEQUENCES FOR POOR PERFORMANCE AND TRANSGRESSIONS

Lack of consequences most common in North West (100%), Free State (93%) and Northern Cape (81%)



INSTABILITY OR VACANCIES IN KEY POSITIONS OR KEY OFFICIALS LACKING APPROPRIATE COMPETENCIES

Vacancies, instability or lack of competencies most prominent in North West (100%), Free State (80%) and Northern Cape (58%)



ACCOUNTABILITY ↓ = **SLOW/NO RESPONSE** ↑
BY MANAGEMENT

NOTES

NOTES

SECTION 5

Need to know

5.1 OUR AUDIT PROCESS AND FOCUS

WHAT IS OUR AUDIT AND REPORTING PROCESS?

We audit every municipality and municipal entity in the country to report on the quality of their financial statements and performance reports and on their compliance with key legislation.

We further assess the root cause of any error or non-compliance, based on the internal control that has failed to prevent or detect it. We report in the following three types of reports:

- We report our findings, the root causes of such findings and our recommendations in **management reports** to the senior management and municipal managers (including city managers of metros), or chief executive officers in the case of municipal entities, which are also shared with the mayors and audit committees.
- Our opinion on the financial statements, material findings on the performance report and compliance with key legislation, as well as significant deficiencies in internal control, are included in an **audit report**, which is published with the auditee's annual report and dealt with by the municipal council.
- Annually, we report on the audit outcomes of all auditees in a **consolidated report** (such as this one), in which we also analyse the root causes that need to be addressed to improve audit outcomes. Before the general report is published, we share the outcomes and root causes with the national and provincial leadership, Parliament and the legislatures, as well as other key role players in national and provincial government.

Over the past few years, we have intensified our efforts to assist in improving audit outcomes by identifying the **key controls** that should be in place at auditees, regularly assessing these, and sharing the results of the assessment with mayors, municipal managers, chief executive officers as well as audit committees.

During the audit process, we work closely with municipal managers, chief executive officers, senior management, audit committees and internal audit units, as they are **key role players** in providing assurance on the credibility of the auditees' financial statements and performance reports as well as on their compliance with legislation.

We also continue to strengthen our relationship with the mayors, ministers and members of the executive council responsible for cooperative governance, coordinating and monitoring departments (such as the treasuries, premier's offices and departments of cooperative governance) as well as Parliament and provincial legislatures, as we are convinced that their involvement and oversight have played – and will continue to play – a crucial role in the performance of local governance.

We have further increased our efforts by using the **status of records review** to engage with municipal managers. Such a review is an assessment of records, risks and progress made by the municipality to address prior year issues early in the financial year.

The **overall audit outcomes** fall into five categories:

1. Auditees that receive a **financially unqualified opinion with no findings** are those that are able to:
   - produce financial statements free of material misstatements (material misstatements mean errors or omissions that are so significant that they affect the credibility and reliability of the financial statements)
   - measure and report on their performance in line with the predetermined objectives in their integrated development plans and/or service delivery and budget implementation plans in a manner that is useful and reliable
   - comply with key legislation.

This audit outcome is also commonly referred to as a 'clean audit'.

2. Auditees that receive a **financially unqualified opinion with findings** are those that are able to produce financial statements without material misstatements, but are struggling to:
   - align their performance reports to the predetermined objectives to which they have committed in their integrated development plans and/or service delivery and budget implementation plans

- set clear performance indicators and targets to measure their performance against their predetermined objectives
- report reliably on whether they have achieved their performance targets
- determine which legislation they should comply with, and implement the required policies, procedures and controls to ensure that they comply.

3. Auditees that receive a **financially qualified opinion with findings** face the same challenges as those that are financially unqualified with findings in the areas of reporting on performance and compliance with key legislation. In addition, they are unable to produce credible and reliable financial statements. Their financial statements contain misstatements that they cannot correct before the financial statements are published.

4. The financial statements of auditees that receive an **adverse opinion with findings** include so many material misstatements that we disagree with virtually all the amounts and disclosures in the financial statements.

5. Those auditees with a **disclaimed opinion with findings** cannot provide us with evidence for most of the amounts and disclosures in the financial statements. We are therefore unable to conclude or express an opinion on the credibility of their financial statements.

   Auditees with adverse and disclaimed opinions are typically also:

   - unable to provide sufficient supporting documentation for the achievements they report in their performance reports
   - not complying with key legislation.

WHAT IS THE PURPOSE OF THE ANNUAL AUDIT OF THE FINANCIAL STATEMENTS?

The purpose of the annual audit of the **financial statements** is to provide the users thereof with an **opinion** on whether the financial statements fairly present, in all material respects, the key financial information for the reporting period in accordance with the financial reporting framework and applicable legislation. The audit provides the users with reasonable assurance regarding the degree to which the financial statements are reliable and credible on the basis that the audit procedures performed did not reveal any material errors or omissions in the financial statements. We use the term 'material misstatement' to refer to such material errors or omissions.

We report the **poor quality of the financial statements** we receive in the audit reports of some auditees as a material finding on compliance, as it also constitutes non-compliance with the Municipal Finance Management Act. The finding is only reported for auditees that are subject to this act and if the financial statements we receive for auditing include material misstatements that could have been prevented or detected if the auditee had an effective internal control system. We do not report a finding if the misstatement resulted from an isolated incident or if it relates to the disclosure of unauthorised, irregular or fruitless and wasteful expenditure identified after the financial statements had been submitted.

WHAT DOES COMPLIANCE WITH KEY LEGISLATION MEAN?

We annually audit and report on **compliance by auditees with key legislation** applicable to financial and performance management and related matters. We focus on the following areas in our compliance audits, if they apply to the particular auditee: ■ the quality of financial statements submitted for auditing ■ asset and liability management ■ budget management ■ expenditure management ■ unauthorised, irregular, and fruitless and wasteful expenditure ■ effecting consequences ■ revenue management ■ strategic planning and performance management ■ financial statements and annual report ■ transfer of funds and conditional grants ■ procurement and contract management (in other words, supply chain management) ■ human resource management and compensation.

In our audit reports, we report findings that are material enough to be brought to the attention of auditee management, municipal councils, boards of municipal entities as well as oversight bodies and the public.

WHAT IS THE SCOPE OF SUPPLY CHAIN MANAGEMENT AUDITS?

We test whether the **prescribed procurement processes have been followed** to ensure that all suppliers are given equal opportunity to compete and that some suppliers are not favoured above others. The principles of a fair, equitable, transparent, competitive and cost-effective supply chain management process are fundamental to the procurement practices of the public sector, as enshrined in the country's constitution and prescribed in the Municipal Finance Management Act and its regulations. The act and these regulations define what processes should be followed to adhere to the constitutional principles, the level of flexibility available, and the documentation requirements.

We also focus on **contract management**, as shortcomings in this area can result in delays, wastage as well as fruitless and wasteful expenditure, which in turn have a direct impact on service delivery.

We further assess the **financial interests of employees and councillors of the auditee and their close family members** in suppliers to the auditee. The requirements in this regard are as follows:

- Supply chain management regulation 44 prohibits the awarding of contracts to, and acceptance of quotations from, employees, councillors or other state officials, or entities owned or managed by them, if they are in the service of the auditee or if they are in the service of any other state institution. Such expenditure is also considered irregular. During our audits, we identify such prohibited awards and also test whether the legislated requirements with regard to declarations of interest were adhered to.
- Awards to close family members of persons in the service of the state, whether at the auditee or another state institution, are not prohibited. However, such awards of more than R2 000 must be disclosed in the financial statements of the auditee for the sake of transparency and as required by supply chain management regulation 45. A close family member is a spouse, child or parent of a person in the service of the state.

The aim of the **human settlements development grant** is to make funding available for the creation of sustainable and integrated human settlements that enable improved quality of household life, access to basic services and secure tenure. The **municipal disaster grant** is used to provide for the immediate release of funds for disaster response; for example, droughts or pandemics such as Covid-19.

WHAT IS IRREGULAR EXPENDITURE?

Irregular expenditure is expenditure that was **not incurred in the manner prescribed by legislation**; in other words, somewhere in the process that led to the expenditure, the auditee did not comply with the applicable legislation.

Such expenditure does **not necessarily mean that money had been wasted or that fraud had been committed**. It is an indicator of non-compliance in the process that needs to be investigated by management to determine whether it was an unintended error, negligence or done with the intention to work against the requirements of legislation (which, for example, require that procurement should be fair, equitable, transparent, competitive and cost-effective).

Through such **investigation**, it is also determined who is responsible and what the impact of the non-compliance is. Based on the investigation, the next steps are determined. One of the steps can be condonement if the non-compliance had no impact and negligence was not proven. Alternatively, if negligence was proven, the steps can be disciplinary steps, the recovery of any losses from the implicated officials or even cancelling a contract or reporting it to the police or an investigating authority.

The Municipal Finance Management Act is clear that municipal managers are **responsible for preventing irregular expenditure** as well as on what process to follow if it has been incurred.

In order to promote transparency and accountability, auditees **should disclose all irregular expenditure identified (whether by the auditee or through the audit process)** in their financial statements with detail on how it had been resolved; in other words, how much had been investigated, recovered or condoned.

WHAT IS UNAUTHORISED EXPENDITURE?

Unauthorised expenditure refers to expenditure that auditees incurred without provision having been made for it in the approved budget by the council or that does not meet the conditions of a grant.

The Municipal Finance Management Act requires municipal managers to take all **reasonable steps to prevent unauthorised expenditure. Auditees should have processes to identify any unauthorised expenditure** and disclose the amounts in the financial statements. The act also includes the steps that municipal managers and councils should take to investigate unauthorised expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven.

WHAT IS FRUITLESS AND WASTEFUL EXPENDITURE?

Fruitless and wasteful expenditure is expenditure that was made in vain and that could have been avoided had reasonable care been taken. This includes penalties and interest on the late payment of creditors or statutory obligations as well as payments made for services not used or goods not received.

The Municipal Finance Management Act requires municipal managers to take all **reasonable steps to prevent fruitless and wasteful expenditure**. Auditees should have processes to detect fruitless and wasteful expenditure and disclose the amounts in the financial statements. Fruitless and wasteful expenditure is reported when it is identified – even if the expenditure was incurred in a prior year.

The act also sets out the steps that municipal managers and councils should take to investigate fruitless and wasteful expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven.

WHAT ARE CONDITIONAL GRANTS?

Conditional grants are **funds allocated from national government to auditees, subject to certain services being delivered or on compliance with specified requirements**.

Municipalities receive two types of allocations from the national revenue fund, namely equitable share and conditional allocations. Equitable share allocations are non-conditional, based on the municipality's share of revenue raised nationally. Conditional allocations are made for a specific purpose, and include:

- allocations to municipalities to supplement the funding of functions funded from municipal budgets
- specific-purpose allocations to municipalities
- allocations-in-kind to municipalities for designated special programmes
- funds not allocated to specific municipalities that may be released to municipalities to fund immediate disaster response.

Conditional grant allocations are approved each year through the Division of Revenue Act. This act indicates the approved allocation per auditee for that particular year, together with a forward estimate for the next two years.

With regard to forward estimates, the following take place before a set deadline for the final allocation to be approved through the Division of Revenue Act:

- Each municipality must agree on the provisional allocations and the projects to be funded from those allocations. This information is sent to the national transferring officer.
- After consolidating the information for each municipality, the national transferring officer submits the final allocation list and the draft grant framework for each allocation to the National Treasury for approval.

Municipalities may only use a conditional allocation for its intended purpose in accordance with the requirements of each grant framework and for projects or programmes included in their business plans.

WHAT IS THE PURPOSE OF THE GRANTS THAT WERE AUDITED?

The Department of Cooperative Governance introduced the **municipal infrastructure grant** in 2004-05 with the core outcome to improve access to basic service infrastructure for poor communities by providing specific capital finance for basic municipal infrastructure backlogs for poor households, micro-enterprises and social institutions servicing poor communities.

In achieving the core outcome, annual targets must be set in respect of the following expected outputs derived from the municipal infrastructure grant framework:

- Number of poor households impacted through the construction, upgrading and/or renewal of infrastructure for water and sanitation services
- Number of poor households impacted through the construction, upgrading and/or renewal of infrastructure for sport and recreation facilities
- Number of kilometres of municipal roads developed and maintained
- Number of poor households impacted through the construction, upgrading and/or renewal of infrastructure for solid waste disposal sites, central refuse collection points, recycling facilities and transfer stations
- Number of poor households impacted through the construction, upgrading and/or renewal of infrastructure for street and community lighting
- Number of poor households impacted through the construction, upgrading and/or renewal of infrastructure for public facilities
- Number of work opportunities created using the guidelines of the expanded public works programme for the above outputs

For this purpose, municipalities must annually submit business plans to the Department of Cooperative Governance. The grant uses the registration requirements of the municipal infrastructure grant management information system to register, track and monitor projects as per the business plans. Such plans should include timelines regarding project designs, initiation of procurement, environmental impact assessments, and relevant permit or licence approvals in the prescribed format.

The **urban settlements development grant** was introduced to assist metropolitan municipalities in improving access to basic services by households through the provision of bulk and reticulation infrastructure as well as urban land production to support broader urban development and integration, while the **public transport network**

grant aims to provide accelerated construction and improvement of non-motorised transport infrastructure.

The **regional bulk infrastructure grant** aims to develop new – as well as refurbish, upgrade and replace ageing – water and wastewater infrastructure of regional significance, which connects water resources to infrastructure serving extensive areas across municipal boundaries or large regional bulk infrastructure serving numerous communities over large areas within the municipality. The grant also aims to pilot regional – or facilitate and contribute to the implementation of local – water conservation and water demand management projects that will have a direct impact on bulk infrastructure requirements.

The **water services infrastructure grant** was introduced to facilitate the planning and implementation of various water and sanitation projects to accelerate backlog reduction and improve the sustainability of services, especially in rural municipalities. The grant also aims to:

- provide interim, intermediate water and sanitation supply that ensures the provision of services to identified and prioritised communities, including through spring protection, drilling, testing and equipping of boreholes
- provide onsite sanitation solutions
- support the existing bucket eradication programme intervention in formal residential areas
- support drought-relief projects in affected municipalities.

The aim of the **human settlements development grant** is to make funding available for the creation of sustainable and integrated human settlements that enable improved quality of household life, access to basic services and secure tenure. The **municipal disaster grant** is used to provide for the immediate release of funds for disaster response; for example, droughts or pandemics such as Covid-19.

WHAT IS THE PURPOSE AND NATURE OF THE ANNUAL AUDIT OF THE PERFORMANCE REPORTS?

Auditees are required to measure their actual service delivery against the performance indicators and targets set for each of their predetermined performance objectives as defined in their integrated development plans and/or service delivery and budget implementation plans, and to report on this in their performance reports.

On an annual basis, we audit **selected development priorities** to determine whether the information in the performance reports is useful and reliable enough to enable the council, the public and other users of the reports to assess the performance of the auditee. The objectives we select are those that are important for delivery by the auditee on its mandate. In the audit report, we report findings that are material enough to be brought to the attention of these users.

As part of the annual audits, we audit the **usefulness of the reported performance information** to determine whether it is presented in the annual report in the prescribed manner and is consistent with the auditee's planned objectives as defined in the integrated development plan and/or service delivery and budget implementation plan. We also assess whether the performance indicators set to measure the achievement of the objectives are:

- well defined (the indicator needs to have a clear, unambiguous definition so that data can be collected consistently, and is easy to understand and use)
- verifiable (it must be possible to validate the processes and systems that produce the indicator)
- specific (so that the nature and the required level of performance can be clearly identified)
- time bound (the time period or deadline for delivery must be specific)
- measurable (so that the required performance can be measured)
- consistent (with the objective, measures and/or targets)
- relevant (so that the required performance can be linked to the achievement of a goal).

We further audit the **reliability of the reported information** to determine whether it can be traced back to the source data or documentation and whether it is accurate, complete and valid.

WHEN IS HUMAN RESOURCE MANAGEMENT EFFECTIVE?

Human resource **management refers to the management of an auditee's employees or human resources**. Human resource management is effective if adequate and sufficiently skilled staff members are in place and if their performance and productivity are properly managed.

Our audits include an assessment of human resource management, focusing on the following areas: ■ human resource planning and organisation ■ management of vacancies ■ appointment processes ■ performance management ■ acting positions ■ management of leave and overtime.

Our audits further look at the management of vacancies and stability in key positions, the competencies of key officials, as well as consequences for transgressions, as these matters directly influence the quality of auditees' financial and performance reports and their compliance with legislation.

Based on the results of these audits, we assess the status of auditees' human resource management controls.

WHEN ARE INTERNAL CONTROLS EFFECTIVE AND EFFICIENT?

A key responsibility of municipal managers, chief executive officers, senior managers and municipal officials is to **implement and maintain effective and efficient systems of internal control**.

We assess the internal controls to determine the effectiveness of their design and implementation in ensuring reliable financial and performance reporting and compliance with legislation. Internal controls consist of all the policies and procedures implemented by management to assist in achieving the orderly and efficient conduct of business, including adhering to policies, safeguarding assets, preventing and detecting fraud and error, ensuring the accuracy and completeness of accounting records, and timeously preparing reliable financial and service delivery information. To make it easier to implement corrective action, we categorise the principles of the different components of internal control under leadership, financial and performance management, or governance. We call these the **drivers of internal control**.

The key **basic controls** that auditees should focus on are outlined below.

Providing effective leadership

In order to improve and sustain audit outcomes, auditees require **effective leadership** that is based on a culture of honesty, ethical business practices and good governance to protect and enhance the interests of the auditee.

Audit action plans to address internal control deficiencies

Developing and monitoring the implementation of action plans to address identified internal control deficiencies are key elements of internal control, which are the responsibility of municipal managers, chief executive officers, and their senior management team.

The Medium Term Strategic Framework defines the implementation of audit action plans and the quarterly monitoring thereof by a coordinating structure in the province as key measures to support financial management and governance at municipalities. It is also echoed in the Department of Cooperative Governance's back-to-basics strategy, which tasks local government with addressing post-audit action plans and the National Treasury, provincial treasuries and departments of cooperative governance with assessing the capacity of municipalities to develop and implement such plans.

Proper record keeping and document control

Proper and timely record keeping ensures that **complete, relevant and accurate information** is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. A lack of documentation affects all areas of the audit outcomes.

Some of the matters requiring attention include the following:

- Establishing proper record keeping so that records supporting financial and performance information as well as compliance with key legislation can be made available when required for audit purposes.
- Implementing policies, procedures and monitoring mechanisms to manage records, and making staff members aware of their responsibilities in this regard.

Implementing controls over daily and monthly processing and reconciling of transactions

Controls should be in place to ensure that **transactions are processed accurately, completely and timeously**, which in turn will reduce errors and omissions in financial and performance reports.

Some of the matters requiring attention include the following:

- Daily capturing of financial transactions, supervisory reviews of captured information, and independent monthly reconciliations of key accounts.
- Collecting performance information at intervals appropriate for monitoring, setting service delivery targets and milestones, and validating recorded information.
- Confirming that legislative requirements and policies have been complied with before initiating transactions.

Reviewing and monitoring compliance with legislation

Auditees need to have mechanisms that can **identify applicable legislation as well as changes to legislation**, assess the requirements of legislation, and implement processes to ensure and monitor compliance with legislation.

WHAT IS INFORMATION TECHNOLOGY AND WHAT ARE INFORMATION TECHNOLOGY CONTROLS?

Information technology (commonly known as IT) refers to the computer systems used for recording, processing and reporting financial and non-financial transactions. IT controls ensure the confidentiality, integrity and availability of state information, enable service delivery, and promote national security. Good IT governance, effective IT management and a secure IT infrastructure are therefore essential.

Non-complex and complex information technology environments

As per our audit methodology, we differentiate between **non-complex** and **complex** IT environments, as follows:

Non-complex environment – level 1 (low risk)

This is the lower end of the spectrum for IT sophistication and relevance. The auditee uses one server associated with financial reporting and/or performance information, a limited number of workstations, no remote locations, commercial off-the-shelf applications and infrastructure, vendors to perform updates and maintenance on the system, little emerging or advanced technology, and a few or no online and e-commerce transactions.

Key controls over financial reporting and/or performance information are not overly reliant on IT, are embedded in the commercial off-the-shelf applications, or are limited to very few manual processes and controls. Many small to medium-sized auditees fall into this category.

Complex environment – levels 2 and 3 (medium and high risk)

This is the middle to high end of the spectrum. These auditees have the following characteristics:

- Use more than one server associated with financial reporting and/or performance information.
- Have remote locations.
- Employ one or more network operating system or non-standard ones.
- Have more workstations in total.
- Use some customisation of application software or have a relatively complex configuration of commercial off-the-shelf applications.
- Use enterprise resource planning systems and/or write their own custom software.
- Perform updates and maintenance on the system centrally onsite or through vendors, or perform centralised updates and maintenance on the system and distribute these to decentralised sites or through onsite vendors.
- Employ a few to moderate or a large number of emerging or advanced technologies.
- Enter into either a few or a large number of online and e-commerce transactions.
- Rely heavily on IT key controls over financial and/or performance information.

An auditee running transversal systems would also fall into this category. Information systems for which certain IT processes are managed centrally, but which are used by various auditees who have limited responsibility regarding the design and enhancement of the system, will also be classified as high risk at a national level.

Which information technology controls do we audit?

During our audits, we assess the IT controls that focus on IT governance, security management, user access management and IT service continuity – as discussed further down. To evaluate the status of the IT controls in the areas we audit, we group them into the following three categories, with reference to the control measures that should be in place:

1. **Where IT controls are being designed**, management should ensure that the controls would reduce risks and threats to IT systems.
2. **Where IT controls are being implemented**, management should ensure that the designed controls are implemented and embedded in IT processes and systems. Particular attention should be paid to ensuring that staff members are aware of and understand the IT controls being implemented, as well as their roles and responsibilities in this regard.
3. **Where IT controls have been embedded and are functioning effectively**, management should ensure that the IT controls that have been designed and implemented are functioning effectively at all times. Management should

sustain these IT controls through disciplined and consistent daily, monthly and quarterly IT operational practices.

Information technology governance

This refers to the leadership, organisational structures and processes which ensure that the auditee's IT resources will sustain its business strategies and objectives. Effective IT governance is essential for the overall well-being of an auditee's IT function and ensures that the auditee's IT control environment functions well and enables service delivery.

Security management

This refers to the controls preventing unauthorised access to the computer networks, computer operating systems and application systems that generate and prepare financial and performance information.

User access management

These are measures designed by business management to prevent and detect the risk of unauthorised access to, and the creation or amendment of, financial and performance information stored in the application systems.

Information technology service continuity

These controls enable auditees to recover within a reasonable time the critical business operations and application systems that would be affected by disasters or major system disruptions.

WHAT ARE ROOT CAUSES?

Root causes are the **underlying causes or drivers of audit findings**; in other words, the reason why the problem occurred. Addressing the root cause helps to ensure that the actions address the real issue, thus preventing or reducing incidents of recurrence, rather than simply providing a one-time or short-term solution.

Our audits include an **assessment of the root causes of audit findings**, based on the identification of internal controls that have failed to prevent or detect the error in the financial statements and performance reports or that have led to non-compliance with legislation. These root causes are confirmed with management and shared in the management report with the municipal managers or chief executive officers and the mayors. We also include the root causes of material findings reported as internal control deficiencies in the audit report.

WHO PROVIDES ASSURANCE?

Mayors and their municipal managers use the **annual report** to report on the financial position of auditees, their performance against predetermined objectives, and overall governance; while one of the important **oversight functions of councils is to consider auditees' annual reports**. To perform their oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report also includes our audit report, which provides assurance on the credibility of the financial statements, the performance report and the auditee's compliance with legislation.

Our reporting and the oversight processes reflect on history, as they take place after the financial year. Many other role players contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.

The mandates of these role players differ from ours, and we have categorised them as follows:

- Those directly involved in the management of the auditee (management or leadership assurance).
- Those that perform an oversight or governance function, either as an internal governance function or as an external monitoring function (internal independent assurance and oversight).
- The independent assurance providers that give an objective assessment of the auditee's reporting (external independent assurance and oversight).

We **assess the level of assurance** provided by the role players based on the **status of auditees' internal controls and the impact of the different role players on these controls**. In the current environment, which is characterised by inadequate internal controls, corrected and uncorrected material misstatements in financial and performance information, and widespread non-compliance with legislation, all role players need to provide an extensive level of assurance.

WHAT IS THE ROLE OF EACH KEY ROLE PLAYER IN PROVIDING ASSURANCE?

Senior management

Senior management, which includes the chief financial officer, chief information officer and head of the supply chain management unit, provides assurance by implementing the following basic financial and performance controls:

- Ensure proper record keeping so that complete, relevant and accurate information is accessible and available to support financial and performance reporting.
- Implement controls over daily and monthly processing and reconciling of transactions.
- Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.
- Review and monitor compliance with applicable legislation.
- Design and implement formal controls over information technology systems.

Municipal managers and municipal entities' chief executive officers

While we recognise that municipal managers and the chief executive officers of municipal entities depend on senior management for designing and implementing the required financial and performance management controls, they are responsible for creating an environment that helps to improve such controls in the following ways:

- Provide effective and ethical leadership and exercise oversight of financial and performance reporting and compliance with legislation.
- Implement effective human resource management to ensure that adequate and sufficiently skilled staff members are employed and their performance is monitored, and that there are proper consequences for poor performance.
- Establish policies and procedures to enable sustainable internal control practices and monitor the implementation of action plans to address internal control deficiencies and audit findings.
- Establish an information technology governance framework that supports and enables the achievement of objectives, delivers value and improves performance.
- Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.
- Ensure that an adequately resourced and functioning internal audit unit is in place and that internal audit reports are responded to.
- Support the audit committee and ensure that its reports are responded to.

The Municipal Finance Management Act also defines the role of the municipal manager as follows:

Role of the municipal manager		
Robust financial and performance management systems	**Oversight and accountability**	**Commitment and ethical behaviour**
Full and proper records of financial affairs Effective, efficient and transparent systems for **financial and risk management and internal control** System of **internal audit** Develop and implement **policies** – tariffs, rates, credit control, debt collection and supply chain management Appropriate **management, accounting and information systems** – assets, liabilities, revenue and expenditure	Effective, efficient, economical and transparent **use of resources** Prevention of **unauthorised, irregular and fruitless and wasteful expenditure** as well as other losses	Act with **fidelity, honesty, integrity** and in the **best interest** of the municipality Manage and safeguard **assets and liabilities** Take appropriate **disciplinary steps** against any official who commits an act of financial misconduct or an offence **Disclose** all material facts to the council or mayor

The **role of the municipal manager** is critical to ensure:

timely, credible information + **accountability** + **transparency** + **service delivery**

Mayors

Mayors have a monitoring and oversight role at both municipalities and municipal entities. They have specific oversight responsibilities in terms of the Municipal Finance Management Act and the Municipal Systems Act, which include reviewing the integrated development plan and budget management and ensuring that auditees address the issues raised in audit reports.

Mayors can bring about improvement in the audit outcomes of auditees by being actively involved in key governance matters and managing the performance of municipal managers.

Internal audit units

The internal audit units assist municipal managers and chief executive officers of municipal entities in the execution of their duties by providing independent assurance on internal controls, financial information, risk management, performance management and compliance with legislation. The establishment of internal audit units is a requirement of legislation.

Audit committees

An audit committee is an independent body, created in terms of legislation, which advises the municipal manager or chief executive officer, senior management and the council on matters such as internal controls, risk management, performance management and compliance with legislation. The committee is further required to provide assurance on the adequacy, reliability and accuracy of financial and performance information.

Coordinating or monitoring departments

Our country's constitution stipulates that national and provincial government must support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and to perform their duties. The Municipal Finance Management Act further requires national and provincial government to assist municipalities in building capacity to support efficient, effective and transparent financial management. Both the Municipal Finance Management Act and the Municipal Systems Act define responsibilities to monitor financial and performance management.

Municipal councils

The council is the executive and legislative authority of the municipality. In order for the council to perform its oversight and monitoring role, the municipal manager and senior managers must provide the council with regular reports on the financial and service delivery performance of the municipality. The Municipal Finance Management Act and the Municipal Systems Act also require the council to approve or oversee certain transactions and events, and to investigate and act on poor performance and transgressions, such as financial misconduct and unauthorised, irregular as well as fruitless and wasteful expenditure.

Municipal public accounts committees

The municipal public accounts committee was introduced as a committee of the council to deal specifically with the municipality's annual report, financial statements and audit outcomes as well as to improve governance, transparency and accountability. The committee is an important provider of assurance, as it needs to give assurance to the council on the credibility and reliability of financial and performance reports, compliance with legislation as well as internal controls.

The primary functions of the committee can be summarised as follows:

- Consider and evaluate the content of the annual report and make recommendations to the council when adopting an oversight report on the annual report.
- Review information relating to past recommendations in the annual report; this relates to current in-year reports, including the quarterly, mid-year and annual reports.
- Examine the financial statements and audit reports of the municipality and municipal entities and consider improvements, also taking into account previous statements and reports.
- Evaluate the extent to which our recommendations and those of the audit committee have been implemented.
- Promote good governance, transparency and accountability in the use of municipal resources.

Portfolio committees on local government

In terms of our country's constitution, the National Assembly and provincial legislatures must maintain oversight of the executive authority responsible for local government. This executive authority includes the minister and members of the executive council responsible for cooperative governance and other executives involved in local government, such as the minister and members of the executive council responsible for finance. The mechanism used to conduct oversight is the portfolio committee on local government.

5.2 GLOSSARY OF KEY TERMINOLOGY USED IN THIS REPORT

Asset	Any item belonging to the auditee, including property, infrastructure, equipment, cash, and debt due to the auditee.
Capital expenditure	Expenditure incurred by auditees on capital items in a particular financial period; for example, fixed assets such as property, infrastructure and equipment with long expected lives and that are required to provide services, produce income or support operations.
Cash flow	The flow of money from operations: incoming funds are revenue (cash inflow) and outgoing funds are expenses (cash outflow).
Cash-backed (grant management)	When unspent grants are supported by available cash.
Commitments from role players	Initiatives and courses of action communicated to us by role players in local government aimed at improving the audit outcomes.
Conditional grants	Funds allocated from national government to auditees, subject to certain services being delivered or on compliance with specified requirements.
Creditors	Persons, companies or organisations to whom the auditee owes money for goods and services procured from them.
Current assets	These assets are made up of cash and other assets, such as inventory or debt for credit extended, which will be traded, used or converted into cash within 12 months. All other assets are classified as non-current, and typically include property, plant and equipment as well as long-term investments.
Current liability	Money owed by the auditee to companies, organisations or persons who have supplied goods and services to the auditee.
Cybersecurity (information technology)	The protection of information assets by addressing threats to information processed, stored and transported by internet-worked information systems.
Debt impairment	A loss in the future economic benefits or service potential of a debt, over and above the recognition of the loss of the asset's future economic benefits or service potential through amortisation (by reducing or paying off a debt with regular payments).
Deficit	An excess of expenditure or liabilities over income or assets in a given period.
Equitable share	A financial allocation in the form of an unconditional grant that enables municipalities to provide basic services to poor households, and to enable municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions.
Financial and performance management (as one of the drivers of internal control)	The performance of tasks relating to internal control and monitoring by management and other employees to achieve the financial management, reporting and service delivery objectives of the auditee. These controls include the basic daily and monthly controls for processing and reconciling transactions, the preparation of regular and credible financial and performance reports as well as the review and monitoring of compliance with key legislation.
Governance (as one of the drivers of internal control)	The governance structures (audit committees) and processes (internal audit and risk management) of an auditee.

Hacked (information technology)	When unauthorised access to a computer system has been gained.
Implementing agent	Government institutions (e.g. the Independent Development Trust), non-governmental organisations or private sector entities appointed by the auditee to manage, implement and deliver on projects.
Information technology infrastructure (information technology)	The hardware, software, computer-related communications, documentation and skills that are required to support the provision of information technology services, together with the environmental infrastructure on which it is built.
Leadership (as one of the drivers of internal control)	The administrative leaders of an auditee, such as municipal managers and senior management. It can also refer to the political leadership (including the mayor and the council) or the leadership in the province (such as the premier).
Material finding (from the audit)	An audit finding on the quality of the performance report or compliance with key legislation that is significant enough in terms of either its amount or its nature, or both these aspects, to be reported in the audit report.
Material irregularity	Any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty identified during an audit performed under the Public Audit Act that resulted in – or is likely to result in – a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.
Material Irregularity Regulations	The regulations stem from the provisions of section 52(1A) of the Public Audit Act. The regulations enable us to implement the material irregularity provision in the Public Audit Act by, among others, regulating the decision-making on material irregularities and the time frames applicable to the material irregularity process.
Material misstatement (in financial statements or performance reports)	An error or omission that is significant enough to influence the opinions or decisions of users of the reported information. Materiality is considered in terms of either its rand value or the nature and cause of the misstatement, or both these aspects
Medium Term Strategic Framework	Government's strategic plan for the 2014-19 electoral term. It reflects the commitments made in the election manifesto of the governing party, including the commitment to implement the National Development Plan. Its aim is to ensure policy coherence, alignment and coordination across government plans as well as alignment with budgeting processes.
Misstatement (in financial statements or performance reports)	Incorrect or omitted information in the financial statements or performance report.
Non-cash item	An entry in the financial statements correlating to expenses that are essentially just accounting entries rather than actual movements of cash. Depreciation and amortisation are the two most common examples of non-cash items.
Operational expenditure	Expenditure incurred by auditees associated with their operations, such as service delivery costs, administration and salaries.
Payables	Amounts owed for the purchase of goods or services at a specific date.
Property, infrastructure and equipment	Assets that physically exist and are expected to be used for more than one year, including land, buildings, leasehold improvements, equipment, furniture, fixtures and vehicles.

Public Audit Act
(Act No. 25 of 2004)

This is the Auditor-General of South Africa's enabling legislation. The objective of the act is to give effect to the provisions of our country's constitution by establishing and assigning functions to an auditor-general and by providing for the auditing of institutions in the public sector. The Public Audit Act was amended [Public Audit Amendment Act (Act No. 5 of 2018)] to provide us with more power to ensure accountability in the public sector. The intent of the amendments is not to take over the functions of the municipal manager, the mayor or the council, as their accountability responsibilities are clear in municipal legislation. It is rather to step in where those responsibilities are not fulfilled in spite of us alerting leadership to material irregularities that need to be investigated and addressed.

Ransomware
(information technology)

A type of malicious software designed to block access to a computer system until a ransom demand is satisfied.

Reconciliation
(of accounting records)

The process of matching one set of data to another; for example, the bank statement to the cheque register, or the accounts payable journal to the general ledger.

Receivables or debtors

Money owed to the auditee by companies, organisations or persons who have procured goods and services from the auditee.

Reporting on outstanding amounts owing on utilities
(bulk water and electricity)

The total amount owing at year-end represents the full amount outstanding (including amounts owed for the 0 – 30 day period). When reporting on amounts in arrears, the amount excludes the 0 – 30 day portion.

Status of records review

A process whereby the auditor performs basic review procedures to identify risks and areas of concern for discussion with the accounting officer. The purpose of the status of records review is to:

- ensure that there is a system of early warning to the accounting officer on challenges that may compromise good financial and performance management and compliance with legislation
- demonstrate to the accounting officer a deepened level of understanding of the business of the auditee and the value added by the auditor
- contribute to capacitating the accounting officer and senior management in instilling good practices of regular reporting, review and oversight
- identify risks early and throughout the audit cycle to respond to these timeously and correctly.

Spoofing
(information technology)

Faking a sending address of a transmission in order to gain illegal entry into a secure system.

System development
(information technology)

The development of an integrated set of computer programs designed to serve a particular function that has specific input, processing and output activities.

Vulnerable financial position
(going concern)

The presumption that an auditee will continue to operate in the near future, and will not go out of business and liquidate its assets. For the going concern presumption to be reasonable, the auditee must have the capacity and prospect to raise enough financial resources to stay operational.

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