AUDITOR-GENERAL
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Auditor-general laments lack of accountability as he releases declining local government audit results

CAPE TOWN – The auditor-general (AG), Kimi Makwetu, today reported an overall deterioration in the audit results of South Africa's municipalities for 2016-17.

Makwetu says despite his office's constant and insistent advice and caution to those charged with governance and oversight about administrative lapses since 2013, their counsel has largely not been heeded.

"When we released the 2011-12 municipal audit outcomes in August 2013, we highlighted, amongst others, a lack of decisive leadership to address the lack of accountability by ensuring consequences against those who flouted basic processes that hampered effective municipal governance. We reported weaknesses in internal control and the risks that needed attention in local government by providing root causes for audit findings and recommendations to remedy these underlying causes. It is now five years later, and we are still faced with the same accountability and governance challenges we had flagged throughout these years. There has been no significant positive change towards credible results; instead we are witnessing a reversal in audit outcomes," laments the AG.

Makwetu says although there are municipalities in some provinces that are diligently working hard to attain and maintain the desirable audit outcomes through an entrenched culture of accountability and decisive leadership, those outcomes and efforts are overshadowed by the many elements of regressions in the local government audit outcomes.

Previous year's accountability advice largely unheeded

In his last municipal report for 2015-16, Makwetu had extensively cautioned government's administrative and oversight leadership, at all levels, to prioritise accountability and also warned against possible regressions in audit outcomes following changes in the political leadership after the last local government elections. The latest municipal results indicate that the AG's audit counsel in the previous year has largely not been implemented, at best, or totally ignored, at worst, as the audit outcomes reflect the state of governance he had painstakingly cautioned against.

Makwetu's report on the 2016-17 local government audit results comes a few weeks after Finance Minister Nhlanhla Nene had told Parliament in a written parliamentary response that 112 municipalities do not have money to carry out service delivery plans for the current financial year, and that only 14 of these have approved financial recovery plans.

The minister's announcement supports the AG's consistent message, over the years, that most municipalities' governance and financial affairs – their going concern status – were not in a good state.

A. Accountability continues to fail in local government

Announcing his office's latest municipal audit outcomes, the AG emphasises that "accountability continues to fail in local government". This is the theme of the report, and it points to glaring governance, leadership and oversight lapses that have contributed immensely to the undesirable audit results.

Indicators of accountability failures in local government

The AG has, for years now, consistently shared audit messages that emphasise the importance of accountability in the management of municipal affairs, starting with appropriate planning focused on the needs of citizens, and instituting appropriate internal control and supervision that will ensure proper financial and performance management. This, he has maintained, is tied to respect for the law in the running of municipalities, monitoring by all assurance providers that budget and performance targets are achieved, and that there are consequences for mismanagement and non-performance.

At most municipalities, these basic controls have not been implemented, and the AG flags the following as the main indicators of accountability failures in local government during the year under review:

1. Audit outcomes regressed and irregular expenditure increased

The AGSA audited 257 municipalities and 21 municipal entities. The number of municipalities decreased from 278, with the amalgamation of some municipalities during 2016 (37 municipalities were closed down and 16 new municipalities were established).

To ensure reporting simplicity and targeted messaging, the latest report focuses on only the municipalities. The audit outcomes of the municipal entities are included in the report's annexures (available on **www.agsa.co.za**).

i. Overall audit outcome regression

Of the audited municipalities, the audit outcomes of 45 regressed while those of 16 improved. Only 33 municipalities (13%) managed to produce quality financial statements and performance reports, as well as complied with all key legislation, thereby receiving a clean audit.

ii. Poor quality of submitted financial statements and performance reports

Makwetu notes that 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," says the AG.

iii. Highest level of non-compliance with key governance laws since 2012-13

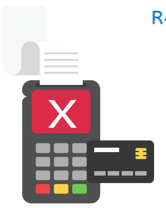
The AGSA reported material non-compliance with key legislation at 86% of the municipalities. This is the highest percentage of non-compliance since 2012-13. Municipalities with material compliance findings on supply chain management increased from 63% to 73%.

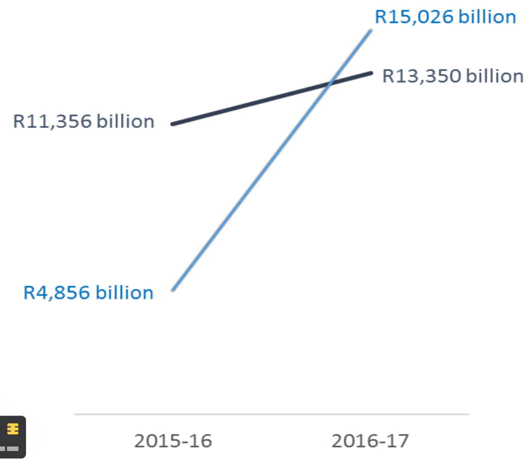
iv. Irregular expenditure increased, but municipalities improve its detection and reporting

The AG reports a 75% increase in municipal irregular expenditure, from R16,212 billion in the previous year to R28,376 billion in the year under review. However, he was quick to point out 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, being irregular expenditure incurred in prior years but only identified and reported in 2016-17. While there is a notable improvement in detection, he encourages a more robust prevention of irregular expenditure.

The remaining R13,350 billion relates to payments or expenses incurred 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.

Irregular expenditure increased from R16,212 billion to R28,376 billion (75% increase)





Irregular expenditure incurred in previous years, identified in current year

53% of the irregular expenditure were payments/expenses in previous years only uncovered and disclosed for the first time in 2016-17.

Municipalities made a significant effort in 2016-17 to identify and transparently report on irregularities in previous years – just over R10 billion more than in 2015-16.

Irregular expenditure identified in current year

47% of the irregular expenditure were payments/expenses in 2016-17.

This represents **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.

How much of the R28,376 billion then represents **non-compliance in 2016-17?** Based on our analysis of the top 26 contributors, it is estimated to be **16%** (+- R4,5 billion).

In other words, 84% of irregular expenditure relates to non-compliance of prior years which remain unaddressed.

2. Little improvement in the accountability cycle

Makwetu says the recommendations made by his office last year to ensure that the basics are in place, thereby improving accountability and audit outcomes, did not receive the necessary attention at most municipalities. This, he notes, "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".

i. Failure to investigate findings

Of most concern to Makwetu is that his office's "consistent and insistent calls for stricter consequences have not been heeded". "We reported material non-compliance with legislation dealing with 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".

He says that, in 2015-16, they reported such findings at 148 municipalities, but 47% of these municipalities did not investigate any of the findings and 24% investigated only some of the findings. In 2016-17, they reported these types of findings at 145 of the municipalities, 71% of which 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.

ii. Failure to take action on findings

"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," he discloses.

3. Increasingly difficult environment for auditing

The AG also reveals that the audit environment in which his audit teams had to work became more hostile, with increased contestation of audit findings and pushbacks whereby their audit processes and motives were questioned.

At some auditees, he divulges, 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," urged the AG.

Negative impact of accountability failures on the lives of citizens

Local government accountability failures, cautions the AG, result in municipalities not achieving their objectives, which in turn has a negative impact on the lives of citizens. The AGSA's audits highlighted three key areas of impact, namely:

- Financial health of municipalities
- Fruitless and wasteful expenditure
- The delivery and maintenance of municipal infrastructure

Examples of how accountability failures negatively affect the lives of citizens include:

i. Financial health of municipalities

The inability to collect debt from municipal consumers was widespread. In these circumstances, it is inevitable that municipalities will struggle to balance their 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 operating, 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," the AG points out.

ii. Fruitless and wasteful expenditure

Fruitless and wasteful expenditure amounted to R1,5 billion (a 71% increase from the previous year). The AG notes that "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".

iii. Shortcomings in the development and maintenance of infrastructure

The AGSA's audits again identified a number of shortcomings in the development and maintenance of infrastructure by municipalities. 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," says Makwetu.

Below are examples of accountability failures on municipal infrastructure:

- Themba water purification plant (City of Tshwane Metro) – The project was delayed due to the non-payment or late payment of contractors, contributing to non-compliance with expenditure management and interest incurred on late payments to contractors. The reasons for non-achievement on the project were inadequate project management of key milestones; lack of planning before appointing the contractor, resulting in overspending on the project; and inadequate monitoring of the contractor.
- Construction of Thabong T16 waterborne sanitation (Matjhabeng) – The project started in 2014-15 at a budgeted amount of R62 million. The municipality prioritised the construction of the toilet structures, plumbing and internal sewers ahead of the bulk network at the pump station, while the sewer pipeline was also not connected to the pump station. This resulted in sewage overflow around the area of construction, which caused pollution and which could potentially compromise the health and safety of the Thabong residents. The appointment of the contractors was irregular and the project was still in progress. To date, R54 million had been spent on this contract.

Reasons for the accountability failures

The AG's report singles out the following as some of the major contributors to the accountability failures and the regression in audit outcomes:

- 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, hindered dealing with consequences 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 repeated audit 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.

Parliament finalising deliberations on AGSA's possible referral powers

The AG's pronouncement on the continuing lack of accountability in local government comes at a time when the parliamentary committee responsible for his office – the multi-party Standing Committee on the Auditor-General (Scoag) – is finalising its deliberations on possible amendments to the Public Audit Act, the legislation that governs the operations of the Auditor-General of South Africa (AGSA), the country's supreme audit institution.

The amendments, if approved, will provide the audit office with the power to refer material irregularities to appropriate authorities to investigate as well as with a level of remedial power, including the recovery of money lost as a result of the irregularities. Material irregularities will include any non-compliance with legislation, fraud or theft, or a breach of fiduciary duty that caused or is likely to cause 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.

Below are a few examples of material irregularities reported by the AGSA, which would have been some of the cases that would have been referred if the AGSA had those referral powers already:

- ✓ The AGSA identified various irregularities in the contracting of a consultant in 2015-16 to assist with financial reporting at a municipal entity at a cost of R3,8 million. These included the absence of a signed service level agreement, regular contract extensions, excessive rates per hour and a lack of monitoring of the work performed by the consultant. Despite the AGSA reporting to the board that this contract was potentially fraudulent, the board did not take any action to investigate the matters raised.

- ✓ A district municipality incurred R164 million in fruitless and wasteful expenditure relating to a water project initially instituted by the municipality. Due to substandard work, the Department of Water Affairs had to redo the project from the start. The municipal leadership did not act in the best interest of the municipality, which not only resulted in substantial financial losses, but also in service delivery delays.

- ✓ A municipality had obtained a disclaimed audit opinion with material findings on performance reporting and compliance with legislation for the past three years. During this period, there was instability in the municipal manager's position, with this position being filled for only two months in the 2016-17 year. As a result, incorrect and misleading information was provided to the AGSA, without any consequences.

- ✓ Irregular expenditure was common at a municipality, but none of the reported instances were investigated. The municipal manager did not afford the council the opportunity to decide on investigations by deliberately not providing the details. The provincial treasury tried to assist, but also hit a stumbling block due to missing information. As a result, it cannot be determined if there are losses that should be recovered.

B. The audit outcomes at a glance

In its annual audits, the AGSA examines the following aspects:

- Fair presentation and absence of material misstatements in financial statements
- Reliable and credible performance information for purposes of reporting on predetermined performance objectives
- Compliance with all legislation governing financial matters

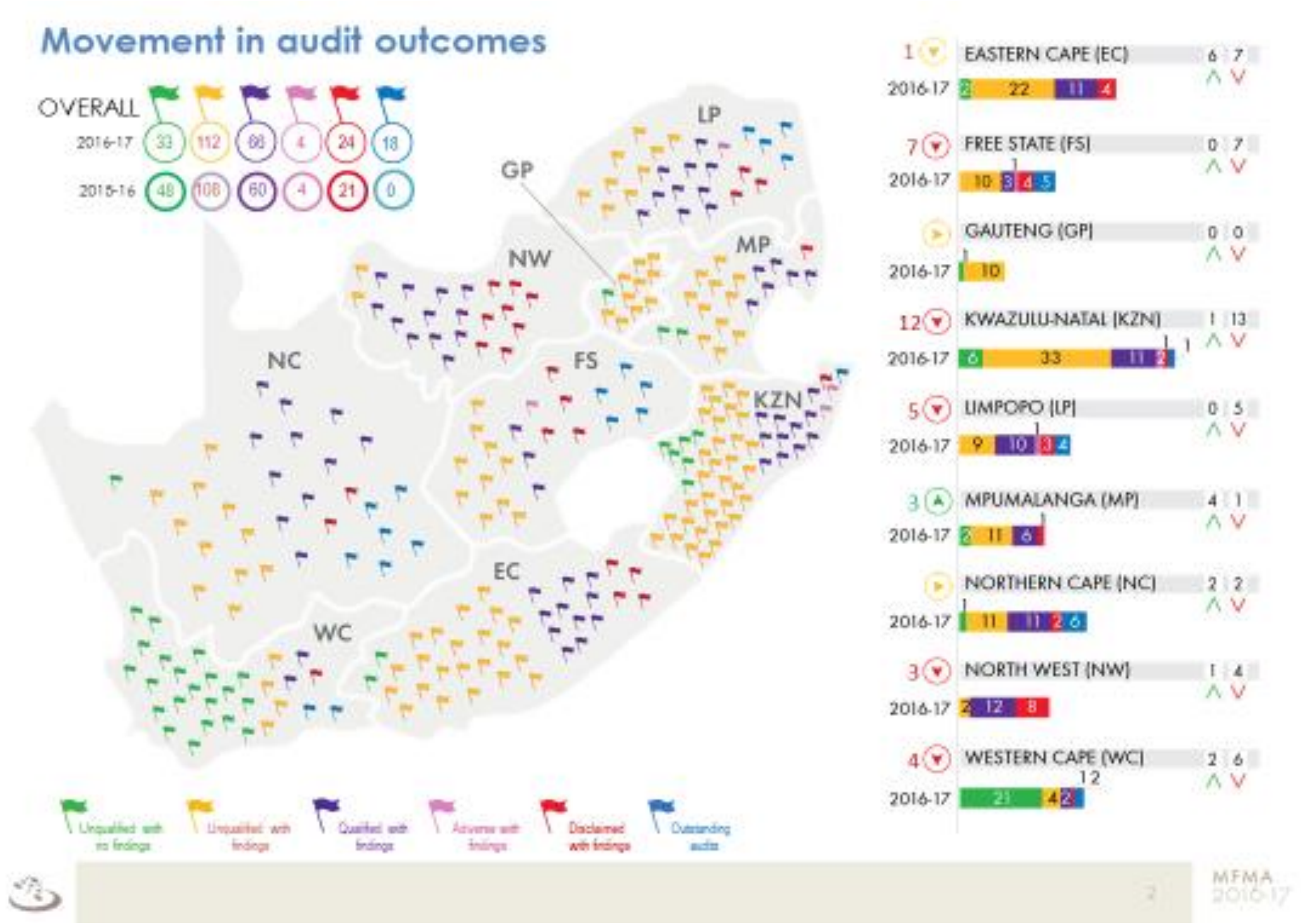
The audited institution achieves a clean audit when its financial statements are unqualified, with no audit findings in respect of reporting on predetermined objectives and compliance with legislation.

Total local government expenditure budget in 2016-17

The expenditure budget for the municipal sphere in 2016-17 was R362,13 billion. Municipalities with clean audit opinions represent R25,68 billion (7%) of this amount, while those with unqualified opinions with findings represent R243,82 billion (68%). Municipalities with qualified audit opinions make up R61,14 billion (17%) of the total budget, while those with adverse and disclaimed opinions represent R22,81 billion (6%). The municipalities with outstanding audits constitute R8,68 billion (2%) of the total expenditure budget.

Movement in municipal audit outcomes

The graph below shows the municipal audit outcome movements in the various provinces:



The summary below highlights how the various provinces, in alphabetic order, performed in the year under review:

Eastern Cape

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," says Makwetu.

The graphic below gives a brief summary of how the province performed in various audit areas:

Free State

The AG says 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," says Makwetu.

Gauteng

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," notes the AG.

KwaZulu-Natal

The province continued on its downward path that started in 2015-16, with 13 municipalities regressing. The AG cautions 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," warns Makwetu.

Limpopo

Limpopo had five municipalities that regressed during the year under review. The AG says 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

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, the AG notes, "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".

Northern Cape

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

North West, the AG says, 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," laments the AG.

"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."

He says the financial viability of municipalities needs to be addressed urgently, as it has a direct impact on their ability to continue rendering services.

Western Cape

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. Makwetu says 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".

Audit results of metropolitan municipalities regress

Overall, the audit outcomes of the eight metros regressed, with Buffalo City improving but Mangaung and 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 non-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 the AGSA raised concerns about City of Johannesburg, City of Tshwane and Nelson Mandela Bay, with Mangaung being in a particularly vulnerable financial position.

Conclusion

We have seen again and again that many of the municipal problems we have flagged, can be turned around through strong, ethical and courageous leadership in the administration and council, with the support of provincial government. Also, we have consistently and insistently advised, cautioned and at times cajoled those charged with local governance and oversight that if the basic principles of accountability, built around strong internal control and good governance, are in place, municipalities should be well geared to live up to the expectations of the communities that they serve. Nothing more needs to be said about the seriousness of the accountability failures in local government.

As the country's supreme audit office, we have always understood that we have an important role to play in the public sector accountability chain. To this effect, we go beyond the basic auditing and reporting role of the auditor. During the year, we proactively engage municipalities – through our status of records reviews – with the aim of flagging internal control weaknesses and to trigger early corrective action. Through our management, audit and general reports, we have also been reporting the weaknesses in internal control and the risks that need attention in local government. In our reports, we provide root causes for 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. It is now up to the leadership and administration to act decisively on our recommendations, to ultimately ensure a better life for the citizens of South Africa. We believe leadership in administrative and oversight structures such as the national and provincial treasuries, national and provincial departments that deal with local government, municipal councils and municipal public accounts committees have a key role to play in changing the current local government audit outcomes picture around.

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Media note: The *Consolidated general report on the MFMA local audit outcomes* is available on www.agsa.co.za.

About the AGSA: The AGSA is the country's supreme audit institution. It is the only institution that, by law, has to audit and report on how government is spending taxpayers' money. This has been the focus of the AGSA since its inception in 1911 – the organisation celebrated its 100-year public sector auditing legacy in 2011.