

// SECTION 1



Executive summary

Accountability and the need for appropriate consequences for accountability failures featured as prominent elements of our messages in 2015-16. Through the previous general report and the many engagements we had with the newly elected mayors and councillors, **we highlighted the shortcomings** we identified through our audits and we provided many recommendations to improve accountability. We called on leadership to prioritise accountability and **highlighted the fact that there might be regressions in audit outcomes** following changes in the political leadership – which we also witnessed in 2011-12. Some of the media headlines following that regression are reflected just after this section.

The key message that we can take from the 2016-17 audits is that **accountability continues to fail in local government.**

There are three main indicators of these accountability failures:

1. Audit outcomes regressed and irregular expenditure increased

- **Overall, the audit outcomes regressed.** The audit outcomes of 45 municipalities regressed while those of 16 improved. Only 33 municipalities (13%) managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit.
- Credible **financial statements and performance reports** are crucial to enable accountability and transparency, but municipalities are failing in these areas. Not only did the unqualified opinions on the financial statements decrease from 68% to only 61%, but the financial statements provided to us for auditing were even worse than in the previous year. Only 22% of the municipalities could give us financial statements without material misstatements. In addition, the performance reports of 62% of the municipalities that produced reports had material flaws and were not credible enough for the council or the public to use.
- Municipalities were in various stages of readiness for the implementation of the **Municipal Standard Chart of Accounts** by 1 July 2017. This is a significantly revised classification framework and required changes to the accounting processes and information systems. We identified various challenges with implementation, which need to be addressed to ensure that these do not affect the ability of municipalities to produce reliable financial statements in 2017-18.
- We reported **material non-compliance** with key legislation at 86% of the municipalities. This is the highest percentage of non-compliance since 2012-13. Municipalities with material compliance findings on supply chain management increased from 63% to 73%.
- **Irregular expenditure increased** from R16,212 billion to R28,376 billion (a 75% increase). It is important to note, however, that municipalities made a significant effort in 2016-17 to identify and transparently report on irregular expenditure incurred in previous years – this accounts for R15,026 billion of the total. The remaining R13,350 billion relates to payments or expenses in 2016-17 by the new local government administration, which represented 4% of the local government expenditure budget. It includes payments

made on contracts irregularly awarded in a previous year – if the non-compliance was not investigated and condoned, the payments on these multi-year contracts continue to be viewed and disclosed as irregular expenditure. By analysing the top 26 contributors to irregular expenditure, we estimated that 16% (±R4,5 billion) represented non-compliance by the new administration.

2. There has been little improvement in the accountability (plan+do+check+act) cycle

- The **recommendations** we made last year to improve audit outcomes and accountability **did not receive the necessary attention.** This is evidenced by the findings from our audits that included attention not being paid to audit action plans, poor performance planning and budgeting (resulting in unauthorised expenditure of R12,6 billion), and regressions of varying degree in the status of internal control and the assurance provided by the different role players in local government.
- Of most concern is that our consistent and insistent calls to increase consequences have not been heeded – we reported material non-compliance with legislation on the implementation of consequences at 55% of the municipalities. This **lack of consequences** is also evident in municipalities again not paying sufficient attention to the findings on supply chain management and the indicators of possible fraud or improper conduct that we reported and recommended for investigation. In 2015-16, we reported such findings at 148 municipalities, but 47% of them investigated none of the findings and 24% only some of the findings. In 2016-17, we reported these types of findings at 61% of the municipalities, of which 71% also had such findings in 2015-16.
- At 61% of the municipalities, the council failed to conduct the **required investigation** into all instances of unauthorised, irregular and fruitless and wasteful expenditure reported in the previous year – a regression from 52% in the previous year. Sufficient steps were also not taken to recover, write off, approve or condone unauthorised, irregular and fruitless and wasteful expenditure as required by legislation. As a result, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R65,32 billion, while that of unauthorised expenditure was R43,5 billion and that of fruitless and wasteful expenditure was R4,24 billion.

3. Increasingly difficult environment for auditing

- **The audit environment became more hostile** with increased contestation of audit findings and pushbacks whereby our audit processes and the motives of our audit teams were questioned. At some auditees, pressure was placed on audit teams to change conclusions purely to avoid negative audit outcomes or the disclosure of irregular expenditure – without sufficient grounds. Some auditees used delaying tactics whereby information and evidence were not provided as requested. Leadership should set the tone for accountability – if audit outcomes are not as desired, energy should be directed to addressing the problem and not to coercing the auditors to change their conclusions.

The accountability failures in local government result in municipalities not achieving their objectives, which in turn has a negative impact on the lives of citizens. Our audits highlighted **two key areas of impact**: the financial health of municipalities and the delivery and maintenance of municipal infrastructure. The following are examples of how accountability failures negatively affect the lives of citizens:

- The **inability to collect debt** from municipal consumers was widespread. In these circumstances, it is inevitable that municipalities will **struggle to balance the books**. In total, 31% of the municipalities disclosed a deficit – the total deficit for these municipalities amounted to R5,6 billion. The financial woes of local government also weighed heavily on municipal creditors. The impact of this **inability to pay creditors** was most evident in the huge sums owed for the provision of electricity and water to Eskom and the water boards, respectively. A combination of various factors, including poor revenue and budget management and the non-payment of creditors, led to 31% of the municipalities disclosing in their financial statements that they **might not be able to continue operating**. Although they have to continue to do so, they were reporting that they were in a particularly vulnerable financial position at the end of the financial year.
- 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. **Fruitless and wasteful expenditure** amounted to R1,5 billion (a 71% increase from the previous year). It is difficult to say how much money is lost through irregular processes, as this needs to be determined through an investigation, but the non-compliance we reported at 78% of the municipalities can potentially lead to a financial loss.
- Our audits again identified a number of shortcomings in **the development and maintenance of infrastructure**. These included the underspending of grants, delays in project completion, poor quality workmanship, and inadequate monitoring of contractors. These are symptoms of the larger problem that local government has with managing finances, performance and projects and with taking accountability for outcomes. Although funding and support are generally available from national government for the development and maintenance of municipal infrastructure, the non-delivery thereof at some municipalities and the impact on communities are the issues that need the most focused attention by all role players to ensure that the objective of a better life for all is achieved.

There were **varied reasons for the accountability failures**:

- **Vacancies and instability in key positions** slowed down systematic and disciplined improvements.
- **Inadequate skills led to a lack of oversight** by councils (including the mayor) and insufficient implementation and maintenance of financial and performance management systems by the administration.
- **Political infighting** at council level and interference in the administration weakened oversight and the implementation of consequences for transgressions, and made local government less attractive for professionals to join.
- Leadership's inaction, or inconsistent action, created a culture of **'no consequences'**, often due to inadequate performance systems and processes.

- At some municipalities there was a **blatant disregard** for controls (including good record keeping) and compliance with key legislation, as it enabled an environment in which it would be easy to commit fraud.
- Leadership did not take our **repeated recommendations and warnings** of risks for which they needed to prepare seriously.
- Municipalities focused on obtaining **unqualified financial statements** at a great cost by using consultants and auditors, which was to the detriment of credible performance reporting and compliance with key legislation.
- Provincial and national role players **did not sufficiently support** municipalities.

We have seen again and again that many of these problems can be turned around through strong, ethical and courageous leadership in the administration and council, with the support of provincial government. The audit outcomes and levels of accountability varied among the municipalities in the different provinces.

The trend of improvements in the past few years in the **Eastern Cape** did not continue. Six municipalities in the province improved their outcomes but seven regressed. We warned these municipalities to keep the administration as stable as possible, fill vacant positions, and not underestimate the complexities of the mergers of municipalities. Of greatest concern in this province were the accountability failures in the areas of supply chain management and infrastructure development. Infrastructure projects were not delivered as a result of poor planning and project management. Irregular expenditure of R13,558 billion (48% of the total irregular expenditure) was incurred by municipalities in the Eastern Cape. This represented 35% of their provincial local government expenditure budget.

The continued lack of accountability and leadership failures in the **Free State** were the main causes of governance failures, which led to a significant regression in audit outcomes from the prior year. Seven municipalities regressed while no auditees were able to improve. The deterioration in municipalities' financial health was due to leadership not considering the budget when committing to strategic projects, not always paying the best price for goods and services, and wastage caused by poor planning. Without improved fiscal disciplines for the more effective, efficient and economical use of resources, municipalities' financial health and service delivery will continue to deteriorate.

The results in **Gauteng** held steady with all municipalities maintaining their outcomes from the previous year. This was the only province that had 100% unqualified audit opinions. We continue to highlight that non-compliance with legislation remains the major obstacle preventing most municipalities in the province from attaining a clean audit.

KwaZulu-Natal continued on its downward path that started in 2015-16, with 13 municipalities regressing. We cautioned that at these municipalities, complacency and a lack of follow-through on the previous administration's commitments had an effect. Leadership did not decisively deal with the weaknesses we reported and warned them about. If these lapses in accountability are not dealt with, the regressions will continue.



Limpopo had five municipalities that regressed during the year under review. The province is characterised by complacency with unqualified financial statements being seen as good enough, underperformance as no action is taken to improve, and poor performers with high levels of transgressions and no consequences. This took place notwithstanding the premier's commitment in the previous year to implement stricter consequences. Accountability failures are also evident in inadequate infrastructure development and financial management, which have an impact on the delivery of services.

Mpumalanga saw an improvement in the overall 2016-17 audit outcomes – a continuation of the trend of slow but steady improvements over the past few years. While this is commendable, a lot of work is still needed to ensure that the improvements are sustainable, to curb irregular expenditure (which amounted to 10% of the provincial local government expenditure budget), and to address delays in infrastructure and basic service delivery.

In the **Northern Cape**, the overall outcomes remained the same (two municipalities improved and two regressed). The stagnation confirms that our previous year's message of mayors, municipal managers and senior management needing to hold each other and their subordinates accountable, was blatantly disregarded, resulting in many instances where similar findings were raised during the audit process.

North West stood out when it came to irregular expenditure – contributing 15% of the total irregular expenditure in 2016-17, which represented 22% of their provincial local government expenditure budget. We are also particularly concerned about infrastructure delivery and maintenance as well as the use of grants in North West. The lack of accountability for sound financial management by the leadership had a negative impact on municipalities' financial viability. At eight (35%), the financial information was not reliable enough to analyse financial viability (as they had disclaimed opinions), while a further 20% were in a vulnerable financial position. Given the already vulnerable position of local government, we are very concerned about the overspending of budgets by 16 municipalities, resulting in unauthorised expenditure of R1,19 billion. The financial viability of municipalities needs to be addressed urgently, as it has a direct impact on their ability to continue rendering services.

At 70%, the **Western Cape** still had the largest concentration of municipalities with clean audits, but the audit results of six municipalities, including the City of Cape Town, regressed in the year under review. The changes after the local government elections caused some instability at council level and in key senior positions, but the regressions can mostly be attributed to our messages on risks and recommendations not receiving the attention these warranted.

Overall, the **audit outcomes of the eight metros** regressed with Buffalo City improving but Mangaung and the City of Cape Town regressing. Although six of the metros produced unqualified financial statements, only 50% had credible performance reports and all of them had material compliance findings. The irregular expenditure increased significantly at the metros, but it was mostly as a result of uncovering and disclosing irregular expenditure from previous years. The financial health of half of the metros was stable, but we raised concerns about the City of Johannesburg, City of Tshwane and Nelson Mandela Bay, with Mangaung being in a particularly vulnerable financial position.

As the Auditor-General of South Africa, we have **an important role to play in the accountability chain** and we go beyond the basic auditing and reporting role of the auditor. Through our management, audit and general reports, we have been reporting the weaknesses in internal control and the risks that need attention in local government. In our reports, we provide the root causes of audit findings and recommendations to address the root causes. We ensure that our messages are heard through engagements with senior officials, municipal managers, mayors, municipal public accounts committees, and councils. We will continue with adding value through these practices, but they have not had the desired impact yet – as evidenced in the poor audit outcomes.

Hence, we are increasing our efforts through extending our engagements with municipal managers to a **status of records review**. 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. This provides an early warning system whereby municipal managers can be alerted to matters that can potentially lead to undesirable audit outcomes. All of these measures are aimed at assisting the municipal leadership and the council to prevent accountability failures, or to provide them with information on how to deal with such failures where they have occurred.

The accountability mechanisms in local government are not working as they should and there have been continued calls for more to be done – particularly by my office. Through the support of our parliamentary oversight committee, we are thus busy **amending the Public Audit Act** 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 dealt with. The amendments, if approved, will provide us with the **power to refer** material irregularities to appropriate authorities to investigate as well as the **power to recover** money lost as a result of such irregularities.

If we had those powers today already, there would have been a number of cases in local government that would have been referred based on **material irregularities that we had reported to municipal management and the council to deal with, without any success**. The extension of our mandate to deal with these types of irregularities will assist in restoring public confidence, solidifying accountability, and entrenching the ethical behaviour that is expected of entrusted officials and elected representatives. It will also mean that our reports will be taken seriously and we could start to see an improvement in the audit outcomes.

My office remains committed to working tirelessly within our 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.



‘Wasteful expenditure doubles to R10-billion’

14 August 2013 – Sowetan –

‘Councillors must be “accountable”’

14 August 2013 – New Age –

‘Public officials in dire straits’

14 August 2013 – The Times –

‘Lack of accountability distressing’

19 August 2013 – Herald –



‘SLOW MARCH TO CLEAN AUDITS’

14 August 2013 – Cape Argus –

‘MUNICIPAL MESS!’

14 August 2013 – Daily Sun –



‘Lack of political will, root cause of problems’

14 August 2013 – Cape Times –

‘Municipalities squander millions of rands’

23 August 2013 – Letaba Herald –



‘CT stumbles on officials doing business with city, says AG’

14 August 2013 – Cape Times –



Municipalities must be able to do better than this

19 AUGUST 2013 - MARK BARNES

THE most depressing comment I heard in relation to the recently concluded auditor-general's report on our municipalities (or, perhaps, the one that made me most angry) was: "Well, what did you expect?"

I expect better.

We can do better.

Running a municipality properly is not rocket science. It requires no artistic flair or innovative genius – you've just got to do it right.

Running a municipality is a fairly simple business, compared to most businesses in the private sector.

You know who your clients are. Not just their cellphone numbers or e-mail addresses, you know where they live – because they live within your jurisdiction.

What's more, if even one of them leaves, another inevitably moves in. You don't even have to Fica them (capture their details for the Financial Intelligence Centre Act) – you are the provider of their Fica information; they need you more than you need them.

How do you deal with competitors? Hang on, you have no competitors – there's only one city council, only one municipality per municipality. No need for the Competition Commission here.

You don't even have to advertise your products and services, no need for loyalty programmes or summer sales. Your clients are here to stay. Actually, your clients stay here.

What about pricing policy? Anything you like, really. You're a government legislated monopoly. You can charge what you like, and if they don't pay, regardless of the quality of your delivery, you cut off their vital services until they do. Simple.

What if you need to raise funding? Well, you don't really. You just have to balance your books. Expenses must not exceed income. That's easy, because you control both.

In fact, if you run this kind of business well, because of the predictable nature of its cash flows, capital can be raised at very competitive rates to build things that

improve your municipality and attract even more ratepayers to live there. The virtuous circle of competence. Around the world there is a well-developed asset class of muni-bonds that find their place in most income-focused portfolios. Not here, though. And the reasons behind that become abundantly clear when we examine the findings of the Consolidated General Report on the Audit Outcomes of Local Government.

The report covers 317 municipalities, auditees as they are referred to (I like that word, we're all auditees at some point). The number of auditees exceeds the number of municipalities by 21, those that didn't bother even to submit a report. I love it. "Sorry, we're not going to do a report this year, okay? I thought maybe next year?" How do you get away with that? Surely if you break the law you go to jail? Of course not. Who's going to lock themselves up in their own jail? Silly.

“ If you run this kind of business well, because of the predictable nature of its cash flows, capital can be raised at competitive rates to build things that improve your municipality

Throughout the report it becomes clear that the leadership weren't able to persuade those under their authority to do the right thing – most often because the leadership themselves don't know what to do, and don't have the required competence and skills. Not great.

In the private sector there is a remedy for nonperformance or breaking the rules. You get fired. It seems to work.

The real worry is that things seem to be getting worse, "regressing". It has almost become endemic in our society that procurement processes and contract management



MONDAY COMMENT

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are fraught with opportunity for fraud and favouritism. Our municipalities have the dubious distinction that 84% of them show a flagrant disregard for governance and transparency in awarding lucrative contracts (that means that only 16%, one in six, don't). Contracts to the value of "at least" R118m were awarded to employees or councillors.

That's astounding. In the real world that would be directors and staff getting company deals. Such activities have caused the downfall of significant players in the private sector. It is not okay.

Our framework for good behaviour in the private sector is well and visibly governed by many overlapping pieces of legislation and oversight, particularly when you're using other people's money. An obvious example is the rules that govern whether or not you may list your company on the JSE to enable participation in the capital markets. If you don't comply, you get suspended. There are no exceptions.

Of those audit reports that were in on time, about a quarter had not passed the "going concern" test. How does a municipality go bust? In our world, no going concern, never mind no listing, means no bank facilities, no supplier credit, no second chance, no next year, no nothing. "Technical knowledge of financial management and reporting, performance management and legislation



is not a prerequisite for elected office bearers". I understand that, this is no different in any democratic election process. However, successful leaders recognise their skills gaps and fill them. Those who try to cover them up or appoint even less qualified people always get found out, always fail.

Here's the best part. Instead of training people or setting about finding qualified people to do the job (or at least make progress towards doing the job), what did our municipalities do? You guessed it – they hired consultants. Those who can't do, consult, we all know that. I'm sure consultants can be useful, but they have to be a catalyst, not a substitute. Often, consultants, armed with slick presentations and MBA catch-phrases present generic solutions to the described problem. But then they leave, with nobody qualified to implement the proposed solution, never mind whether it's right or wrong. Perhaps it could have worked for our municipalities, but it didn't. More than two-thirds of our municipalities spent nearly R400m collectively on consultants in the 2011-12 financial year. The auditor-general found that, "Overall, 75% of the auditees that had material misstatements in their submitted financial statements were assisted by consultants." How about that? Why didn't these consultants get fired? Why did they get paid at all?

In a world where the uninspired lead the incompetent on a path of nondelivery it will be no surprise that one of the root problems identified is a lack of accountability, and a tolerance for continued poor performance. If you don't even know what is right, how can you possibly sit in judgment, let alone effect change?

In the result, only 5% of all auditees got clean bills of health. Remarkably, not one of the eight metros did. You would've thought that the metros would at least have the resources and experience base to address the challenges. Stories abound on how past experience has

been set aside (or at least made to feel unwelcome) in favour of new employees with no previous experience. I heard recently that the government employs something like 70% of all new school-leavers. Is that true? If it is, is it a good thing? Is it part of the job-creation strategy or is it a political imperative to retain support from the obviously disappointed youth – many of whom remain unemployed regardless?

In the case of 299 of the 317 auditees, material noncompliance with legislation was reported. Wow.

 Taken together they've blown more than R20bn of our money. That's a whole bunch of dustbins, or repaired potholes, or water piping or electric wiring or painted road signs or toilets

Now for the juicy stuff. There was "unauthorised" expenditure of R9.8bn, "irregular" expenditure of a similar amount (both up 30% on the previous year), and "wasteful" expenditure of R600m.

Taken together, they've blown more than R20bn of our money – now that's real!

That's a whole bunch of dustbins, or repaired potholes, or water piping or electric wiring or painted road signs or inside toilets connected to the sewage system, or whatever. New schools or police stations or hospitals. I could go on and on, it's a lot of cash. This can surely be fixed, no training required. Come on all you mayors out there, zero tolerance for stealing the money?

There are 330 companies listed on the JSE. If their performance was as bad as our municipalities have been found out to be, then only 17 wouldn't be suspended, only 148 would be given a second chance to get their act together. The rest

would simply get delisted.

That would be a fatal blow for the efficient capital market for business. Unthinkable, unacceptable.

I applaud the transparency and brutal criticism of the report.

In fact it could be found to be a little harsh. For instance, about half the auditees received an unqualified report on their financial statements but failed to get a clean report for other reasons, so maybe things aren't all bad.

Audit reports and auditors aside, it is the reality that counts. Of course there is much to fix and even more to complain about, but, somehow, with some terribly notable lavatorial exceptions, the country still kind of works, most of the time.

So what can we do? I think it all has to start with amnesty and acceptance. Yeah, I know, there's a lot of that going around nowadays. But it's the only sure way to get people to put up their hands and ask for help. Can you imagine how soul-destroying it must be to go to work every morning, not knowing what you're doing?

Pick some of the leaders from the places that work and spread them around. Go on Gauteng, ask the Western Cape how they did it.

By the way, I recently met one of the candidates for the next Gauteng premier, Mmusi Maimane. Maybe there is hope? Okay, so rule one is find the proven leaders and deploy them nationally.

Rule two is educate, educate, educate. We all know this, but I've heard it's somewhat down the hierarchy of aspirations – probably because you can't eat it. Well, if you educate yourself more now, you'll eat more later, so get started.

In the meantime, fire all those consultants. Instead, go and hire back some of that prematurely retired expertise that you got rid of in a power moment. Not forever, just until the expertise has actually been transferred. One of the most valuable aspects of authority is that you can require of people that they teach you.

Whatever you do, Mr Government, don't nationalise anything!



