

# MATERIAL IRREGULARITIES



*In this section, we look at the second year of implementation of our expanded mandate and provide insight on the material irregularity process and the material irregularities identified.*

## OUR EXPANDED MANDATE

The responsibilities and duties of municipal managers are well defined in the Municipal Finance Management Act, which are underpinned by the basic values and principles governing public administration as set out in our country's Constitution. It includes the need for high standards of professional ethics, accountability and transparency as well as the promotion of the efficient, economical and effective use of resources.

Our audits have for many years been highlighting a systemic failure in local government to establish the systems, processes and controls required to make the constitutional principles and the requirements of the Municipal Finance Management Act the norm. Not only are irregularities and the resultant losses, misuse and harm not prevented from happening, they are also not appropriately dealt with when they are identified.

Our mandate has always been to audit and report on these matters in order for corrections to be made by municipal managers. Our reporting to councils enables them to also play their oversight role effectively. Our mandate was expanded by the amendments to the Public Audit Act, which became effective on 1 April 2019, to go beyond audit and reporting in an effort to strengthen the accountability mechanisms.

Rather than a punitive measure, the amendments are intended to act as a complementary mechanism in the broader public sector accountability value chain by strengthening

financial and performance management, which in turn will contribute to improved accountability.

Our expanded mandate does not change the role and responsibilities of the municipal manager, mayor or council.

We do not take over the role of the municipal manager who already has the responsibility to prevent irregularities and take action when they occur.

By identifying material irregularities, we support municipal managers by bringing to their attention the irregularities that could have a significant impact on finances, resources and service delivery while also empowering them to take the appropriate steps timeously in terms of legislation. This will lessen the adverse effect of such irregularities on municipalities, set the right tone for accountability, highlight the need for consequences, and encourage a behavioural change at the highest levels.

The amendments to the Public Audit Act and the introduction of the accompanying Material Irregularity Regulations have been shaped in a manner that supports the process of fair, transparent and legally sound administrative justice, by providing an opportunity to the municipal managers to take the actions required to deal with the material irregularities. We use our additional powers only where the municipal manager is not dealing appropriately with such irregularities. This process can be depicted graphically as follows:

## If municipal manager does not appropriately deal with material irregularities, our expanded mandate allows us to:

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**Refer material irregularities**  
to relevant public bodies  
for further investigation



**Take binding remedial action**  
for failure to implement our  
recommendations for material  
irregularities



**Issue certificate of debt**  
for failure to implement  
remedial action if  
financial loss was involved

The oversight and monitoring roles of the mayor and council remain unchanged by the Public Audit Act amendments. We report the material irregularities in the audit report, which also enables municipal public accounts committees to perform their oversight function – focusing on the most material matters affecting municipalities.

If municipal managers, supported by their political leadership, adhere to their legislated responsibilities and commit to take swift action when we notify

them of a material irregularity, there will be no need for us to use our remedial and referral powers.

We are fully committed to the implementation of 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 by municipal managers becomes the norm.

## IMPLEMENTATION OF THE MATERIAL IRREGULARITY PROCESS

The amendments to the Public Audit Act introduced the concept of a material irregularity. But what does this mean?

### What is a material irregularity?

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means any **non-compliance** with, or **contravention** of, legislation, **fraud, theft** or a **breach of a fiduciary duty** identified during an audit performed under the Public Audit Act that **resulted in or is likely to result in** 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**

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As per the definition, there are two main gates through which a matter must pass for it to be classified as a material irregularity – there needs to be an **irregularity** (which is the non-compliance, fraud, theft or breach), and that irregularity must have an **impact** (being loss, misuse or harm).

Irregularities are identified during our normal audit process, as we audit compliance with key legislation as well as consider governance and control as part of the audit. Our audit processes can also identify possible fraud and theft, which we then report to management for investigation.

However, our audit process generally does not consider the impact of the irregularities identified (for example, if a financial loss is likely), as it is not required by the auditing standards. The requirements and processes to follow for a material irregularity as prescribed by the Public Audit Act and the Material Irregularity Regulations introduce additional steps in the audit process, new processes for referrals and remedial action, and the establishment of new structures and additional capacity.

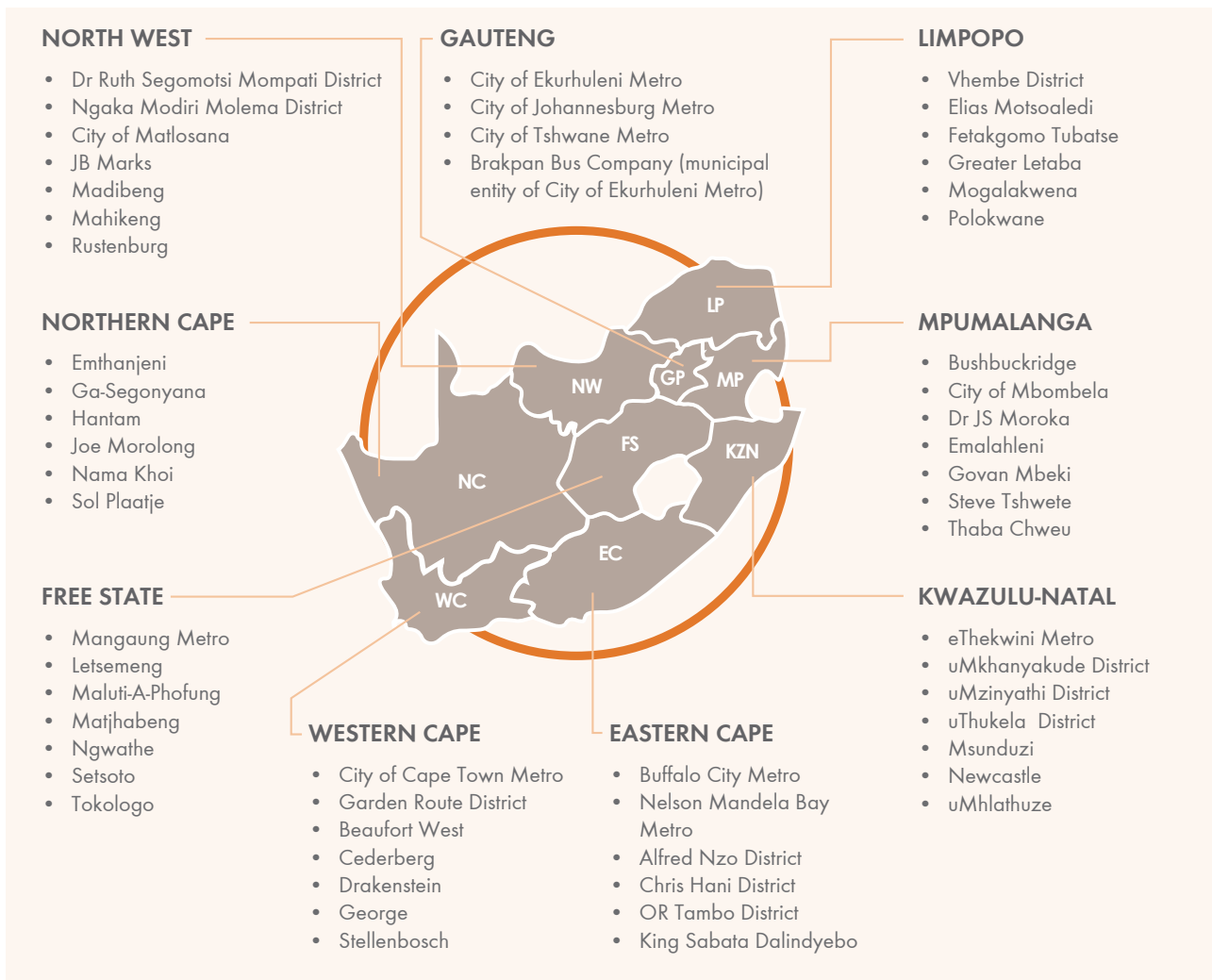
The impact of the expanded mandate on our audit process and organisation as well as the profound implications thereof requires us to implement the changes in a careful, but progressive manner.

As agreed with the Standing Committee on the Auditor-General, we are phasing in the implementation of our expanded mandate. The phasing-in allows us to responsibly align the organisational resources with the demand placed on us by the Public Audit Act and to establish relationships with the public bodies to which we will be referring material irregularities. A phased-in approach also enables us to manage any risks associated with implementation, such as possible disputes and litigation, as well as the costs associated with implementation.

Our phased-in approach is guided by a step-by-step implementation of the material irregularity definition.

In 2018-19, our focus was on the non-compliance with legislation scoped in for auditing as part of normal audits that resulted in, or is likely to result in, a material financial loss. In 2019-20, we expanded this to any non-compliance with, or contravention of, legislation that resulted in, or is likely to result in, a material financial loss. We also considered fraud, theft or a breach of a fiduciary duty if it constituted non-compliance with legislation. The prevalence of municipalities with disclaimed opinions at the conclusion of our 2019-20 audits compelled us to expand the definition further by considering the harm caused to a public sector institution (the municipality) by this persistent lack of proper documents and records.

We incrementally increased the number of auditees in local government where the material irregularity process was implemented from nine in 2018-19 to 57 in 2019-20. We focused on those auditees where we were most likely to have the greatest impact. The selected 57 auditees included the metros, most of the secondary cities (classified as such by the National Treasury based on their rapidly increasing population and economic growth) and some of the smaller municipalities and municipal entities that had high irregular expenditure in the past. The selected auditees are shown on the map that follows.



These auditees covered 42% of the expenditure budget, 54% of the irregular expenditure incurred, and 68% of the irregular expenditure balance. We specifically looked at irregular expenditure as an indicator of the level of non-compliance with

legislation at an auditee and the potential for material financial losses. This does not mean that irregular expenditure and material irregularities are the same thing, as explained later on in this section.

## IDENTIFYING AND REPORTING ON MATERIAL IRREGULARITIES

Our annual regularity audit process has distinct phases, including planning and execution. As the legislated reporting date comes closer, we finalise and conclude on our audits, allowing for the audit report to be signed on time. Thereafter we interact with oversight committees and undertake engagements on the overall audit outcomes and the general report.

The material irregularity process is integrated into the audit process, but is not bound to the audit

cycle in the same way as our regularity audits. It does not have a distinct start and stop date, which is quite a different approach than what our auditees are used to. We can identify matters that can potentially be material irregularities at any time of the audit – even right before the audit report is signed. We then do not leave it to the next annual audit, but rather follow our structured material irregularity route to confirm whether the matter meets the definition and start with the process so as not to delay the accountability process.

## What did we do to identify material irregularities?

The material irregularity process was applied from 1 April 2019 at the selected auditees, when the amendments became effective. The auditor-general used the discretion allowed by the Public Audit Act to direct that the audit teams only consider material irregularities where it continued to have a financial impact from the effective date. This means that we did not consider non-compliance that took place in prior years except where it continued to financially affect the auditee; for example, if payments were still being made on a contract that had been irregularly awarded in prior years, or if a debt owed to the auditee was still in its books.

We also made sure that we applied the definition of a material irregularity correctly by only reporting it if the non-compliance directly resulted in a financial loss or was likely to result in a financial loss. We considered whether a financial loss was material through considering its value, nature and impact. The value of the financial loss had often already been determined by the auditee and disclosed

in the financial statements, such as fruitless and wasteful expenditure (what we refer to as a known financial loss). But for some material irregularities, we estimated the potential financial loss to consider if it was material (what we refer to as an estimated financial loss).

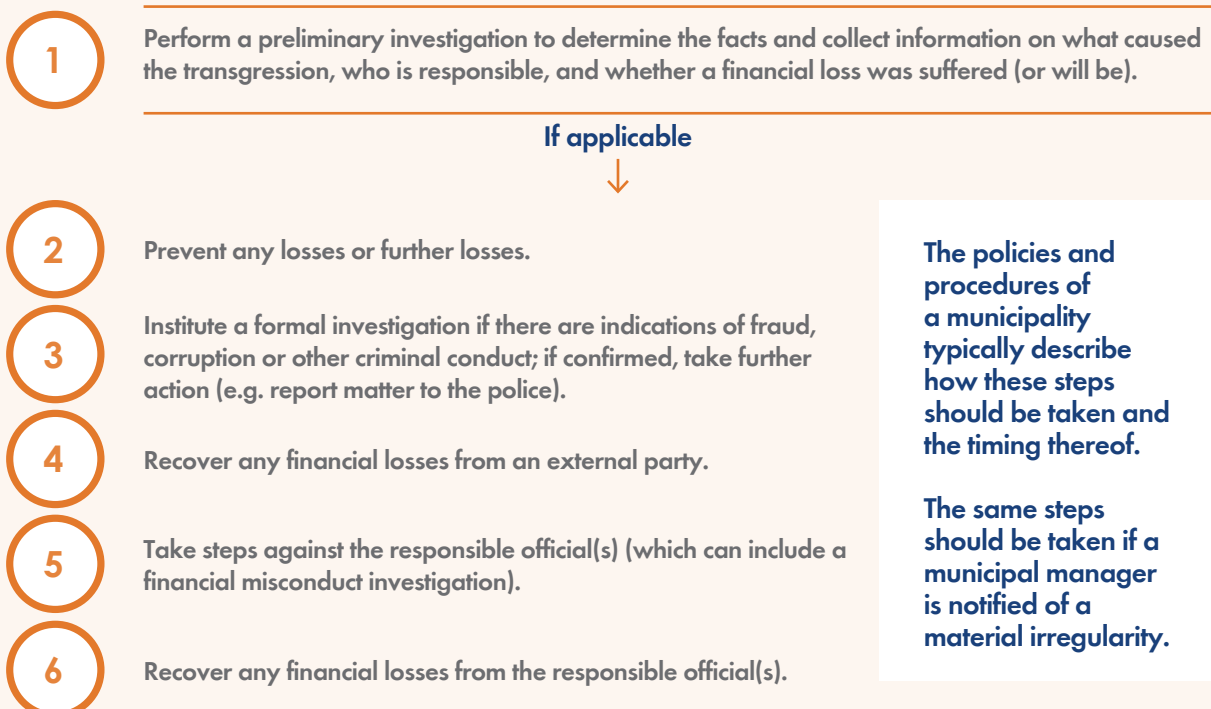
## What did we do when we identified a material irregularity?

When we identified a material irregularity, the municipal manager was notified without delay. We gave them 20 working days to respond to the notification by giving us a written submission and evidence on what they have done to address the material irregularity and what their further planned actions are.

We assessed the responses provided and concluded whether their actions (taken or planned) and its outcomes were appropriate in line with their legal obligations. If we found this to be the case, we gave the municipal manager space to implement the further planned actions. We then follow up on the progress made with resolving the material irregularity in the next audit cycle.

## Legal obligations of municipal manager to address an irregularity

If a municipal manager is made aware of an irregularity (non-compliance, fraud, theft or a breach of fiduciary duty), the Municipal Finance Management Act and its regulations typically prescribe the following steps to be taken:



If we conclude that it was not appropriate, we include recommendations in the audit report on what the municipal manager should do to address the material irregularity. We also include a deadline by when these recommendations should be implemented.

If it requires further investigation, we also refer the material irregularity to a public body.

### What happens with the identified material irregularities?




A material irregularity is only fully resolved if (1) the loss (or further losses) is prevented and/or any losses incurred have been recovered or all possible steps have been taken to recover the losses; and (2) appropriate steps have been taken against the person or party responsible for the loss.

The material irregularities and the progress made in resolving them will be reported in the audit report of

the auditee and in general reports until they have been fully resolved to enable accountability and oversight. When an audit report is signed, we report based on the status of the material irregularities that are confirmed at that date. What we typically include are the following:

- New material irregularities identified and the actions the municipal manager is taking to address them – or we include the recommendations or information on referral (as applicable).
- Whether there are other material irregularities in process (if we have not concluded the notification and response process).
- Progress made in resolving material irregularities reported in the previous audit report.

The responsibilities for the further steps to be taken by the municipal manager, mayor, council and public bodies to resolve an identified material irregularity are detailed below.

	Municipal manager (MM) and Auditor-General of South Africa (AGSA)	Mayor and council
<p><b>MM is dealing with material irregularity</b></p> 	<p><b>MM</b> implements committed actions to address material irregularity and improves controls to prevent recurrence</p> <p><b>AGSA</b> follows up in next audit if actions were implemented and if outcomes were reasonable – if not, can result in referral or recommendation in audit report</p>	<p><b>Mayor</b> monitors progress and supports MM in addressing material irregularity and improving controls</p> <p><b>Council</b> monitors progress and calls MM to account for actions taken and outcomes</p>
<p><b>Material irregularity is referred to public body</b></p> 	<p><b>MM</b> cooperates with public body and implements any remedial actions/recommendations made and improves controls to prevent recurrence</p> <p><b>AGSA</b> provides information on material irregularity to public body, monitors progress with investigation, and follows up in audits the implementation of any remedial actions/recommendations</p>	<p><b>Mayor</b> supports public body's investigation and MM in improving controls; if responsible for public body, monitors progress with investigation</p> <p><b>Council</b> monitors progress with investigation and calls public body to account for undue delays in investigation</p>
<p><b>Recommendation included in audit report</b></p> 	<p><b>MM</b> implements recommendations by date stipulated in audit report and improves controls to prevent recurrence</p> <p><b>AGSA</b> follows up by stipulated date if recommendations were implemented and if outcomes were reasonable; issues remedial action</p>	<p><b>Mayor</b> monitors progress and supports MM in implementing recommendations and improving controls</p> <p><b>Council</b> monitors progress and calls MM to account for actions taken and outcomes</p>

## What did we do to follow up on the progress?

The 2019-20 year was the first time we followed up and reported on the progress with the material irregularities reported in the previous year.

We wrote to the municipal managers to enquire on the progress and request evidence on the actions they had planned to take. We also asked what their further planned actions were.

We assessed the responses provided and concluded whether their actions (taken or planned) and the outcome of these were appropriate in line with their legal obligations. If we found these to be appropriate, we gave the municipal manager space to implement the further planned actions, with an undertaking to follow up on the progress with resolving the material irregularity in the next audit cycle. If we concluded that the actions were not appropriate, we included recommendations in the audit report on what the municipal manager should do to address the material irregularity. We also included a deadline by when these recommendations should be implemented.

If we included recommendations in the audit report in 2018-19, we followed a similar approach to obtain feedback and evidence. As recommendations are to be implemented by a certain date, we requested written submissions from the municipal manager by that date, including reasons for recommendations not having been implemented. If the recommendations had not been implemented by the stipulated date, we

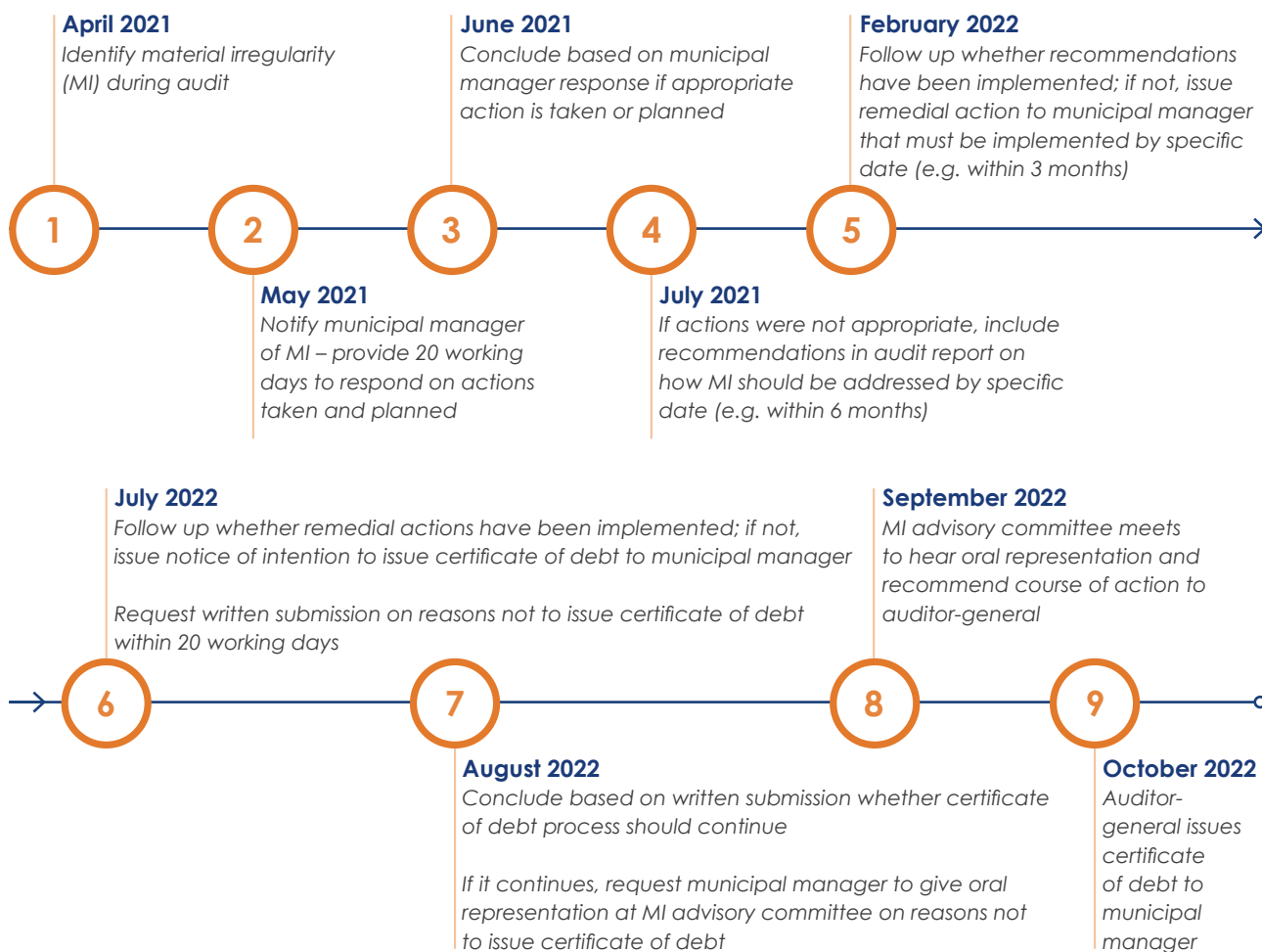
went through a rigorous process before concluding whether the municipal manager should be allowed more time or if remedial action should be implemented.

It is important to clarify that the municipal managers against whom we can take remedial action and ultimately issue a certificate of debt are not the persons or parties who had lost the money or who had been involved in the irregularity – they are those who did not take action to recover the money, stop further losses and act against the officials involved. Hence we must provide them with the time to take the required action. We will only activate our new powers when such action is not taken or not taken timeously, or if the outcome of the action is not appropriate.

We appreciate our stakeholders' frustration regarding the long time it takes from identifying a material irregularity to issuing a certificate of debt. But we have to be fair, reasonable and adhere to the principles of administrative justice, by providing municipal managers sufficient time to take action, implement recommendations and remedial steps as well as state their case for not taking the required action should that be the case.

The timeline below demonstrates the extent and timing of this process by using an example of a material irregularity identified in April 2021. Please note that this is a 'best case scenario' as there are often delays in the process – some within the control of the municipal manager, and some outside the control of either the municipal manager or ourselves.





## MATERIAL IRREGULARITIES IDENTIFIED

By 11 June 2021, we had issued notifications for 96 material irregularities, of which 75 related to non-compliance with legislation that resulted in a material financial loss. We estimate the financial loss associated with these material irregularities to be R2,04 billion.

## Nature of identified material irregularities (MIs)



### Disclaimers – 21 MIs

Full and proper records not kept as evidenced by **repeat disclaimed opinions** – resulting in substantial harm to municipality (lack of service delivery and/or vulnerable financial position)



### Procurement and payments

Non-compliance in procurement processes resulting in **overpricing of goods and services procured**  
**1 MI – R2,5 million** estimated loss

Payment for **goods or services not received** or **invalid salary payments**  
**18 MIs – R285,9 million** estimated loss



### Interest and penalties

Eskom, water boards, lenders and suppliers **not paid on time** resulting in interest  
**23 MIs – R979,3 million** estimated loss

Payroll and value-added tax returns **not paid on time** or incorrectly calculated resulting in South African Revenue Service interest and penalties  
**11 MIs – R54,7 million** estimated loss



### Revenue management

Revenue **not billed**  
**8 MIs – R182,3 million** estimated loss

Debt **not recovered**  
**2 MIs – R149,4 million** estimated loss



### Investments and assets

Loss of **investments**  
**3 MIs – R264,9 million** estimated loss

**Assets not safeguarded** resulting in loss  
**9 MIs – R116,6 million** estimated loss

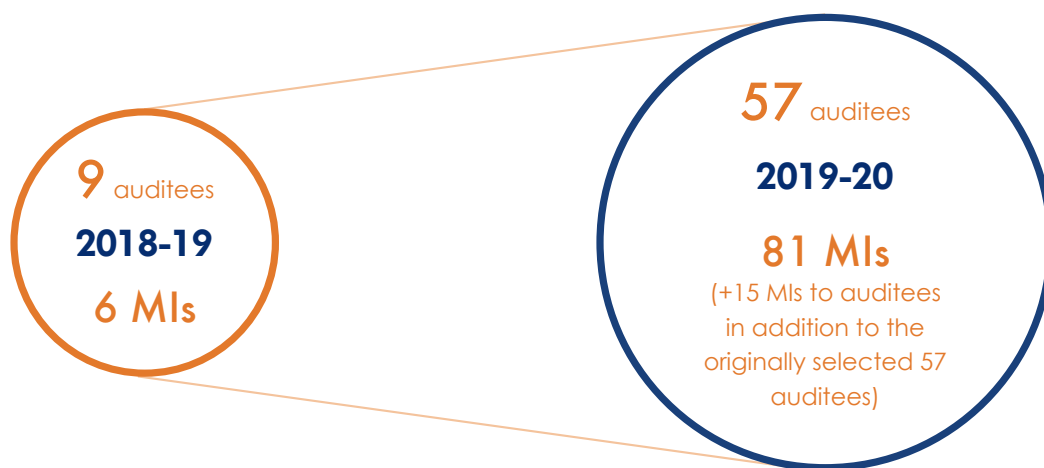
Material irregularities that resulted in material financial losses emerged in four key areas: procurement and payments, interest and penalties, revenue management, and investments and assets. We have highlighted all of these as areas of vulnerability for a number of years, including in this year's audit outcomes.

These are not complex matters, but some of the basic disciplines and processes that should be in place at auditees, such as procure at the best price, pay only for what was received, make payments on time, recover revenue owed to the state, and safeguard assets and investments.

At the conclusion of the 2019-20 audit cycle, the high number of municipalities that received disclaimed opinions (as detailed in section 4) compelled us to consider the impact of full and proper records not being kept and the lack of credible financial reporting. We concluded that these lapses in accountability caused substantial harm to the majority of these municipalities, as their

financial position was so poor that they disclosed in their financial statements a material uncertainty regarding their ability to continue operations. Some of the municipalities were not able to deliver services as required and the Department of Cooperative Governance determined them to be dysfunctional. By 11 June 2021, we had notified the municipal managers of 21 municipalities of this material irregularity. We did not issue the notifications only to disclaimed municipalities if they were part of the 57 auditees selected for implementation, but also to an additional 15 municipalities. We will implement the full material irregularity process at these municipalities from 2020-21.

As reflected below, the number of material irregularities increased significantly from 2018-19 as a result of the increase in auditees selected, the broadening of the definition for implementation, and the continuing refinement of our practices and processes as we learn from the implementation process.



Of the 96 material irregularities, 10 were reported in detail in the audit reports of the applicable auditees – six in 2018-19 and four in 2019-20 as the municipal manager response and our assessment of the response had been finalised by the time of audit report signing. We originally reported seven in 2018-19, but closed one based on information subsequently provided through an investigation instituted by the municipal manager. As it is no longer an active material irregularity, we exclude it from our discussion in the rest of this section.

The remaining 86 material irregularities have not yet been reported in detail in the audit reports of the applicable auditees as the response to the notification and assessment process had not been completed by the time we signed the audit reports.

As explained earlier, the material irregularity process is a continuous process and not bound by the audit cycle, which means that it continues even after an audit report has been signed. We will include the details of these material irregularities and the actions taken to resolve them in our 2020-21 audit and general reports.

By 11 June 2021, there were also a high number of matters being considered as potential material irregularities. These include matters identified during our audit of covid-19 expenditure and auditees with disclaimed opinions where the notifications had not yet been issued. These material irregularities, if confirmed and once the municipal managers have been notified, will also be reported in our 2020-21 reports.

## STATUS OF REPORTED MATERIAL IRREGULARITIES

### STATUS OF 10 MATERIAL IRREGULARITIES REPORTED IN AUDIT REPORT ISSUED BY 11 JUNE 2021

- 
**Implementation of appropriate actions by municipal manager in process**
- 
**Lack of progress by municipal manager resulting in recommendations issued**
- 
**Referred for investigation to a public body**

The six material irregularities where appropriate actions are being taken include three reported in 2018-19, which are being dealt with diligently by the municipal managers and are in various stages of resolution.

We would have wanted to see all of these material irregularities having been resolved but progress overall has been affected by the lockdown measures in response to the covid-19 pandemic as well as instability at municipal manager level.

We included recommendations in the audit report of Ngaka Modiri Molema (North West) for the three material irregularities we reported in 2018-19, as the actions the municipal manager had committed to were not implemented. To date we have not issued remedial actions as municipal managers have been playing their part. However, if the municipal manager of Ngaka Modiri Molema does not implement the recommendations in the audit report by the date stipulated, it could result in remedial action. In general, the municipal managers in North West were

not very responsive to the material irregularity process – some notifications were not even responded to.

We are in the process of referring a material irregularity identified at Matjhabeng (Free State) to a public body for investigation, as the municipal manager did not take or plan appropriate actions in response to being notified of the material irregularity.

We now discuss the status of the 10 reported material irregularities in more detail.

## DETAIL OF REPORTED MATERIAL IRREGULARITIES

### IMPLEMENTATION OF APPROPRIATE ACTIONS IN PROCESS

Auditee and year reported	Description	Actions being taken by audit report date
Mogalakwena (LP)  <b>2018-19</b>	<b>Payments to contractor for construction work not done</b> at Moshate stadium.  <b>Financial loss:</b> R13 million  <b>Notified:</b> 14 December 2019	Investigation completed in August 2020 confirmed the financial loss and recommended that officials responsible be charged with misconduct.  Disciplinary proceedings are underway and attorneys were appointed in February 2021 to recover money from contractor.
City of Tshwane Metro (GP)  <b>2018-19</b>	<b>Assets stolen and vandalised</b> at the Annlin reservoir project in January 2018, as not all reasonable steps were taken to safeguard the assets.  <b>Financial loss:</b> R5,5 million  <b>Notified:</b> 11 December 2019	An investigation by the internal forensic division was completed by June 2020. The investigation did not cover adherence to the asset management policy, the verification and quantification of the financial loss or whether there was any fraud, corruption or misconduct related to the material irregularity. The municipal manager committed to conclude the investigation covering the entire scope by 1 July 2021, and will take action against responsible officials and steps to recover financial loss based on the outcome.  Steps were taken to improve security at the site, but the appointment of a security company was delayed by the covid-19 lockdown measures. The new date committed to is 30 June 2021.  The matter was reported to the South African Police Service for investigation on 11 January 2018 but has not yet been concluded.

Auditee and year reported	Description	Actions being taken by audit report date
<p>City of Tshwane Metro (GP)</p> <p><b>2018-19</b></p>	<p><b>Assets stolen and vandalised</b> at the Baviaanspoort wastewater treatment works in February 2016, as not all reasonable steps were taken to safeguard the assets.</p> <p><b>Financial loss:</b> R3,9 million</p> <p><b>Notified:</b> 17 December 2019</p>	<p>The matter was reported to the South African Police Service – arrests were made and the perpetrators sentenced.</p> <p>An investigation by the internal forensic division was completed by June 2020. The investigation did not cover adherence to the asset management policy, the verification and quantification of the financial loss or whether there was any fraud, corruption or misconduct related to the material irregularity. The municipal manager committed to conclude the investigation covering the entire scope by 1 July 2021, and will take action against responsible officials and steps to recover financial loss based on the outcome.</p> <p>Steps were taken to improve security at the site, but the appointment of a security company was delayed by the covid-19 lockdown measures. The new date committed to is 30 June 2021.</p>
<p>Nelson Mandela Bay Metro (EC)</p> <p><b>2019-20</b></p>	<p><b>Interest not charged</b> in 2018-19 on debtors in arrears who had entered into long-term arrangement agreements with the municipality.</p> <p><b>Financial loss:</b> To be quantified by municipal manager</p> <p><b>Notified:</b> 9 December 2019</p>	<p>Preliminary investigation completed in February 2020 by the billing coordination division in consultation with debtor management division. Outcome of investigation indicated that the material irregularity is the result of a system deficiency.</p> <p>Accounting system was re-programmed in February 2020 to make raising interest every month an inherent part of the system.</p> <p>Municipal manager plans to submit proposal to budget and treasury standing committee in June 2021 and to council for consideration and approval that interest on arrangements not be raised retrospectively for the period when the accounting system did not raise such interest.</p>
<p>Nelson Mandela Bay Metro (EC)</p> <p><b>2019-20</b></p> <p><b>(2 material irregularities)</b></p>	<p><b>Payments</b> in 2018-19 to two suppliers <b>for provision of storm-water drain cleaning services that were not received.</b></p> <p><b>Financial loss:</b> To be quantified by municipal manager</p> <p><b>Notified:</b> 13 December 2019</p>	<p>Investigation into matter by provincial Hawks unit commenced in January 2020.</p> <p>Municipal manager plans to recover losses incurred and effect consequences against responsible official(s).</p>

## RECOMMENDATIONS IN AUDIT REPORT AND REFERRALS TO PUBLIC BODY FOR INVESTIGATION

Auditee and year reported	Description	Recommendation/referral as reported in audit report
<p>Ngaka Modiri Molema (NW)</p> <p><b>2018-19</b></p>	<p><b>Failure by municipality to monitor contract for construction work</b> to municipal office building and gate house <b>resulted in contract extension</b> that included items already paid for as part of original contract. These costs could have been avoided.</p> <p><b>Financial loss:</b> To be quantified by municipal manager</p> <p><b>Notified:</b> 14 November 2019</p>	<p>The municipal manager failed to implement the planned actions.</p> <p>Recommendations to be implemented by 1 October 2021:</p> <ul style="list-style-type: none"> <li>• The financial loss should be quantified.</li> <li>• Any person liable for the loss should be identified and appropriate action should commence to recover the financial loss.</li> <li>• The non-compliance should be investigated to determine if any official might have committed an act of financial misconduct or an offence in terms of chapter 15 of the Municipal Finance Management Act.</li> <li>• Disciplinary or, when appropriate, criminal proceedings should commence against any official who has allegedly committed an act of financial misconduct or an offence, as required by section 62(1)(e) of the Municipal Finance Management Act and in the manner prescribed by the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings.</li> <li>• If it appears that the municipality suffered the financial loss through fraud, this should be reported to the South African Police Service, as required by section 32(6)(b) of the Municipal Finance Management Act.</li> </ul>

Auditee and year reported	Description	Recommendation/referral as reported in audit report
<p>Ngaka Modiri Molema (NW)</p> <p><b>2018-19</b></p>	<p><b>Overpayment</b> in 2018-19 to supplier <b>for water-tankering services</b> to communities as a result of municipality not having an effective system of expenditure control.</p> <p><b>Financial loss:</b> To be quantified by municipal manager</p> <p><b>Notified:</b> 28 November 2019</p>	<p>The municipal manager failed to implement the planned actions.</p> <p>Recommendations to be implemented by 18 November 2021:</p> <ul style="list-style-type: none"> <li>• The financial loss in the form of overpayments should be quantified and appropriate action should commence to recover the loss from the supplier.</li> <li>• A system of expenditure control should be implemented, as required by section 65(2)(a) of the Municipal Finance Management Act, for the provision of water-tankering services, to prevent over-invoicing of kilometres and hours.</li> <li>• The non-compliance should be investigated to determine if any official might have committed an act of financial misconduct or an offence in terms of chapter 15 of the Municipal Finance Management Act.</li> <li>• Disciplinary or, when appropriate, criminal proceedings should commence against any official who has allegedly committed an act of financial misconduct or an offence, as required by section 62(1)(e) of the Municipal Finance Management Act and in the manner prescribed by the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings.</li> <li>• If it appears that the municipality suffered the financial loss through fraud, this should be reported to the South African Police Service, as required by section 32(6)(b) of the Municipal Finance Management Act.</li> </ul>

Auditee and year reported	Description	Recommendation/referral as reported in audit report
<p>Ngaka Modiri Molema (NW)</p> <p><b>2018-19</b></p>	<p><b>Loss of assets</b> due to lack of internal control system to safeguard assets.</p> <p><b>Financial loss:</b> To be quantified by municipal manager</p> <p><b>Notified:</b> 9 December 2019</p>	<p>The municipal manager failed to implement the planned actions.</p> <p>Recommendations to be implemented by 1 October 2021:</p> <ul style="list-style-type: none"> <li>• The asset verification and investigation process should be completed and the financial loss quantified.</li> <li>• Any person liable for the loss should be identified and appropriate action should commence to recover the financial loss.</li> <li>• Reasonable steps should be taken to safeguard these municipal assets from any further losses, as required by section 63(1) of the Municipal Finance Management Act.</li> <li>• The non-compliance should be investigated to determine if any official might have committed an act of financial misconduct or an offence in terms of chapter 15 of the Municipal Finance Management Act.</li> <li>• Disciplinary or, when appropriate, criminal proceedings should commence against any official who has allegedly committed an act of financial misconduct or an offence, as required by section 62(1)(e) of the Municipal Finance Management Act and in the manner prescribed by the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings.</li> <li>• If it appears that the municipality suffered the financial loss through fraud, this should be reported to the South African Police Service, as required by section 32(6)(b) of the Municipal Finance Management Act.</li> </ul>
<p>Matjhabeng (FS)</p> <p><b>2019-20</b></p>	<p><b>Payments made for</b> construction of <b>attenuation</b> (flood-protection) <b>dam</b> on Nyakallong storm-water system <b>not constructed</b> resulting in overpayments on project.</p> <p><b>Financial loss:</b> To be determined through public body investigations</p> <p><b>Notified:</b> 5 May 2020</p>	<p>Municipal manager could not provide sufficient and appropriate evidence of actions taken in response to being notified of the material irregularity. Actions taken were also considered to be inadequate.</p> <p>As a result, the material irregularity is being referred to a public body for investigation.</p>



# MATERIAL IRREGULARITIES VERSUS IRREGULAR EXPENDITURE

Now that we have looked at the material irregularities in detail, let's address a question that we frequently get asked on the correlation between irregular expenditure and material irregularities. Our stakeholders often expect that all irregular expenditure will also be material

irregularities. This is not the case, however, as explained below by looking at how the definition and application of irregular expenditure differ from those of material irregularities.

## How irregular expenditure (IE) is different from material irregularities (MIs)

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### Definition

**IE:** Expenditure incurred in contravention of, or that is not in accordance with, a requirement of any applicable legislation

**MI:** Any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty identified during an audit performed under the Public Audit Act that resulted in or is likely to result in 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



### Difference: irregularity

**IE:** Irregularity is only **non-compliance with legislation when incurring expenditure**

**MI:** Irregularity is **any non-compliance (not limited to expenditure)** as well as **fraud, theft or breach of fiduciary duty**



### Difference: impact

Impact is not specified, as MFMA requires municipal manager and council to determine impact

There can be **irregular expenditure that did not result in any financial losses, misuse or harm**

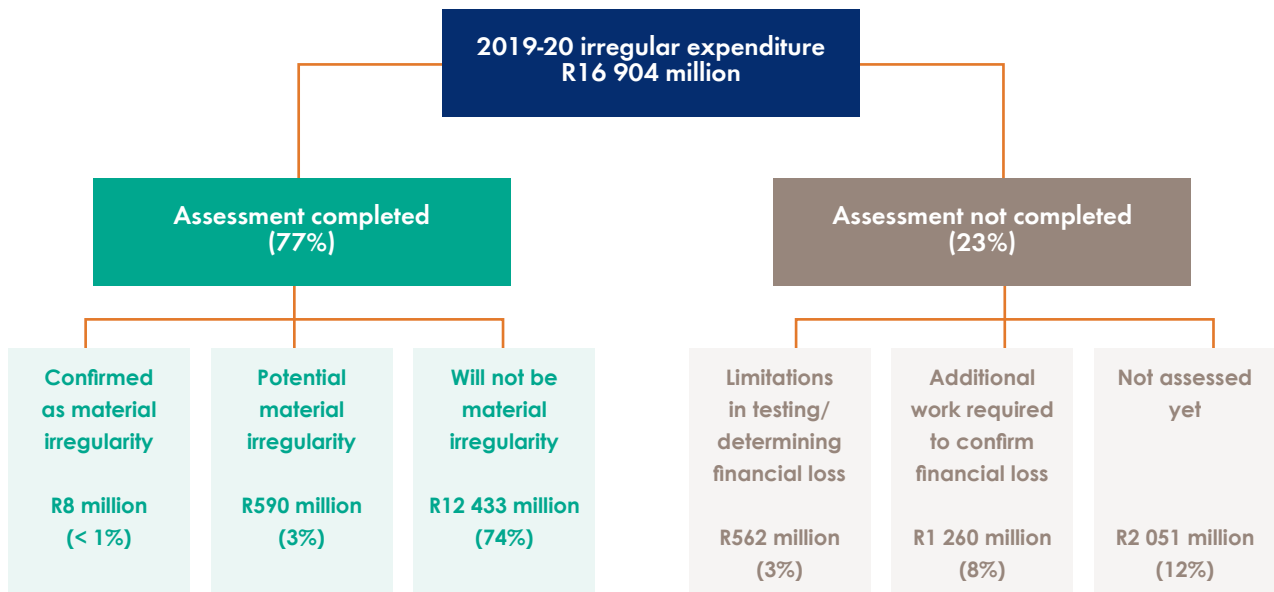


### Difference: value

**IE:** Value is **expenditure to date**

**MI:** Does not necessarily have a value, but if impact is financial loss, **value we report is estimated financial loss**

One of the sources of potential material irregularities we use, is the irregular expenditure disclosure in the financial statements of auditees and the register of instances they keep. Below we show how we assessed the R16 904 million in irregular expenditure incurred in 2019-20 as disclosed by the selected auditees.



Some assessment work (23% of the value) still needs to be completed due to various reasons such as limitations in determining the loss or additional work that must still be done.

Based on the assessments completed, however, 74% of the irregular expenditure will not translate into material irregularities. There were two main reasons for this:

1. It did not meet the definition of a material irregularity that we are currently applying, as we confirmed that the non-compliance did not result in a financial loss (64%). There was also a portion (8%) that was non-compliance from a prior year that did not continue to have an impact.
2. The value of some of the non-compliance was very low (2%) – these cases typically related to quotations. It is unlikely that such non-compliance will result in financial loss that will be considered material.

## CONCLUSION

We have already seen great value from the implementation of the material irregularity process. Based on our experiences to date, the following are our key observations:

- Most **municipal managers are taking appropriate action** to address the material irregularities identified (based on the 60% of material irregularities reported in the audit reports where appropriate action is being implemented, as described earlier under *Detail of reported material irregularities*). We observed that municipalities knew about the irregularities and losses – and even disclosed these as irregular expenditure, fruitless and

wasteful expenditure, or impairments. However, little action had been taken before we officially notified the municipal managers of the material irregularities.

- In following up the progress with the material irregularities we reported in 2018-19, we found that the municipal managers of Mogalakwena and City of Tshwane Metro were actively working on resolving the material irregularities, although there were some delays as a result of the impact of covid-19. We were also encouraged by the positive responses received from most municipal managers when we notified them of material irregularities, with the exception of those in North West. It signals

a **behavioural change towards responding in a decisive and timely manner to our findings.**

At some auditees, matters we have been reporting for a number of years are finally receiving attention – the non-billing of interest at Nelson Mandela Bay Metro is a good example in this regard.

- The timely resolution of material irregularities is **dependent on investigations** that are thorough but also speedily completed. Municipal managers can monitor the progress made on the investigations they commissioned, and can ensure that the completion is not unduly delayed. However, when a material irregularity is referred to another public sector institution, the municipal manager has little influence. The executive authorities and committees in Parliament and legislatures will need to monitor progress on such investigations and hold the institutions to which they were referred accountable.
- Most of the material irregularities identified were money lost as a result of late payments to Eskom, water boards, the South African Revenue Service, lenders and suppliers, resulting in interest being charged. These material irregularities **are not complex accounting or procurement issues and could have been prevented through basic controls.** The material irregularities resulting from supply chain management non-compliance were also

mostly not complex or ambiguous and could have been prevented – or at least detected and dealt with – before they resulted in such material financial losses for the auditees. None of the material irregularities were as a result of human error, but were rather due to poor processes and judgement. There were most definitely indicators of fraud in some of these material irregularities, which have been (or will still be) uncovered by the investigations and referrals.

Preventing material irregularities is more effective than having to deal with the consequences thereof – money is lost, costly investigations have to be instituted and officials are subjected to the discomfort and anxieties associated with these processes, which often take a number of years to be concluded.

As we continue on our journey to implement the material irregularity process, we hope to see a definite move by municipal leadership and oversight towards the prevention of material irregularities to the benefit of the financial management, reputation and service delivery of our auditees – and ultimately the lives of the citizens they serve. As expressed throughout this report, the change needed in local government must be driven by an ethical and accountable leadership.