



MEDIA RELEASE

15 June 2022

Auditor-General calls on municipal leaders to transform local government to improve people's lives

PRETORIA – Auditor-general (AG) Tsakani Maluleke called on all role players in the local government accountability ecosystem to diligently play their part to ensure accountability for government spending, and for improving service delivery and quality of life for South Africa's citizens.

The AG made this call while launching the <u>2020-21 consolidated general report</u> on the local government audit outcomes.

Her office's latest report reflects on the audit outcomes over the five-year term of the previous local government administration, and she says the trends in the report demonstrate that the fourth administration (2016-17) left municipalities in a worse financial position than when they took office.

"The lack of improvement in municipal outcomes is an indictment on the entire local government accountability ecosystem, which failed to act and arrest the decline that continued to be characterised by service delivery challenges in municipalities," says Maluleke.

Therefore, the report "presents a not-to-be-missed opportunity for the new administration to address the already reported audit findings," and she called on all role players involved in local

government to "heed our call to action to transform local government and improve people's lives".

Unheeded calls result in undesirable audit outcomes

The AG reports that, over the term of the previous administration, the national audit office was consistent in its messages about the progressive and sustainable improvements required to prevent accountability failures and how such failures should be dealt with.

Among other matters, the AGSA had emphasised the need to strengthen basic financial and performance management disciplines, and to safeguard and maintain municipal infrastructure to prevent mismanagement, transgressions, non-performance, fraud and financial loss.

"Unfortunately, these issues persist," the AG notes. "Our message was always directed at the leadership, imploring them to turn the tide in local government – the theme of our 2019-20 general report was, Ethical and accountable leadership should drive the required change."

A renewed call for a culture shift

Maluleke says local government now has new political leaders, "elected by communities to represent their interests and address their pressing need for services, economic opportunities, and a safe and healthy living environment".

"Following the 2021 municipal elections, new councils were formed, with a new electoral mandate. It is now time to activate the accountability ecosystem to shift the culture in local government towards performance, integrity, transparency and accountability. This can be achieved through courageous, ethical, accountable, capable and citizen-centric leadership.

"Such a culture should be a shared vision for all involved in local government. We urge all role players to fulfil their designated roles and to play their part effectively to the betterment of people's lives," she says. These role players include mayors, municipal councils, municipal public accounts committees, audit committees, provincial leadership, premiers, members of the executive council (MECs) of Cooperative Governance and Traditional Affairs (Cogta) and Finance, coordinating national ministries of Cogta and Finance, provincial legislatures, Parliament, citizens and community organisations.

"Active citizenry is crucial to ensure that the needs of communities are heard and acted on, and that municipal leaders are held accountable for their actions. We call on all citizens to always take part in the public participation processes for determining and reviewing the

integrated development plan, and in ward committees; to get involved in community organisations; and to use the available channels to report any indicators of abuse, mismanagement, fraud and service delivery failures," says Maluleke.

In the 2020-21 general report, we renew our call that "capable leaders should demonstrate change by strengthening transparency and accountability".

State of local government

Overall audit outcomes (See page 8 of the report)

The AGSA's audit outcomes are based on the audits we perform on the quality of financial statements and performance reports, and on compliance with key legislation. Maluleke says some municipalities improved their audit outcomes, just to regress again in later years. Overall, only 61 municipalities had a better audit outcome in 2020-21 than in 2016-17, with 56 now having a worse audit outcome.

She states that it is encouraging to see the slight increase in the number of clean audits – 27 municipalities were able to maintain their clean audit status throughout the administration, while 14 achieved a clean audit for the first time and six lost their clean audit status. However, clean audit outcomes continue to represent less than a fifth of the local government budget.

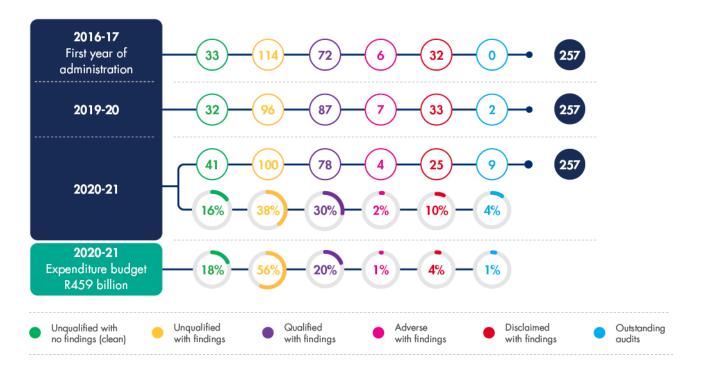
"A clean audit outcome is not always an indicator of good service delivery and does not always directly correlate to the lived experience of all the communities in a municipal area," explains Maluleke. "However, we have seen that municipalities that have the controls and systems in place to plan, measure, monitor and account for their finances and performance, and to stay within the rules, often also have a solid foundation for service delivery that will benefit their communities. This provides these municipalities with opportunities to shift their focus to ensuring the delivery of services for the benefit of all their residents."

For example, Senqu – a small, rural Eastern Cape municipality – has received a clean audit for five consecutive financial years, and reports show that the municipality has used its firm controls and systems to benefit its community through effective service delivery. Western Cape municipalities such as the Cape Winelands and West Coast have also achieved this outcome for the past five years.

"A clean audit should not be undermined or underestimated; it is an important foundation to achieve for a municipality to deliver much-needed services to their communities and spend scarce public resources prudently to improve their lived experiences," emphasises Maluleke.

The graphic below shows the overall audit outcomes and movement since the 2016-17 financial year.

Audit outcomes-municipalities



Despite the improvement in the number clean audits, the AG says that the substance of the outcomes indicates that local government still has a long way to go before we can celebrate improvements. The vast majority of unqualified audit opinions are only achieved after the auditee was given an opportunity to correct the annual financial statements that were submitted for auditing, which is not sustainable. This means that internal controls and financial management disciplines are still lacking. There are also still municipalities with disclaimed audit opinions, while municipal financial health continues to deteriorate and service delivery is declining.

Material irregularities (See page 22 of the report)

The audit office has recorded successes and has made an impact in implementing our enhanced powers. Through our expanded mandate, and especially the issuing of material irregularities (MIs), we have enriched our insights and strengthened our ability to influence and enforce performance, accountability, transparency and integrity in local government. In this regard, we recorded a number of notable successes, including the following.

We issued MIs on matters relating to actual or potential financial loss, as well as those causing substantial harm to institutions and their entities, and those causing substantial harm to communities. For 81% of these matters, municipalities had not taken any action until we issued the MI notifications to them.

On MIs with financial loss, our notifications led to the successful correction of municipal billing systems, which led to an increase in revenue; prevention of further financial losses; improved municipal systems; improved controls; and safeguarding of assets. In some cases, accounting officers responded to our MIs by stopping supplier contracts where money was being lost or where there was the potential for fraud, instituting criminal investigations by the relevant state agencies and disciplining municipal officials where that was required.

For example, at the City of Tshwane (Gauteng) assets worth R3,9 million were stolen and vandalised at the Baviaanspoort wastewater treatment plant. Of this, R174 716 has since been recovered. The matter was reported to the South African Police Service and the perpetrators were arrested, prosecuted and sentenced.

Nelson Mandela Bay (Eastern Cape) was losing millions of rands because it was not billing customers for services. Through the MI, the municipality is now billing correctly and collecting much-needed revenue. In addition, in 2018-19 the metro was not charging interest on long-outstanding debts for customers who had entered into long-term payment arrangements, resulting in financial loss of R11,2 million. The matter was resolved and, following the MI notification, and from February 2020 the municipality has been charging interest, thereby preventing further financial loss.

In another effort to prevent further financial loss, we issued an MI to King Sabata Dalindyebo (Eastern Cape) for interest incurred due to late payments to Eskom and the South African Revenue Service. In response, the accounting officer included cost-containment targets in the performance agreements of managers and directors, and ring-fenced electricity income to pay only electricity expenses. The municipality also implemented a revenue recovery plan.

Emalahleni (Mpumalanga) did not pay one of its suppliers on time, resulting in interest of R8,59 million being charged. The municipal manager engaged with the supplier, which led to the interest being reversed and loss being prevented. Controls were also put in place to ensure the supplier was paid on time to avoid further interest charges.

Rustenburg (North West) entered into a contract for the provision of automated fleet and fuel management solutions in June 2018. The scope of work was extended during the price negotiation and items that were not part of the competitive bidding process were included at higher than market-related prices. Disciplinary steps were taken against the responsible officials, who either resigned or were dismissed. The contract with the service provider was terminated in August 2019 based on a high court order, to prevent further financial loss. The matter was also referred to the Hawks and legal action was instituted against the supplier to recover the financial loss.

In the 2021-21 financial year, we issued MIs against repeatedly disclaimed municipalities. These MIs were causing substantial harm to the institutions. Since then, our impact has been felt, with firm actions having been taken. We noted that investigations have been performed or were underway to determine the root causes for the lack of records, registers and reconciliations. Accounting officers have now developed action plans – or are in the process of doing so – to address the root causes, and financial recovery plans are receiving attention from municipalities, the national government and provincial government.

In Umzinyathi District (KwaZulu-Natal), we issued an MI notification at one of the repeatedly disclaimed municipalities. The MI related to the failure of the municipal manager (as accounting officer) to ensure that there was adequate record-keeping, which had resulted in the prior year's audit findings. The accounting officer worked on internal capacity building and corrected internal controls. As a result, the audit opinion improved from a repeat disclaimer to a qualified audit opinion.

In the past year, we also, for the first time, raised MIs where significant weaknesses in infrastructure and environmental management resulted in pollution that caused harm to the general public.

"We are convinced that by implementing our enhanced powers and being deliberate in raising these MIs, we can encourage corrective action and enforce accountability. In this regard, the successful resolution of the MI is when further financial loss is prevented, the loss is recovered, the harm is effectively addressed and consequences are effected against implicated officials," says Maluleke.

There are 29 MI notifications that were not appropriately addressed.

Matjhabeng (Free State) paid an estimated R7,2 million between April 2017 and June 2019 for the construction of an attenuation (flood-protection) dam on the Nyakallong stormwater system after it had been certified as complete. However, a site visit by our team confirmed that the attenuation dam had not been built, resulting in overpayments on the project. The matter was referred to the Hawks for investigation in June 2021.

The AG included recommendations on 25 MIs in the audit reports of 20 municipalities at which the responses to the MIs were too slow or it was clear that the MIs were not being attended to with the required seriousness. The recommendations cover the steps that should be taken to recover the money, prevent further losses and harm, and effect consequences for the transgressions.

We issued remedial action for three of the MIs at Ngaka Modiri Molema (North West). If these MIs are not appropriately dealt with, the AG will issue a certificate of debt.

A detailed report on the MIs is on page 46 of the report and on our website.

Financial reporting (See page 16 of the report)

Financial statements are a key instrument for accountability. The municipal council uses financial statements to call the municipal manager to account and to make financial and related service delivery decisions. Creditors, banks and ratings agencies use them to determine how much risk there is in extending debt to a municipality, and the public uses them to see how well the municipality is using the rates and taxes collected to provide services.

Financial reporting consultants have become a permanent feature in municipalities' processes, and the annual cost of consultants doubled over the term of the previous administration, with the financial reporting cost of consultants totalling R1,26 billion in 2020-21. Financial reporting consultants cost local government R5,31 billion over the term of the previous administration, and 70% of municipalities used consultants for every year of the term.

Maluleke states that the expected benefits of using consultants to enable quality financial statements were not always realised. The financial statements submitted for auditing by

121 (59%) of the municipalities that used consultants had material errors. Even after corrections, 41% received modified audit opinions.

When combining the money spent on finance units and consultants at municipalities, it is clear that financial reporting carried a substantial price tag in 2020-21, coming to just over R11,67 billion. Internal audit units and audit committees also reviewed the prepared financial statements, while national and provincial coordinating departments deployed specialist advisors to support finance units and provided tools to help ensure that financial reporting was credible.

However, Maluleke notes that "despite the resources and support municipalities have available for financial management and reporting, the key financial management controls were not adequate to prevent material misstatements or major mistakes in the financial statements submitted for auditing".

Financial health (See page 20 of the report)

The AG reports that local government finances remain under severe pressure due to non-payment by municipal debtors, poor budgeting practices and ineffective financial management.

She says the financial position of 28% of South Africa's municipalities is so dire that there is significant doubt about whether they will be able to continue operating in the near future. This effectively means that such municipalities do not have enough revenue to cover their expenditure; they owe more money than they have; and they can no longer pay salaries and other obligations as they fall due, or maintain infrastructure assets such as roads and provide water and other basic services. Many of these municipalities have been in this dire financial position multiple times over the course of the administration.

The AGSA's assessment of the financial health of 230 municipalities and 18 municipal entities based on their financial statements revealed increasing indicators of a collapse in local government finances and continued deterioration over the term of the administration.

Maluleke paints a picture of municipalities often depending on the money they receive from the national government (in the form of an equitable share) to stay afloat. In 2020-21, this amounted to R80,26 billion, up from R67,83 billion in the previous year.

Metros

The financial health of metros is particularly concerning, as they serve the largest segment of the population and account for more than half of the local government expenditure budget.

The City of Tshwane (Gauteng), City of Johannesburg (Gauteng), City of Ekurhuleni (Gauteng), City of Cape Town (Western Cape) and Nelson Mandela Bay (Eastern Cape) were all downgraded to below investment grade by 30 June 2021.

"The downgrades put pressure on some of the metros to raise funding for capital expenditure, and they had to use internal savings from operational budgets to fund shortfalls. Most of the metros were put on review for further downgrades by the credit-rating agencies, meaning that they could plunge deeper into sub-investment territory if economic conditions worsen.

"Although some of these metros have cash reserves, its further use to make up revenue shortfalls will reduce the metros' capacity to meet future debt obligations as they fall due," cautions the AG.

She adds that while the economic downturn does affect revenue collection, "municipalities do not always play their part either". Not all revenue owed is billed and poor debt-collection practices are common. In addition to highlighting these concerns through audit findings, the AGSA also issued MI notifications where municipalities were suffering material financial losses as a result of revenue owed not being billed or debt not being collected.

Service delivery

Planning and reporting (See page 30 of the report)

Most municipalities had inadequate systems to collate and report on their performance information, and officials did not understand or could not apply the performance management and reporting requirements.

There is a correlation between a good performance management system and service delivery, which weakens if the incorrect performance measures and targets are managed.

Many municipalities had no material findings on performance information because they corrected material errors identified during the audit process. This indicates weak and inconsistent monitoring controls over performance management processes and systems.

To develop a fully representative integrated development plan, each municipality is required to embark on a public participation programme for the performance planning process and give communities the opportunity to influence the strategic course and direction of the municipality. The intent of public participation was not consistently realised, as some metros did not include all required and relevant targets and, where these were included, the set targets were not achieved.

Four metros have consistently submitted poor performance reports since the start of the administration, namely Buffalo City, City of Johannesburg, Mangaung and Nelson Mandela Bay.

The National Treasury introduced common indicators for reporting and planning on which all metros should report from 2018-19, but implementation has been slow, with only City of Ekurhuleni and eThekwini having fully implemented the requirements. The other six metros are phasing in the implementation because they do not have the required systems and processes in place to report on all the required indicators.

Maluleke says that "weaknesses in metro performance planning and reporting not only affect service delivery and reliable reporting, but reduce the council's ability to monitor and make meaningful contributions to the fulfilment of the promises made to communities in the integrated development plan".

Impact – municipalities with disclaimed audit opinions

In 2020-21, there were 25 municipalities that received disclaimed audit opinions – the worst audit opinion possible. This is almost 10% of all municipalities in the country. Only Gauteng and the Western Cape did not have municipalities with disclaimed opinions during this period. Most of the municipalities that repeatedly received disclaimed opinions are in North West.

A disclaimed opinion is the worst audit opinion a municipality can receive, as it means that the municipality could not provide auditors with evidence for most of the amounts and disclosures in its financial statements. Therefore, the AGSA could not express an opinion on the credibility of these financial statements or determine what was done with the funds the municipality received for the year towards service delivery.

Says Maluleke, "In spite of all our messages, as well as initiatives by national and provincial government, and even municipalities being placed under administration / provincial intervention, there was little improvement over the term of the previous administration. Only

18 municipalities improved from previously disclaimed opinions, while 17 regressed to disclaimed outcomes over the period. Eight municipalities that received disclaimed opinions in the first year of the administration are still disclaimed. Repeatedly disclaimed opinions should not be tolerated as they indicate a lack of stewardship over public funds. Rather than a technical audit matter, a disclaimed opinion is a confirmation of dysfunction in the management of the municipality, with a devastating impact on the lives of the residents living in these municipal areas as they are robbed of service delivery."

In her office's 2019-20 general report, Maluleke told the story of the 10 municipalities (Maluti-A-Phofung, Masilonyana, Tokologo, Govan Mbeki, !Kheis, Joe Morolong, Lekwa Teemane, Madibeng, Mamusa and Ramotshere Moiloa) that had received disclaimed audit opinions for years. The latest report shows that these municipalities have still not improved.

She says that at most of these municipalities, the auditors observed leadership instability (both at political and administrative level), poor oversight by councils, significant financial health problems, protests and strikes, a lack of consequences, and interventions that were not effective.

One of the key matters that plague the disclaimed municipalities is the lack of proper asset registers and records, which limited the AGSA's ability to confirm that the values and information disclosed on municipal infrastructure assets in the financial statements of most of these municipalities were correct.

The AG says this is not only related to financial statements. "It means that these municipalities could not properly account for the existence and state of their infrastructure assets, which should be used to provide water, sanitation, electricity, refuse removal and roads to communities."

"Our audits of key water, sanitation and roads infrastructure projects funded by conditional grants found that half of these municipalities struggled with project management, resulting in delays in project completion, overspending on contract amounts and contractors being paid for substandard work. These municipalities already struggle financially and cannot afford to waste the limited resources available to manage basic service delivery initiatives. Poor project management was largely due to a lack of technical skills and to vacancies in the technical departments and in positions responsible for signing off on work done in the project management units."

In addition, these municipalities' poor management of infrastructure has affected service delivery and the lived experience of citizens within their area, and they must therefore pay careful attention to these deficiencies and address them with urgency.

Some of these municipalities have been issued with MIs for causing substantial harm to the institution.

In our 2019-20 general report, we shared our concern that disclaimed municipalities receive funding from national government through an equitable share and conditional grants, but that the lack of proper records makes it difficult to confirm what had been done with this money since it was received and reconcile this with what was left in the bank account at year-end. This year, we did additional work in this area. We noted that six municipalities did not use unique identifiers such as payment descriptions and descriptive references for bank payments to enable meaningful matching and analysis between the bank statements and the financial system. This will make it difficult for these municipalities to perform bank reconciliations, which are an important internal control to detect payments of which municipalities may be unaware. In such cases, fraudulent activities could go undetected, and funds meant for service delivery could be misappropriated without being picked up.

At four of these municipalities, we did further analysis and could trace between 67% and 89% of the expenditure recorded in the financial system to bank statements. The R6,03 billion spent by these municipalities was used for employee costs, bulk purchases, payments to service providers, and statutory and other payments. Payments to service providers pose the biggest risk for fraud, as the lack of supporting documents mean that we could not confirm whether municipalities had actually received the goods and services they had paid for.

See page 37in the report for the service delivery impact – municipalities with disclaimed audit opinions.

Infrastructure assets

Findings on infrastructure

Municipal infrastructure plays a key role in supporting service delivery. A lack of the infrastructure required to provide basic services, combined with inadequate maintenance not only negatively affect service delivery, but often also caused harm to communities and the

environment. We reported on weaknesses in infrastructure projects and inadequate maintenance and management of infrastructure throughout the term of the previous administration.

Maluleke also notes that communities could be negatively affected by municipalities not properly maintaining the infrastructure and managing the environment for which they are responsible.

"After inspecting some of the wastewater treatment works and landfill sites controlled by municipalities, our experts identified poor or ineffective environmental management, limited environmental monitoring and enforcement, as well as defective management and delivery of wastewater and solid waste services at municipalities.

"When these sites are not properly operated, there is a significant likelihood that both service delivery and the environment could be negatively affected. This is the case when untreated sewage is discharged into water sources or refuse is illegally dumped or not properly compacted and treated at suitable sites," the AG warns.

See page 41-432 in the report for the impact of infrastructure neglect on service delivery

Conclusion

The new administration must instil a culture of performance, accountability, transparency and integrity

"As the national audit office, we have a vision, shared by many, for this new administration to make significant strides towards instilling in local government a culture of performance, accountability, transparency and integrity. This is what the Constitution envisaged – municipalities that perform by delivering services and that are transparent about their level of performance and how municipal finances are managed. This, in turn, will enable these municipalities to be accountable to the communities they serve. Above all, communities want to see their elected representatives and municipal officials act with integrity, including being honest, ethical and incorruptible, and complying with legislation.

"Our role and mandate as the country's supreme audit institution is to audit every municipality and municipal entity, report on what we found and share the insights to strengthen transparency and enable accountability. It is not mere compliance for us, but a genuine effort to ensure improvement and enforce accountability where it is lacking. This is especially

significant if one considers that municipalities and municipal entities were responsible for an estimated expenditure budget of R509 billion in 2020-21.

"This report is therefore not intended only for local government leaders; it is equally important for national and provincial leadership and community organisations. We have engaged with critical stakeholders in the accountability ecosystem and called upon them to be effective and deliberate in executing their mandates in order to transform local government and improve service delivery to citizens. We will monitor the implementation, effectiveness and impact of the commitments made by various leaders over the term of the new administration," concludes Maluleke.

End.

Issued by: Auditor-General of South Africa

Contact: Africa Boso • (012) 422 9880 • Africab@agsa.co.za



Follow the AGSA on Twitter: AuditorGen_SA

Media note: The Consolidated general report on the audit outcomes of local government 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.