The covid-19 pandemic struck local government a few months before the end of the 2019-20 financial year. It resulted in the shutdown of offices, a shift towards a covid-19 response, and inevitable delays in attending to normal municipal business. In continuing with our commitment to President Ramaphosa, we performed a real-time audit of the local government covid-19 initiatives on which we report separately in our third special report on government’s financial management of the funding made available for the covid-19 response.

Our normal audit processes and timelines were severely affected by the two-month concession granted by the finance minister to local government for the submission of their financial statements. Performing a real-time audit at the same time as the normal audits and the unavoidable challenges of auditing during a pandemic further contributed to our audits running into April 2021.

Looking back to our previous general report, we delivered a very direct message that local government finances were under severe pressure and were not being managed as they should. Accordingly, it was titled Not much to go around, yet not the right hands at the till. We warned that drastic changes were needed to ensure that the diminishing funds available to deliver on services to citizens were used in a prudent and effective manner - and that there was credible and transparent reporting of such use to enable accountability. We also emphasised that short-term solutions were not going to bring about the change needed and were often costly and ineffective, such as the continuing use of consultants for financial reporting.

We put forward the following solutions:

- Investing in preventative controls as it is more effective than having to deal with the impact of accountability failures, such as financial loss, fraud and corruption, the misuse of public resources, and service delivery failures.
- Significantly improving monitoring, review and oversight by senior officials, municipal leaders and councils.
- Using our reports, briefings and engagements to identify the key areas that needed attention and would benefit most from preventative controls, such as our status-of-record reviews that alert municipalities to risks during the year and act as an early warning signal.
- Effecting consequences for accountability failures. Over the past few years, we have emphasised the need to create an environment in which transgressions and poor performance are dealt with appropriately to set the standards for the public service and act as a deterrent to wrongdoing. In the first year of implementation of the material irregularity process, we highlighted the value and importance of supporting this process to strengthen the accountability mechanism.

We have seen little evidence of our messages being taken to heart. The progressive and sustainable improvements required to prevent accountability failures, or deal with them appropriately when they do occur, do not exist. We also do not see the fundamentals being strengthened to enable strong financial and performance management disciplines. The responsibility to turn local government around is entirely in the hands of its leadership. Hence, the theme of this general report is Ethical and accountable leadership should drive the required change.

Our conclusions and call to leadership for change are based on the overall state of financial and performance management, the material irregularities we identified, and our observations in the provinces, as outlined further on.
Local government finances continue to be under severe pressure as a result of non-payment by municipal debtors, poor budgeting practices, and ineffective financial management. The financial position of just over a quarter of municipalities is so dire that there is significant doubt that they will be able to continue operating as a going concern in the near future. This effectively means that such a municipality does not have enough revenue to cover its expenditure and owes more money than it has. Almost half of the other municipalities are exhibiting indicators of financial strain, including low debt recovery, an inability to pay creditors, and deficits.

The impact of municipal creditors not being paid is well-known – it severely affects Eskom and the water boards, but is even more devastating for smaller suppliers. Some municipalities do not even pay over taxes such as pay-as-you-earn and value-added tax to the South African Revenue Service or transfer contributions to the pension funds of their employees. Local government loses billions of rand annually because of interest and penalties. In 2019-20 alone, the resulting fruitless and wasteful expenditure totalled R3,47 billion.

Financial statements are not only an accountability mechanism but are also used by mayors, councils, the National Treasury, banks and lenders to inform important financial decisions. After all our years of reporting shortcomings and making recommendations, municipalities have still not mastered financial reporting – only 28% could provide us with quality financial statements to audit. This also does not bode well for the in-year financial reporting done to manage the budget and finances of a municipality – we observed good practices in this regard at municipalities that constitute only 12% of the expenditure budget.

Financial reporting carries a hefty price tag at just over R5 billion. This figure is based on only the salary cost of finance units and the cost of financial reporting consultants (which accounts for 18% of the total cost). Financial reporting consultants have become permanent features in the financial reporting processes of municipalities – 74% of municipalities that had used consultants in 2018-19 again used them in 2019-20. At only 2% of municipalities, consultants were used to bridge a vacancy gap; at the rest they were appointed to provide skills the finance unit did not have. What is concerning, however, is that the use of consultants was not necessarily effective. A total of 64% of the municipalities did not provide adequate records, appointed consultants too late or did not manage their work to benefit from their appointment – effectively outsourcing responsibilities. It is time to ask difficult questions about underperformance by finance units and the value derived from the money spent on financial reporting.

Disclaimed opinions are the worst audit opinion municipalities can get, as it means that they could not provide us with evidence for most amounts and disclosures in their financial statements. We could therefore not express an opinion on the credibility of these financial statements or determine what had been done with the funds they received for the year.

In spite of all our previous messages, actions taken by oversight, initiatives by national and provincial departments, and even placing some municipalities under administration, 22 municipalities had received disclaimed opinions by 4 June 2021. Another four that were previously disclaimed have not even submitted their financial statements for auditing yet. In this report, we look at 10 disclaimed municipalities to illustrate what went wrong, what it means, and its impact on residents. At most of these municipalities, we 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.

A lack of complete and proper records inevitably leads to unreliable financial reporting during the year and at year-end, or is likely to result in substantial harm to these disclaimed municipalities’ ability to deliver on their service mandate. We therefore notified the relevant municipal managers that this constitutes a material irregularity in terms of the Public Audit Act. In their response, these municipal managers are required to clearly articulate what caused the material irregularity. They must also commit to actions that will prevent any further harm and ensure that there are consequences for those responsible for the dire state of their municipality. If they do not respond appropriately or do not implement the actions to which they have committed, we will use our expanded powers to take action to remedy the situation.
The reporting by municipalities on their performance was even worse than their financial reporting. It is not surprising that citizens experience poor service delivery from municipalities if not even a quarter of them could provide us with quality performance reports to audit. Even after addressing our findings, just under half of the municipalities still published performance information that was unreliable or had little relevance to what they had promised to do in their strategic planning documents.

We again observed widespread non-compliance with legislation and reported material non-compliance at 86% of municipalities. As in prior years, non-compliance with supply chain management legislation was prevalent, significantly contributing to the irregular expenditure of R26 billion. This amount is likely to be even higher, as just over a third of municipalities were qualified on the completeness of their disclosure or were still investigating the full extent of the irregular expenditure. We could also not audit contracts and quotations worth R1,43 billion as municipalities did not provide us with the required documentation and evidence in support of the procurement processes. Accurately disclosing irregular expenditure is only the first step in the accountability chain: councils need to investigate all instances and then either regularise the expenditure or take firm steps to quantify and recover losses and discipline those responsible. This is not happening, however: at year-end the cumulative amount of irregular expenditure not dealt with stood at R79,22 billion. Municipalities’ disregard for effecting consequences is also clearly shown in their lack of investigations and actions in response to our findings on potential fraud and abuse of the supply chain management system.

The lapses in financial and performance management resulted in the uninspiring overall audit outcomes shown below (the picture includes 32 municipalities of which we finalised the audits after the cut-off date of this report up to 4 June 2021, while the rest of the report focuses on only the audits finalised up to 23 April 2021). Most municipalities are now in a worse position than at the beginning of this administration’s term in 2016-17, with 46 improving their outcomes but 61 regressing over this period.

The findings from the real-time audit we performed on the covid-19 initiatives show a striking resemblance to the poor outcomes and other findings we are reporting in this general report. The impact of compromised control environments and poor financial and performance management was even more pronounced in the midst of a pandemic when vulnerable citizens relied all the more on local government support.

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### Audit outcomes at a glance

<table>
<thead>
<tr>
<th>Year</th>
<th>Unqualified with no findings</th>
<th>Unqualified with findings</th>
<th>Qualified with findings</th>
<th>Adverse with findings</th>
<th>Disclaimed with findings</th>
<th>Outstanding audits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019-20</td>
<td>27</td>
<td>96</td>
<td>80</td>
<td>7</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>2018-19</td>
<td>20</td>
<td>94</td>
<td>93</td>
<td>6</td>
<td>39</td>
<td>5</td>
</tr>
<tr>
<td>2016-17</td>
<td>33</td>
<td>114</td>
<td>72</td>
<td>6</td>
<td>32</td>
<td>0</td>
</tr>
</tbody>
</table>
MATERIAL IRREGULARITIES

The poor state of financial and performance management in local government, as evidenced by the audit outcomes, resulted in material financial losses at some municipalities and substantial harm to their ability to deliver on their mandate. The amendments to the Public Audit Act, which came into effect on 1 April 2019, provide us with the mandate to report on these matters as material irregularities and to take action if municipal managers do not deal with them appropriately.

In this, the second year of carrying out our expanded mandate in local government, we significantly expanded our work by implementing the process at more auditees and moving beyond just considering financial loss. By 11 June 2021, we had issued notifications for 96 material irregularities.

A total of 75 of the material irregularities related to non-compliance with legislation that resulted in, or is likely to result in, a material financial loss, totalling an estimated R2.04 billion. These material irregularities emerged in four key areas: procurement and payments, interest and penalties, revenue management, and investments and assets. These are all matters that we have been reporting as areas of vulnerability for a number of years, including as part of this year’s audit outcomes. They are not complex issues, but some of the basic disciplines and processes that should be in place at municipalities, such as procuring at the best price, paying only for what was received, making payments on time, recovering the revenue owed to the state, and safeguarding assets. Good preventative controls would have made all the difference in preventing or detecting these matters before they became so material.

As mentioned earlier, we identified material irregularities where municipalities received disclaimed opinions. By 11 June 2021, we had issued notifications on these material irregularities to the municipal managers of 21 municipalities. As the material irregularity process is continuous in nature and not bound by the audit cycle, we continue to assess the findings from our audits that could potentially be material irregularities. If confirmed and once the municipal managers have been notified, we will report on these matters in our 2020-21 reports.

Based on the responses to the notifications and the actions being taken to resolve the material irregularities reported in the previous year, we can conclude that we are starting to see signs of a behavioural change by most of the municipal managers towards responding in a decisive and timely manner to our findings. In order to resolve material irregularities, the support of mayors and councils is crucial, but this is an area where we have not yet observed any significant uptake or commitments.

We are fully committed to implementing the enhanced powers given to our office, without fear, favour or prejudice. The success of our amended powers will become evident when a culture of responsiveness, consequences, good governance and accountability becomes the norm rather than the ideal.

PROVINCIAL MESSAGES

Every province has a unique set of circumstances and diverse solutions to their problems, but the need for leadership – also at provincial level – to step up and turn the tide is transversal. We summarise our key provincial messages here and invite you to read our detailed insights in section 6.
<table>
<thead>
<tr>
<th>Region</th>
<th>Observation</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>EC</td>
<td>Improvement in outcomes, but this might not be sustainable due to poor control environments</td>
<td>Improve and focus on controls for sustainable outcomes</td>
</tr>
<tr>
<td>FS</td>
<td>Lack of accountability creates a perpetual disrespect for regulations, resulting in mismanagement of resources and lack of service delivery</td>
<td>Accountability can be realised through decisive leadership tone</td>
</tr>
<tr>
<td>GP</td>
<td>Despite pockets of improvements, inadequate monitoring of preventative controls resulted in stagnant outcomes and increasing levels of unauthorised, irregular and fruitless and wasteful expenditure</td>
<td>Improve monitoring of preventative controls</td>
</tr>
<tr>
<td>KZN</td>
<td>Stagnation in audit outcomes – effective accountability and consequences not consistently enforced</td>
<td>Upscale implementation of preventative controls and drive consistent consequences</td>
</tr>
<tr>
<td>LP</td>
<td>Improvement in audit outcomes, which is mainly consultant driven and not supported by equivalent improvement in sustainable key control environment</td>
<td>Active leadership supervision will lead to sustainable key control environment</td>
</tr>
<tr>
<td>MP</td>
<td>The state of internal controls, coupled with lack of consequences for transgressions and weakened oversight, is at the centre of the deteriorating accountability in our local government</td>
<td>A need for leadership to act on accountability to bring about the desired change</td>
</tr>
<tr>
<td>NC</td>
<td>The benefits derived from implementing preventative controls are evident, but there is still a lot to be done to address undesirable audit outcomes</td>
<td>Sustainable change starts with the leadership will to drive it</td>
</tr>
<tr>
<td>NW</td>
<td>Total neglect of internal control disciplines, resulting in financial and operational collapse, weakened governance and lack of accountability</td>
<td>To bring about accountability, leadership must be aligned and actively lead</td>
</tr>
<tr>
<td>WC</td>
<td>Good financial accounting controls but inadequate preventative controls on compliance</td>
<td>Improvement but concerns remain</td>
</tr>
</tbody>
</table>
A CALL TO LEADERSHIP

There have been many calls from all quarters of the country to turn around the decline in local government. Barely a day goes by without shocking revelations of fraud and corruption, wastage, infrastructure deterioration, and municipalities that have lost the trust of the communities they serve. The most jarring is the impact of service delivery failures on the most vulnerable of our citizens – the poor.

We have seen many initiatives, plans and strategies – even direct interventions by national and provincial government – but these have had little effect. Short-term solutions such as consultants, administration and additional monitoring, rules and capacitation are just not working. As an audit office, we have also done everything within our mandate and beyond to support municipalities; we have even taken on a more direct role in the accountability process through the material irregularity process.

We are convinced that if municipal leaders at both administrative and political level, supported by their provincial leadership, are fully committed to turn around local government towards the capable, efficient, ethical and development-oriented institutions envisaged by the Constitution, improvements are bound to follow. We have seen great results where leadership has moved beyond the politics and obstacles and taken definite strides towards a better future for the communities they serve.

We remain committed to working tirelessly within our new mandate to strengthen financial and performance management in local government, emphasising the need for accountability and doing the basics right.

We encourage councils, Parliament, provincial legislatures as well as the political and administrative leadership to play their part effectively and without fear or favour to ensure accountability for government spending and improvement in the lives of the citizens of this country. Ethical and accountable leadership should drive the desired change.