

Auditor-General calls for urgent action to address challenges in local government

CAPE TOWN – Auditor-General (AG) Tsakani Maluleke today called on local government leadership to build a culture of accountability that will improve service delivery and living conditions for citizens.

She also called for all South Africans to be “active participants in helping improve accountability and to hold local government accountable”.

The AG made this call to action while releasing her office’s **2021-22 consolidated general report** on the local government audit outcomes.

AG Maluleke noted that, “Local government has been characterised by dysfunctional municipalities, financial mismanagement, council and administrative instability, and crumbling municipal infrastructure. This leads to deteriorating standards of living and service delivery failures, resulting in service delivery protests. I firmly believe that service delivery improvements will be enabled by capable, accountable and citizen-centric municipal leadership delivering on their mandates to improve the lives of ordinary South Africans.” In line with this call, the AG themed her latest general report **A culture of accountability will improve service delivery**.

She expressed concern that the state of local government is deteriorating and needs urgent attention. Municipalities are continuously failing to address issues of accountability, integrity, performance and good governance. Maluleke also noted that significant progress was made with the collaboration and support from leadership of provincial cooperative governance departments (Cogta) and treasury. Thus, while there were fewer clean audits, there were also fewer municipalities that received disclaimed audit opinions, with nine (9) municipalities improving from a disclaimed outcome. “If the municipalities with outstanding audits also receive disclaimed audit opinions, the improvement in this area will be less significant, but the movement of the nine municipalities should still be acknowledged,” said the AG.

“The support we have seen from provincial Cogta and treasuries is what we as the national audit office have been calling for – for all stakeholders to be part of the solution in addressing challenges in local government. I commend the efforts of the provincial leadership for taking ownership, and for the support they have provided to municipalities. My plea is that this support be sustained, as it has shown to have the desired impact if we are to realise any improvement.”

If a municipality receives an **adverse audit opinion**, this means that it submitted financial statements that are so unreliable that they cannot be used for oversight and decision-making. Six municipalities received adverse audit opinions in 2021-22.

“There is little transparency and accountability on how these municipalities use their funds,” the AG continued. “As is the case with municipalities that receive disclaimed audit opinions, national and provincial leadership and coordinating institutions should continue to offer support and, where necessary, intervene. Of the municipalities that received adverse audit opinions, only uMzinyathi District Municipality in KwaZulu-Natal is under provincial intervention, and although this intervention began in October 2016, it has had little impact.”

The AG said she is pleased that her message on the need to eradicate disclaimed audit opinions has been taken seriously and is being at least partially heeded by the municipal and provincial leadership. She believes that there could have been greater improvement if those charged with governance, administrative and oversight responsibilities had intensified their efforts, noting that their efforts were hampered by instability due to the transition to the new administration after the elections. The AG called for continued support and collaboration across the accountability ecosystem for local government to realise improvement.

Financial statements submission improvement

The AG is also pleased that municipalities heeded her call for financial statements to be submitted by the legislated date. In this cycle, municipalities that submitted their financial statements by the legislated date improved from 81% in the previous year to 91%. This, she said, “was largely due to provincial government’s concerted efforts to support municipalities as well as the impact of our enforcement mandate”.

“Where financial statements remained outstanding, we continued to reach out to all key role-players in the accountability ecosystem to intervene and we again used our enforcement mandate (as we did in 2020-21) for the non-submission of the 2021-22 financial statements at

15 municipalities. In response, we received the financial statements of 12 of these municipalities.”

The AG added that her office should not be required to use its enhanced powers for the non-submission of financial statements, as this is one of the basic disciplines of accountability that each municipality must practice. The submissions are also critical and required to allow her office to do its work, which is to audit and report.

Material irregularities

The material irregularity (MI) process is continuing to have an impact in the AG holding auditees to account where accountability has failed. In the fourth year of implementation, her office has been very responsive, expanding its work significantly by implementing the MI process at 170 auditees – up from 94 last year. According to the AG, the plan is to increase this number to 276 auditees next year.

“We have continued to see greater responsiveness from accounting officers to our MI process, and we noted that no action was being taken on 87% of irregularities until we issued MIs. The MIs we issued jolted them to desired action to address the irregularities and transgressions we raised,” the AG explained.

“When accounting officers respond to our notifications with commitment and workable plans for how they will take appropriate action to resolve the MI, the intended impact of the Public Audit Act amendments is achieved. The main objective of these amendments was to enable those responsible to take corrective action to resolve the identified MIs and to prevent similar ones from occurring in future.”

Through the MI process, accounting officers have taken action to prevent or recover financial losses of R479,56 million. Of this, R150,55 million in financial loss has been recovered, R18,85 million has been prevented from being incurred, and R310,16 million is in the process of being recovered.

In the 50 cases where accounting officers did not appropriately address the MIs reported to them, the audit office used its expanded mandate to include recommendations in the audit reports, or the AG invoked her additional powers of referral and remedial action. She has also taken the first steps towards issuing a certificate of debt. The municipalities where further action

was taken are also those that are typically slow to respond to audit findings and to improve the control environment.

When the AG invokes her powers of referral, remedial action and, in future, issuing certificates of debt, it not only reflects poorly on the accounting officer, but also means that other role-players in the accountability ecosystem have failed to fulfil their responsibilities.

“We are fully committed to implementing the enhanced powers given to our office – without fear, favour or prejudice. If accounting officers, supported by their political leadership, meet their legislated responsibilities and commit to taking swift action when we notify them of an MI, there is no need for us to use our remedial and referral powers. If, however, they do not deal with MIs with the required seriousness, we do not hesitate to use these powers.”

The state of local government

The AG warned that the state of local government is deteriorating and requires urgent attention from authorities at local and provincial level. She repeated her call for provincial support to be intensified to help rescue local government from this state. Municipalities must move swiftly to fill vacancies in key positions with capable and qualified officials, and to provide them with the necessary support to do their work and hold them accountable.

The audit outcomes, and the insights included in the latest report, reflect the concerning state of financial and performance management, as well as compliance with key legislation in local government.

Maluleke reported that the audit outcomes were in a poor state at the end of the previous administration's term and the new administration, which was in office for half the period under review, had little impact and, as a result, did not improve in 2021-22.

Her report reflects on the audit outcomes of local government and presents observations and insights from the audits of the financial year ended 30 June 2022, which covers the first year of the current administration.

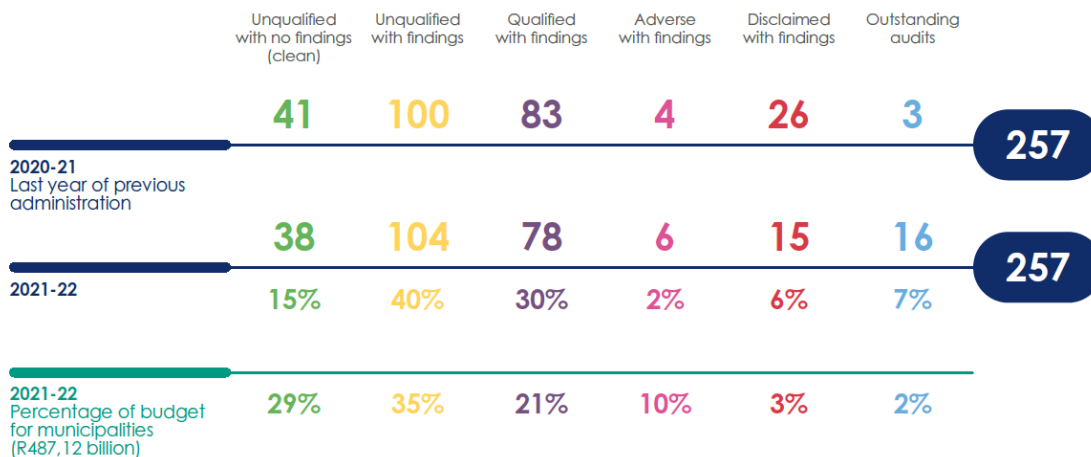
For the year under review, municipalities had an estimated expenditure budget of R487,12 billion to operate and deliver services.

Overall audit outcomes

The audit office's annual, regularity outcomes are based on audits of the financial statements and performance reports of municipalities, as well as their compliance with key legislation.

The figure below shows the 2020-21 and 2021-22 audit trends:

Audit outcomes – municipalities



Overall, 33 municipalities have a better audit outcome than they did in 2020-21, while 29 have a worse outcome.

Clean audits

The AG expressed concern that the number of clean audits decreased, mainly due to the instability that occurred with the transition to the new administration. She also expressed concern that internal performance disciplines are not institutionalised – when political transition occurs, the administrative functions must continue to fulfil their duties.

Municipalities with a clean audit status managed 29% of the expenditure budget of local government. Two metros fall into this category, namely City of Ekurhuleni (Gauteng) and City of Cape Town (Western Cape). The total number of municipalities with clean audit opinions decreased slightly, as more municipalities lost their clean audit status than improved to a clean audit status. The regressions were due to instability in key positions, as well as inadequate monitoring and review of controls relating to compliance. The Western Cape continued to lead with the highest number of municipalities with clean audit opinions.

The AG says the municipalities that maintained their clean audit status continue to be an example of what is possible.

“A clean audit is important and positions a municipality to transparently communicate to communities on whether and when their needs will be met through accurate records, which also enables informed decisions. We have also seen that municipalities with institutionalised controls and systems 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. When this is the case, municipalities can focus on ensuring they deliver quality services to all of their residents,” Maluleke said.

“A clean audit remains desirable and reflects the basics that municipalities should aspire to achieve. Auditees that receive an unqualified with findings audit opinion could easily regress and therefore should increase their focus and work towards achieving a clean audit opinion,” she added.

Root causes of challenges identified

Overall, there has been little change, but the report highlights the pockets of improvement and the actions government has initiated to drive change as a message of hope for better outcomes and the resulting impact on the lived realities of all South Africans. It also urges elected representatives to intensify their actions towards instilling a culture of performance, transparency and integrity, and to be accountable to the communities they serve.

Local government is plagued by a number of challenges, but some of the root causes require urgent attention to realise wholesale good governance. These include:

- **Inadequate skills and capacity:** Limited skills and capacity in finance, information technology and technical units (which are responsible for infrastructure projects) led to municipalities relying heavily on consultants. Vacancies and instability in key positions such as those of municipal manager and chief financial officer contributed to the limited improvement in audit outcomes and to delays in dealing with MIs and other transgressions.
- **Governance failures:** A lack of institutionalised financial and performance management controls continued to leave municipalities ill-prepared to operate optimally during times of change and instability. Instability and disruption in councils, along with ineffective municipal public accounts committees and disciplinary boards, continued to limit the

effectiveness of governance processes. Audit committees and internal audit units did not have the required impact, mostly because their recommendations were not implemented. The interventions and support initiatives provided by some of the coordinating institutions, and the reporting by the members of the executive council for local government to provincial legislatures, also had limited impact.

- **Lack of accountability and consequences:** Equally important as appointing skilled officials is the need to ensure that they are disciplined and held accountable for their performance to create a culture that values excellence and supports continuous improvement. Limited, or even no, action was taken against municipal officials and leadership for wrongdoing and poor performance. This can most clearly be seen where councils did not deal effectively with unauthorised, irregular, and fruitless and wasteful expenditure, and where municipal managers and senior management took limited action in response to our findings and to allegations by other parties of possible fraud, non-performance and the abuse of the supply chain management system.

The report calls upon the municipal leadership and those in the accountability ecosystem, working together with the provincial leadership, to urgently address these root causes.

Service delivery

The AG expressed concern that government continues to neglect service delivery to the detriment of institutions. She made a call for leaders to closely monitor municipalities' performance against their stated targets and to ensure that these targets are measurable and will have the desired impact on service delivery.

Maluleke added that service delivery must be planned based on the needs of communities and on the budgets and resources municipalities have available. It must also be managed throughout the year and the achievements (or the lack thereof) should be reported in a credible and transparent manner.

"We continued to see municipalities that do not adequately plan for delivering key basic services and do not report credibly on that delivery, with many also not achieving their planned targets. In addition, accountability is hampered as there is little transparency on the true state of local government's delivery of key basic services such as water, sanitation, electricity and housing," she explained.

“Municipalities’ inability to deliver basic services contributes to the deteriorating living conditions of communities and erodes trust in government’s ability to deliver on their promises. These continuing failures in the most critical part of municipal operations are not receiving the necessary attention from councils, national and provincial government, and oversight structures. It is crucial for councils to have robust systems in place to plan, monitor and report on performance to enable them to prioritise and allocate resources to efficiently and effectively deliver services and build trust within their communities.”

Infrastructure for service delivery

Every year, the national audit office audits infrastructure and reports to municipal managers on the status of selected infrastructure projects, as well as on deficiencies and inadequate infrastructure maintenance.

The focus is on critical infrastructure such as water, wastewater treatment, electricity, housing, public transport and roads, as failure to deliver on the promised new infrastructure in these areas directly affects the public and deprives them of the basic services they are entitled to receive.

Maluleke said that despite this, her office has seen little change and continues to identify the same issues every year.

“Inadequate maintenance, ineffective planning and poor execution of infrastructure projects over many years have not only affected government’s ability to deliver services to the public, but also have significant cost implications, placing further strain on both government finances and the environment,” she explained. “Investing in preventative controls to address the causes of infrastructure project failures is more effective than dealing with the consequences of such failures, which include lengthy delays, poor build quality, financial loss, and harm to the public and the environment.”

Environmental impact of infrastructure neglect on service delivery

The AG reported that her office raised audit findings on wastewater treatment plants in most of the municipalities where it audited, including two municipalities with disclaimed audit opinions. The audits also confirmed that neglected municipal infrastructure and ineffective environmental management led to polluted water sources, including underground water, and revealed an unacceptable state of the management of wastewater treatment plants.

“In our previous general report, we reported that we had notified the municipal manager of Maluti-a-Phofung Local Municipality (Free State) of MIs at four of its sites, and the municipal manager of Ngaka Modiri Molema District Municipality (North West) of MIs at three sites. By 15 February 2023, we had issued notifications to various municipal managers of 24 material irregularities related to their wastewater treatment plants, with more to follow.”

At nine (56%) of the municipalities selected for auditing, the audit teams found that wastewater discharged at wastewater treatment plants did not comply with waste standards and practices (per the Department of Water and Sanitation's Green Drop report of April 2022). Reasonable measures were also not taken to prevent pollution or degradation of the adjacent environment or water resources at 11 (69%) of the selected municipalities. These municipalities are Mangaung Metro and Ngwathe, Metsimaholo, Moqhaka and Matjhabeng local municipalities in the Free State; Ugu District Municipality and eThekweni Metro in KwaZulu-Natal; Mopani District Municipality and Bela-Bela Local Municipality in Limpopo; Thaba Chweu Local Municipality in Mpumalanga; and Kgatelopele Local Municipality in the Northern Cape.

“These shortcomings harmed the communities using the water every day for drinking and washing, and the farmers using the water for irrigation and for their livestock. The situation at some of these municipalities is well known and has been the subject of investigations by the South African Human Rights Commission and of court cases, but little has been done to rectify the problems. As a water-scarce country, South Africa must protect its water resources, both by managing pollution at the source and by preventing avoidable water losses due to ageing infrastructure that is not properly maintained,” the AG cautioned.

She added that service delivery improvements and the responsible use of the limited funds available will only be enabled when municipalities are capable, cooperative, accountable and responsive, and when they deliver on their mandates. Municipal leadership, particularly councils and mayors, play a critical role in setting the tone for ethical behaviour, good governance and accountability; and in creating a culture that fosters trust and confidence in local government.

Maluleke said her office had provided municipal managers and senior management with recommendations on how to improve their specific audit outcomes during the audits, and that the call to action in her latest report was aimed at the broader accountability ecosystem – in particular, at municipal councils (including mayors), legislatures, provincial leadership and coordinating institutions and their executive authorities.

Financial planning and reporting

Poor financial planning

The AG reports that municipalities are spending funds they have not budgeted for, which results in unauthorised expenditure.

In 2021-22, 68% of municipalities incurred a combined R25,47 billion in unauthorised expenditure, with R13,03 billion being for non-cash items. This means that municipalities spent money that the council had not provided for in the approved budget, or that the spending did not meet the conditions of a particular grant.

Maluleke said that when municipalities adopt unfunded budgets or overspend their budgets, this shows that they are unable to budget properly and stay within that budget. These practices not only pose an imminent threat to the sustainability of municipalities, but also perpetuate the spiral of non-delivery. Often, the mayor and municipal manager submit a budget for spending that cannot be funded, and, in such cases, the council must ensure financial discipline by carefully reviewing and assessing the proposed budget to determine whether it is financially viable and sustainable.

Inadequate financial controls and unreliable reporting

“Despite the resources and support municipalities had available to enable sound financial management and reporting, their processes and controls were not adequate to prevent material misstatements in the financial statements,” the AG reported.

If the audit office had not allowed municipalities to correct the identified material misstatements, only a quarter would have produced financial statements that were reliable enough for the council and other decision-makers to use. In total, 84 municipalities (35%) relied on the audit process to identify misstatements that they then corrected to obtain an unqualified audit opinion.

“Over the years, we have consistently said that municipalities must institutionalise a culture of compliance and controls. They should implement standardised, effective accounting processes for daily and monthly accounting disciplines; ensure proper record keeping and document control; perform independent reviews and reconciliations of accounting records; and ensure that in-year reporting and monitoring take place. However, we can see from the status of these

key financial management controls that this solution is not receiving the necessary attention," she said.

Ineffective use of consultants for financial reporting

In 2021-22, 220 municipalities spent R1,61 billion on consultants to help with financial reporting – an increase by almost a fifth from R1,36 billion in 2020-21. More than half of these municipalities (53%) used financial reporting consultants to provide skills that their finance units did not have. Overall, 40% hired consultants for specific skills and to bridge a vacancy gap, while 7% used consultants purely to compensate for vacancies.

Consultants were mostly used for asset management services (34%), tax services (29%), and the preparation or review of financial statements (26%).

"Despite the amount spent on consultants to ensure good-quality financial statements, we could not always see the expected benefits, and as a result we identified material irregularities at 11 auditees. The financial statements submitted for auditing by 137 of the municipalities that used consultants (62%) had material misstatements in the areas in which the consultants did work. Even after we allowed for corrections, nearly two-thirds (64%) of these municipalities received modified audit opinions – 66 received qualified opinions, six received adverse opinions and 15 received disclaimed opinions," noted the AG.

Pressure on local government finances

Local government is financially distressed

Maluleke revealed that local government is financially distressed due to reduced revenue and funding, and that municipalities were not prudently spending the limited funds available. She said that this puts further pressure on municipalities' ability to operate and provide services.

The financial position of 70 (29%) of the 241 municipalities at which the audit office completed its audits was so dire that they had to disclose significant doubt about their ability to fully operate in future. These municipalities included the City of Tshwane and Mangaung metros in Gauteng and the Free State, respectively, which together were responsible for 10% of the total local government budget and for service delivery to 9% of the households in the country.

The AG said that many of these municipalities made this disclosure multiple times over the term of the previous administration. "This means that they were not fully operational for many years

as a result of their financial position. Typically, these are the municipalities that do not pay Eskom and water boards on time and do not deliver services at the required level."

Financial position of municipalities

"When we analysed the financial statements of the 217 municipalities with audit opinions other than disclaimed or adverse, we found 56% of them to have indicators of financial strain. If not attended to, this can result in significant doubt about their ability to continue operating. By year-end, just over half of all municipalities (52%) owed their creditors more money than they had available in the bank as they continued to spend money they did not have. The total deficit in local government for the year amounted to R11,87 billion, while 79 municipalities (36%) had spent more money than they had generated.

"As a result, municipalities were using their budget for the next year to cover their spending in the current year. At 32% of municipalities, their current liabilities were more than 50% of their revenue budget for the next year. This means that the 2022-23 budget will pay for spending that had already taken place, either in 2021-22 or in prior financial years. This cycle is likely to continue unless municipalities reduce their spending and generate additional revenue, which is highly doubtful given the prevailing economic conditions and overall economic outlook," Maluleke warned.

Lack of prudence in spending limited funds

Local government is losing billions of rands each year because of poor decisions, neglect or inefficiencies. **Fruitless and wasteful expenditure** has continued to increase, and in 2021-22 it more than doubled, rising from R2,15 billion to R4,74 billion. Since 2019, the national audit office has also identified non-compliance and fraud through the MI process, resulting in an estimated R5,19 billion in financial loss.

The AG cited the following as the main reasons why municipalities were losing money:

- Poor payment practices when paying suppliers of goods and services
- Unfair or uncompetitive procurement practices when procuring goods and services
- No or limited benefit received for money spent
- Fraud committed by officials

Status of compliance with supply chain management legislation

Uncompetitive and unfair procurement processes and inadequate contract management remained widespread. The audit office reported findings (62% of which were material) on uncompetitive and unfair procurement processes at 83% of municipalities, and contract management findings (39% of which were material) at nearly half of all municipalities (47%).

At some municipalities, uncompetitive and unfair procurement processes resulted in (or are likely to result in) financial losses because the goods and services procured could have been obtained at a lower price or because a contractor was appointed that could not deliver. The municipal managers were notified of these MIs for payments of goods and services not received and for which value for money could not be realised.

Municipalities disclosed a total of R30,34 billion in **irregular expenditure** in 2021-22 – significantly more than the R22,40 billion in the previous year. The biggest contributors to this huge increase were Buffalo City Metro in the Eastern Cape (R6,21 billion increase), uMkhanyakude District Municipality in KwaZulu-Natal (R1,33 billion increase) and King Sabata Dalindyebo Local Municipality in the Eastern Cape (R1,30 billion increase), mainly because they disclosed irregular expenditure incurred in prior years. The accountability and consequence managed has been ineffective as result of municipal public accounts committees' failure to investigate and close the irregular expenditure presented to them.

Maluleke said that in reality, this amount could be even higher, as 31% of municipalities did not report all the irregular expenditure they should have reported in their financial statements. In other cases, the amount of irregular expenditure reported was incorrect.

Conclusion

“The leadership in national and provincial government made commitments in response to our previous general report, as well as during our engagements with them in the build-up to tabling this report, to improve accountability and service delivery in local government. Various initiatives are being implemented, such as increased interventions, support and financial recovery plans for dysfunctional and financially distressed municipalities, as well as the implementation of the district development model. We will continue to monitor and report on these developments.

“We acknowledge the support by Cogta and treasuries to municipalities, which resulted in a decrease in the number of disclaimed audit opinions and an improvement in the submission of financial statements. However, it is important to emphasise that for municipalities to realise improvement and good governance, they need to build those disciplines themselves and should be sustainable.

“We reiterate our call for all the leadership in the accountability ecosystem to work with urgency and intensify the support and help municipalities to build the right controls and institutionalise the disciplines towards accountability and service delivery,” the AG concluded.

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

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