

## 2 Introduction

## 2.1 Introduction

The **local government elections** took place on 3 August 2016, just over a month after the 2015-16 year-end and a few weeks before the financial statements and performance reports had to be submitted for auditing. The **re-demarcation of municipal boundaries** also came into effect shortly after the 2016 elections, which resulted in the amalgamation of 39 municipalities, effectively closing down the administration and political structures of 21 municipalities. These two major events had an impact on the 2015-16 results, contributing to the slow progress made in improving audit outcomes since the previous year. The political leadership at some municipalities was more focused on the election and little was done to improve the vacancies and instability in local government with the view that this would receive attention in 2016-17, or that the amalgamations would address it. The political leadership and municipal officials did not prioritise addressing weaknesses in the control environment. The opportunity has already presented itself where the new leadership in local government has a chance to prioritise these matters over the next five years of their term.

The 2014-15 general report provided an overview of the audit outcomes and our messages since 2010-11, and we highlighted that the audit outcomes in 2011-12 had significantly regressed after the 2011 elections. This was as a result of instability following changes in the political leadership and at the level of municipal manager and senior management, including the non-renewal of contracts.

A closer assessment of the matters raised during the analyses of these outcomes is the following:

- Financial management
- SCM
- Maintenance of the accounting records
- Follow-through on action plans
- Supporting documentation
- HR controls and management of consultants
- IT controls
- mSCOA

All of the above matters can be addressed decisively over the term of this administration.

In this context, we introduced quarterly key control engagements with all municipalities in the 2016-17 financial year. The main thrust of this intervention is the evaluation and review of the status of accounting records. The objective is to appraise management and the leadership of the areas of significant audit risk that require their priority action. It is hoped that this will be a sufficient red-flag mechanism to enable swift management reaction before major disasters materialise in the control of finances.

In local government, the political leadership and municipal officials must achieve their municipalities' objectives while acting in the public interest at all times and consistently adhering to the requirements of legislation and government policies. **Acting in the public interest** implies that municipalities' primary consideration should be improving the lives of citizens. **Accountability** is the principle that municipal leaders are answerable to the public and take responsibility for their actions, decisions and policies. Municipalities should be able to demonstrate the appropriateness of all of their actions and should have mechanisms in place to encourage and enforce adherence to ethical values and to respect the rule of law. These concepts of public interest and accountability are entrenched in the country's constitution and the legislation that governs local government.

The MTSF defines the overall outcome for local government (outcome 9) to be 'a responsive, accountable, effective and efficient developmental local government system'. This is the target that municipalities are working towards.

In order to achieve this, we propose the use of the '**plan+do+check+act**' cycle. This cycle, also known as the Deming cycle, is used courtesy of the International Organization for Standardization. It is a repetitive, four-stage approach for continually improving processes, products and services. The cycle encourages a commitment to

continuous improvement, which is consistent with the recommendations we have been communicating in the past few years to improve audit outcomes through our reports. As illustrated in figure 1, following this approach will ensure a solid foundation for accountability in the work of municipalities.

**Figure 1: Plan+do+check+act cycle – committing to accountability**



**PLAN:** In the context of improved audit outcomes, the **target should be defined** and time and resources should be allocated to ensure that performance is managed through robust internal control and strong financial management.

**DO:** Municipalities should have and sustain **performance management systems** that facilitate effective and efficient delivery of planned services. A strong system of **financial management** is essential for the implementation of policies and the achievement of intended outcomes, as it will enforce financial discipline, strategic allocation of resources, efficient service delivery, and accountability. Risk management and internal control are important and integral parts of a financial and performance management system, and are crucial to the achievement of outcomes. These two parts consist of an ongoing process designed to identify and address significant risks to achieving outcomes.

**CHECK:** A key element of internal control is monitoring by the different assurance providers to ensure that internal controls are adhered to, risks are managed, and outcomes are achieved.

**ACT:** Accountability means that those performing actions or making decisions are answerable for them, but also that there should be consequences for transgressions, a lack of action and poor performance.

Focused attention on improving financial and performance management and compliance with legislation to achieve better audit results will contribute to achieving the MTSF targets for local government, resulting in a better life for citizens.

Committing to accountability and following the plan+do+check+act cycle will assist the new political leadership and administration to have a positive impact on their municipalities from the first year.

The rest of our report provides a view of the audit outcomes for 2015-16 and their movement since the previous year as well as recommendations for improvement (in section 10), which link to the cycle described above. We focus on municipalities throughout the report, but summarise the key audit outcomes of municipal entities in section 11.

We use icons in this report to indicate the following:



References to the annexures



Proposed recommendations to assist auditees to improve their audit outcomes



Examples to illustrate the effects of weaknesses

When studying the figures and reading the report, please note that the percentages are calculated based on the completed audits of 263 municipalities, unless indicated otherwise. Movement over a period is depicted as follows:



Improved



Unchanged / Slight improvement / Slight regression



Regressed

## 2.2 Status of internal control

Good **internal control** is the key to ensuring that municipalities deliver on their priorities in an effective, efficient and economical manner, produce quality financial statements and performance reports, and comply with applicable legislation – especially in the area of procurement and contract management. It is the responsibility of municipal managers, senior managers and municipal officials to implement and maintain effective and efficient systems of internal control.

Figure 1 shows the status of the different drivers of internal control over the past three years and the movement since the previous year. We determined the movements taking into account either increases in good controls or reductions in controls requiring intervention.

Figure 1: Drivers of internal control

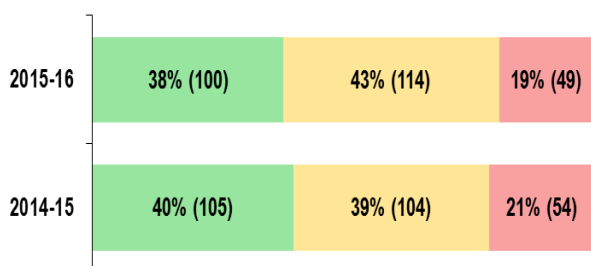


As illustrated in figure 1, all three drivers of internal control had shown little improvement since the previous year, with leadership even showing a slight regression. This corresponds to the limited improvement in audit outcomes and regressions at some municipalities as detailed in section 3.1.

### Basic controls

In figures 2 to 6, we deal with a number of basic controls that should receive specific attention.

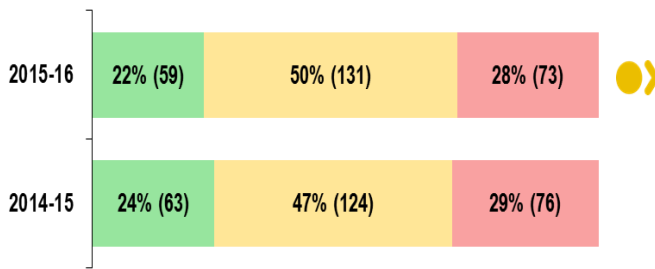
Figure 2: Effective leadership



In order to improve and sustain audit outcomes, municipalities require **effective political and administrative leadership** that is based on a culture of honesty, ethical business practices and good governance, which protects and enhances the interest of the municipality.

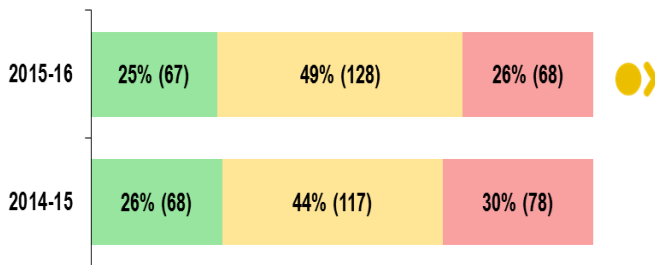
The leadership culture controls had remained unchanged overall, despite the slight reduction in good controls and those requiring intervention.

**Figure 3: Audit action plans**



The controls relating to **audit action plans** had regressed slightly. The reason for this was that in many cases audit action plans responded only to our audit findings and did not always address the associated root causes, while not all audit action plans that had been drawn up were fully implemented. Furthermore, audit action plans did not sufficiently take into account recommendations relating to other role players, such as internal audit units and audit committees, or risks arising from municipalities' own risk-assessment processes.

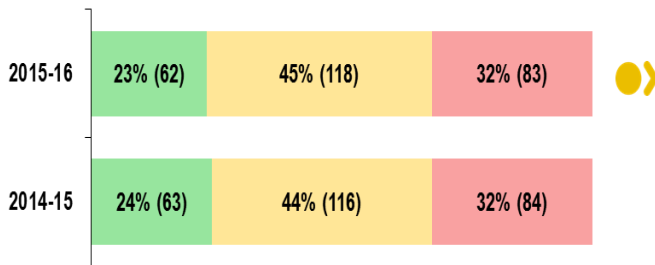
**Figure 4: Proper record keeping**



**Record-keeping** controls had improved slightly due to a reduction in the number of municipalities whose controls required intervention; however, the number of municipalities with good controls in this area remained low.

Proper and timely record keeping ensures that **complete, relevant and accurate information** is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. A lack of documentation affects all areas of the audit outcomes.

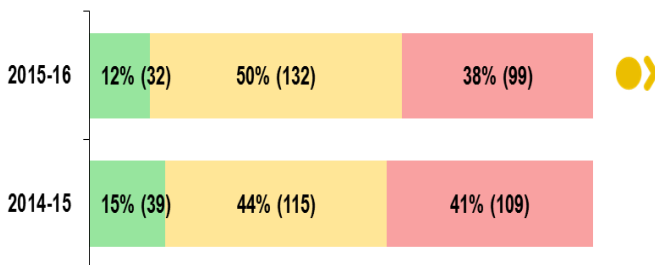
**Figure 5: Daily and monthly controls**



Controls should be in place to ensure that **transactions are processed in an accurate, complete and timely manner**, which in turn will reduce errors and omissions in financial and performance reports.

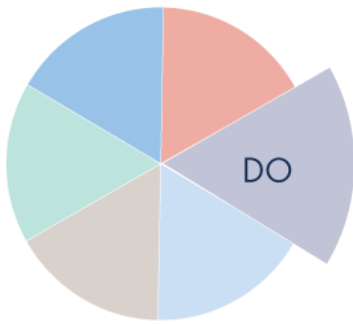
There was a slight regression in daily and monthly controls due to a slight decrease in municipalities with good controls.

**Figure 6: Review and monitor compliance**



The controls relating to **monitoring compliance** slightly regressed and continued to be the poorest control area at municipalities. Many municipalities did not comply with legislation (as detailed in section 4.2), while most of the irregular expenditure incurred was still identified during the audit process. This indicates that the internal controls of most municipalities not only failed to prevent non-compliance with legislation, but also failed to timeously detect the deviations, some of which were only detected during, and responded to following, our audits.

Details of HR management, consultants and IT controls, which also form part of the basic controls and are critical to internal control, are discussed later on in this report.



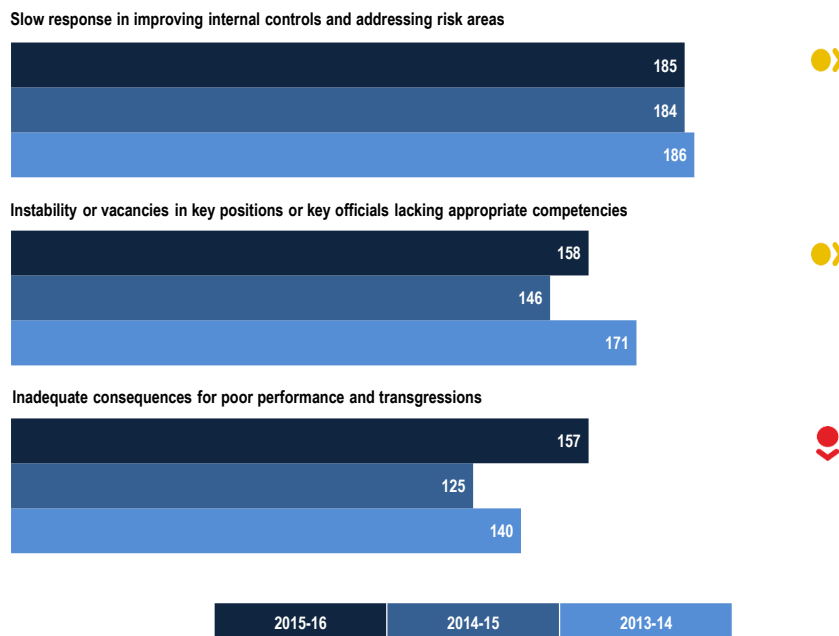
Strong internal controls are the key to unlocking improvements in local government. If underlying weak internal controls are not addressed, it increases the risk of the misappropriation of funds, unreliable financial and performance reporting as well as non-compliance with legislation. On the other hand, a sound internal control environment that is monitored in a robust manner by the different assurance providers (as further discussed in section 9) will enable **effective, efficient and economical service delivery, accurate and reliable financial and performance reporting** as well as **compliance with legislation**. This in turn will facilitate accountability and transparency in the management of public funds.

## 2.3 Root causes

The main root causes of municipalities' continuing inability to improve internal controls and obtain better audit results are discussed below.

Our message on these root causes has remained constant over the years. As illustrated in figure 1, however, there had been **little improvement** in the response to root causes since the previous year and a definite **increase in municipalities where the root cause of poor audit outcomes was inadequate consequences**.

Figure 1: Status of overall root causes



### *Slow response in improving internal controls and addressing risk areas*

The most common root cause was that management (accounting officers and senior management), the political leadership (mayors and councils) and oversight structures (MPACs and portfolio committees) **did not respond with the required urgency** to our messages about addressing risks and improving internal controls.

Our message and its delivery have been consistent for a number of years, but the slow response to this message and to the initiatives taken by national and provincial government is standing in the way of improvements in audit outcomes.

The **main reasons for the slow response** in 2015-16 were the following:

- All municipalities had audit action plans but for some it was focused on the short term – to only fix the problems that resulted in audit report findings. There was no capacity or even competency to address the gaps at some of the municipalities, while a small number of municipalities only paid attention to our recommendations and the action plan during the audit.
- Unfortunately, there were municipalities where the leadership had no desire to improve internal controls, as the lack of controls (especially with regard to record keeping) enabled an environment conducive to corruption.
- Some municipalities did not aspire to a clean audit opinion and were content with an unqualified audit opinion with findings, with no commitment to address poor performance reporting and non-compliance.
- Municipalities continued to rely on the auditors and consultants to assist them at year-end to fix the financial statements and the performance report. As a result, there was little motivation to improve the municipal capacity in this regard.
- The attention of officials and the political leadership at some municipalities was diverted by the local government elections in that their main focus was on campaigning.
- Officials and the political leadership of the municipalities that were to be amalgamated were not motivated to correct errors or prevent them from happening again.

### *Instability or vacancies in key positions or key officials lacking appropriate competencies*

**Vacancy levels and instability in key municipal positions** did not receive the required attention in 2015-16, although there was a definite move towards obtaining the **minimum competency requirements** for these positions (as detailed in section 6.1). The high demand for consultants and support from national and provincial government, however, serves as evidence of the remaining competency gap. Where competencies were confirmed, a lack of leadership and accountability existed to ensure that municipal officials performed the duties for which they were appointed.

24

We continued to see the negative impact of instability and prolonged vacancies in key positions on the audit outcomes.

### *Inadequate consequences for poor performance and transgressions*

The low level of action in response to the high levels of non-compliance, poor audit outcomes, SCM transgressions and unauthorised, irregular as well as fruitless and wasteful expenditure **demonstrated a lack of consequences** in local government for poor performance and transgressions.

It is important that officials who deliberately or negligently ignore their duties and contravene legislation should be dealt with decisively through performance management and by enforcing the legislated consequences for transgressions. If they are not held accountable for their actions, the perception is created that such behaviour and its results are acceptable and tolerated. Section 4.2.4 provides more detail in this regard.



The objectives of municipalities and improved audit outcomes will not be achieved if poor internal controls and instability are not addressed (**DO**) and the leadership and officials are not held accountable through implementing consequences for transgressions, a lack of action and poor performance (**ACT**).