



Free State - Local government audit outcomes | 2017-18

**Accountability for financial and performance
management continues to deteriorate**



AUDITOR - GENERAL
SOUTH AFRICA

Accountability for financial and performance management continues to deteriorate



This presentation on local government outcomes covers:

Indicators of deteriorating accountability

Impact of deteriorating accountability

Root causes

Addressing deteriorating accountability



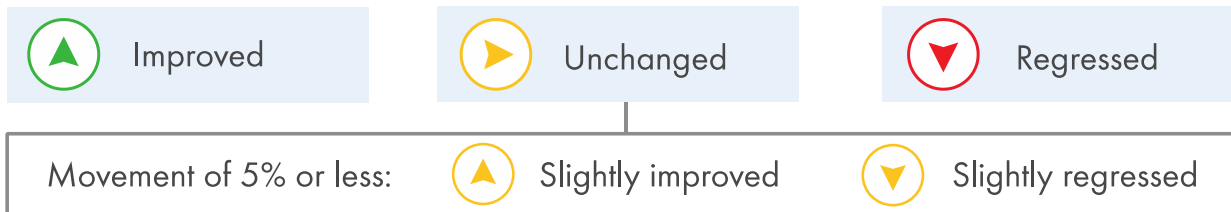
Important to note

The percentages in this presentation are calculated based on the **completed audits of 14 municipalities as at 31 January 2019**, unless indicated otherwise.

Audit outcomes are indicated as follows:

-  Unqualified with no findings
-  Unqualified with findings
-  Qualified with findings
-  Adverse with findings
-  Disclaimed with findings
-  Outstanding audits

Movement from the previous year is depicted as follows:

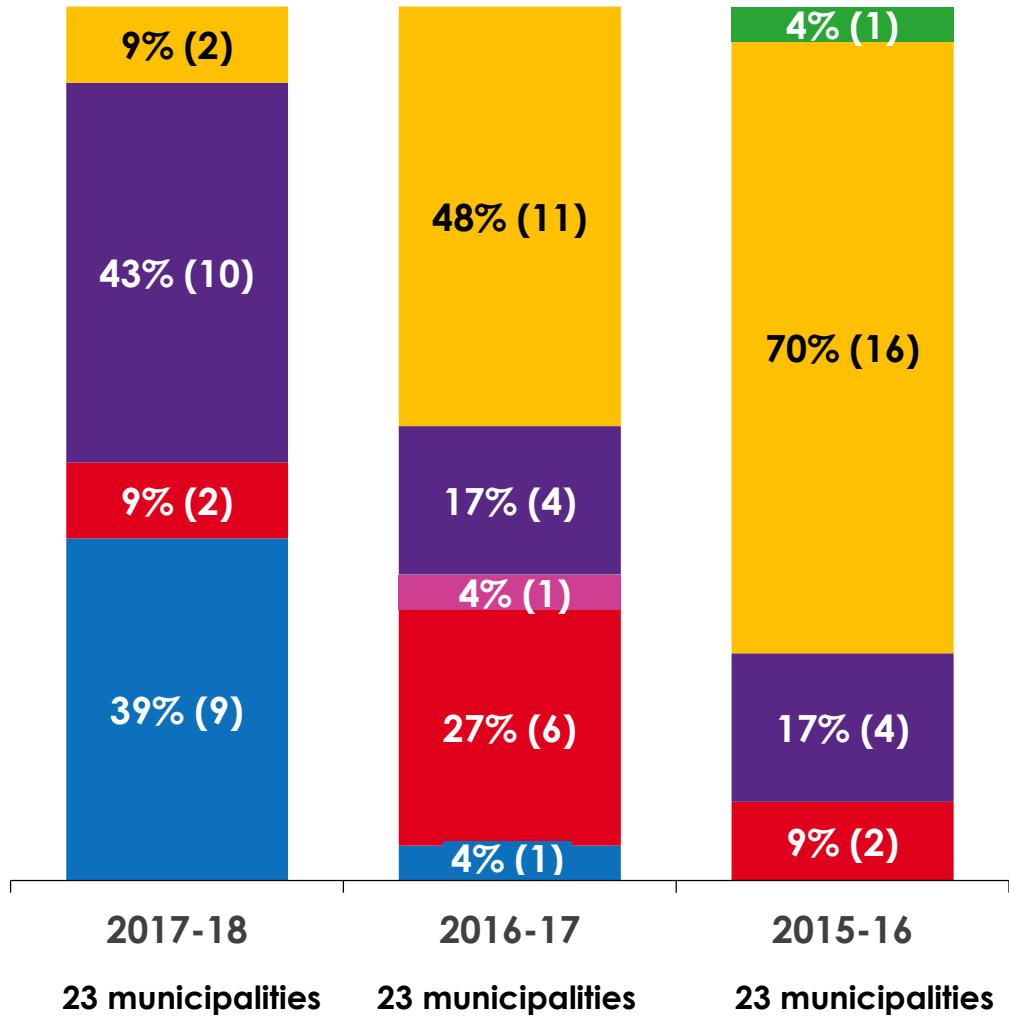


Accountability failures in Free State

- There was a **total breakdown in internal controls** as the province's political and administrative leadership, yet again, exhibited **no response** to improve its accountability for financial and performance management.
- The required level of **oversight by all assurance providers** in the province was non-existent at most municipalities and we doubt that there is **political will** to do the right thing for the right reason, mainly due to political interference and loyalty towards politicians to the detriment of good governance.
- The **financial crisis** in the province is becoming a critical concern. The **provincial intervention in municipalities** have not yet yielded any results. Many of the municipalities in the province qualified for mandatory intervention by the provincial executives in terms of section 139(5) of the Constitution of the Republic of South Africa, which is applicable where a municipality is in a serious financial crisis and is in material breach of its obligations to provide basic services or to meet its financial commitments.
- The **continued disregard** for procurement processes by the leadership that resulted in irregular expenditure, coupled with limited consequences for these transgressions, created an environment vulnerable to misappropriation, wastage and the abuse of state funds. Irregular expenditure disclosed in the financial statements increased from R677 million to R913 million
- **Significant regression** in audit outcomes – nine municipalities regressed, while none improved and no clean audits were achieved.
- Nine municipalities' audits were not finalised by the cut-off date due to **late or non-submission** of financial statements, delays in the audit process caused by **service delivery protests** at the municipality and **information systems-related issues** such as mSCOA conversion.



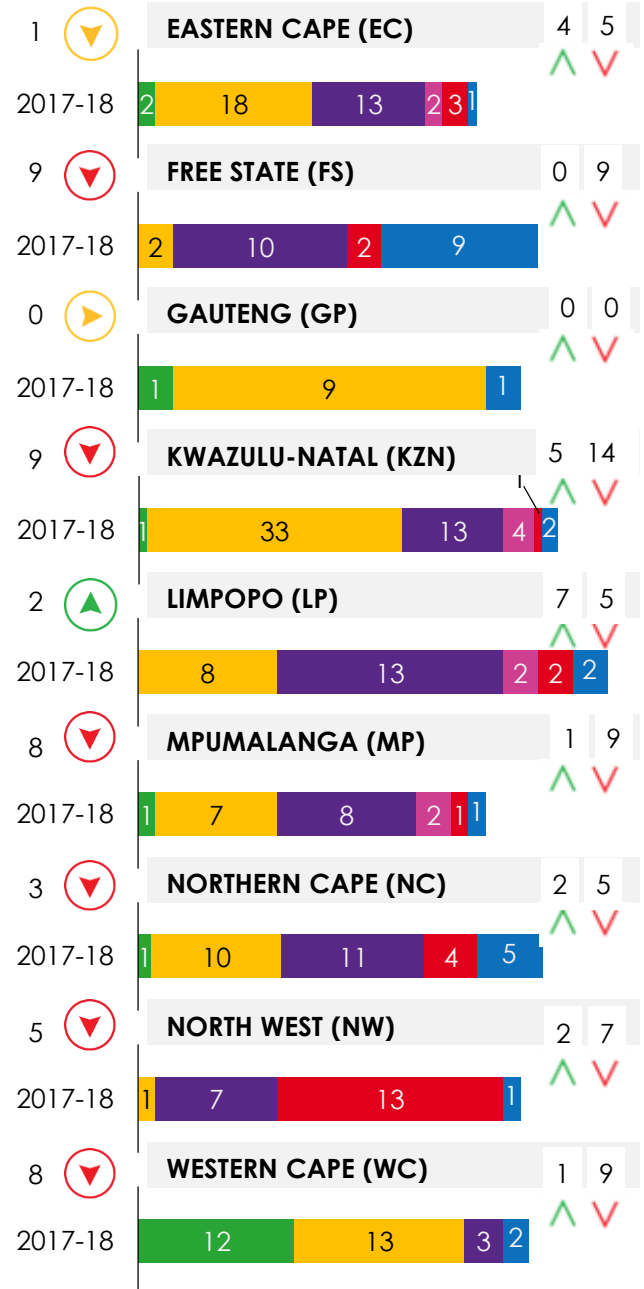
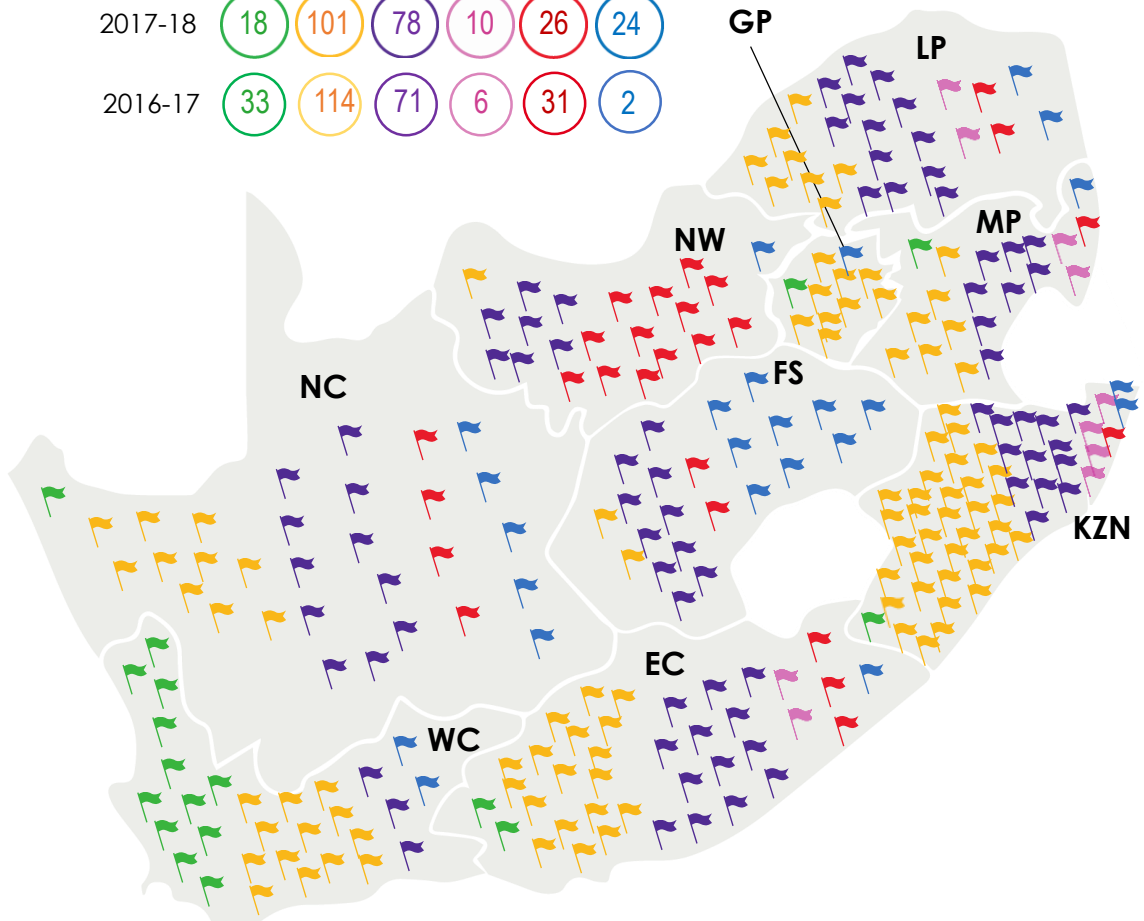
In the second year of administration, audit outcomes continue to regress



Movement	
▲	0
▼	9
▶	5
Outstanding audits	9

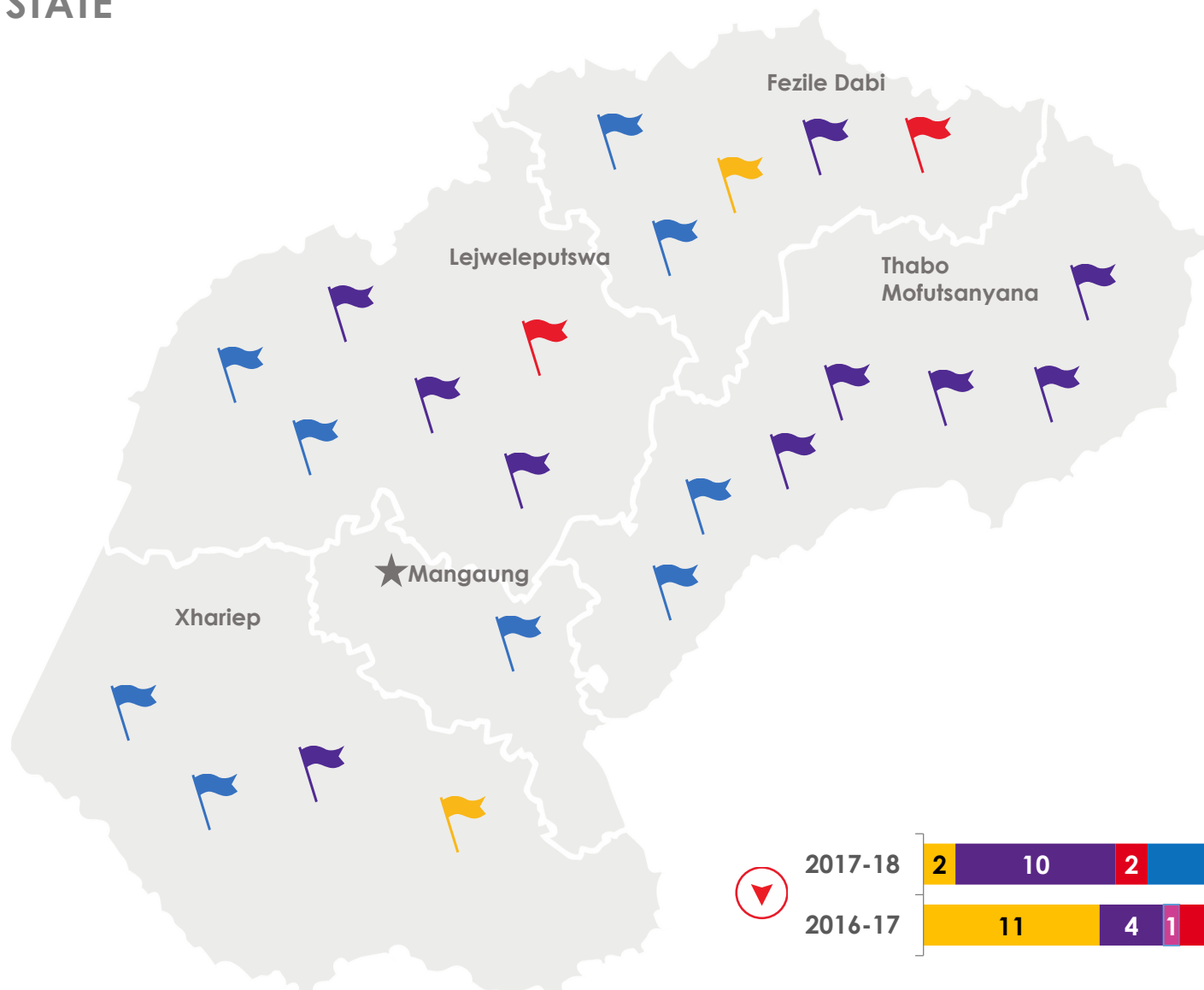


Movement in audit outcomes



Movement in audit outcomes – municipalities

FREE STATE



- Unqualified with findings
- Qualified with findings
- Adverse with findings
- Disclaimed with findings
- Outstanding audits

Accountability and transparency not enabled through credible financial and performance reporting



Financial statements

Target

Submission of financial statements by legislated date (all municipalities)

Quality submission for auditing

Quality of published financial statements

Movement



2017-18

2016-17

65%

70%

0%

7%

14%

71%

14% achieved unqualified opinions only because they corrected all misstatements identified during the audit



Performance report

Target

Preparation of performance report

Quality submission for auditing

Quality of published performance report

Reliable reporting of achievements

Usefulness of performance indicators and targets

Movement



2017-18

2016-17

100%

93%

0%

0%

7%

21%

21%

31%

14%

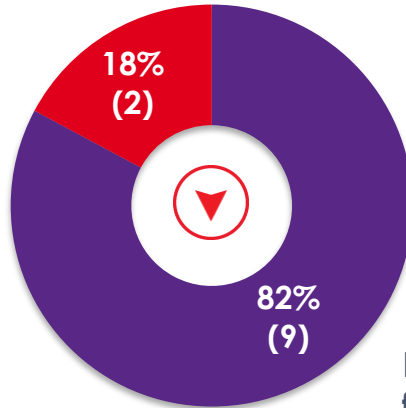
23%

7% had no material findings only because they corrected all misstatements identified during the audit

Municipalities assisted by consultants – financial reporting

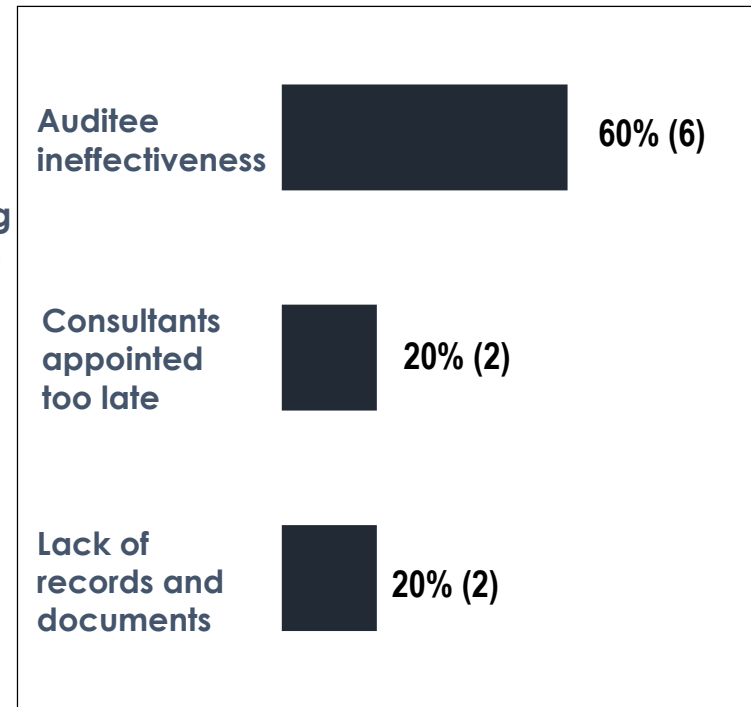
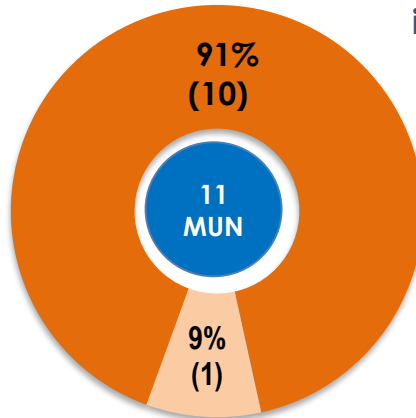
R50 million paid to consultants at 11 auditees on financial reporting services

Audit outcomes of municipalities assisted by consultants – financial reporting



Reasons for the financial reporting consultants being ineffective

Material misstatements in area of consultant's responsibility

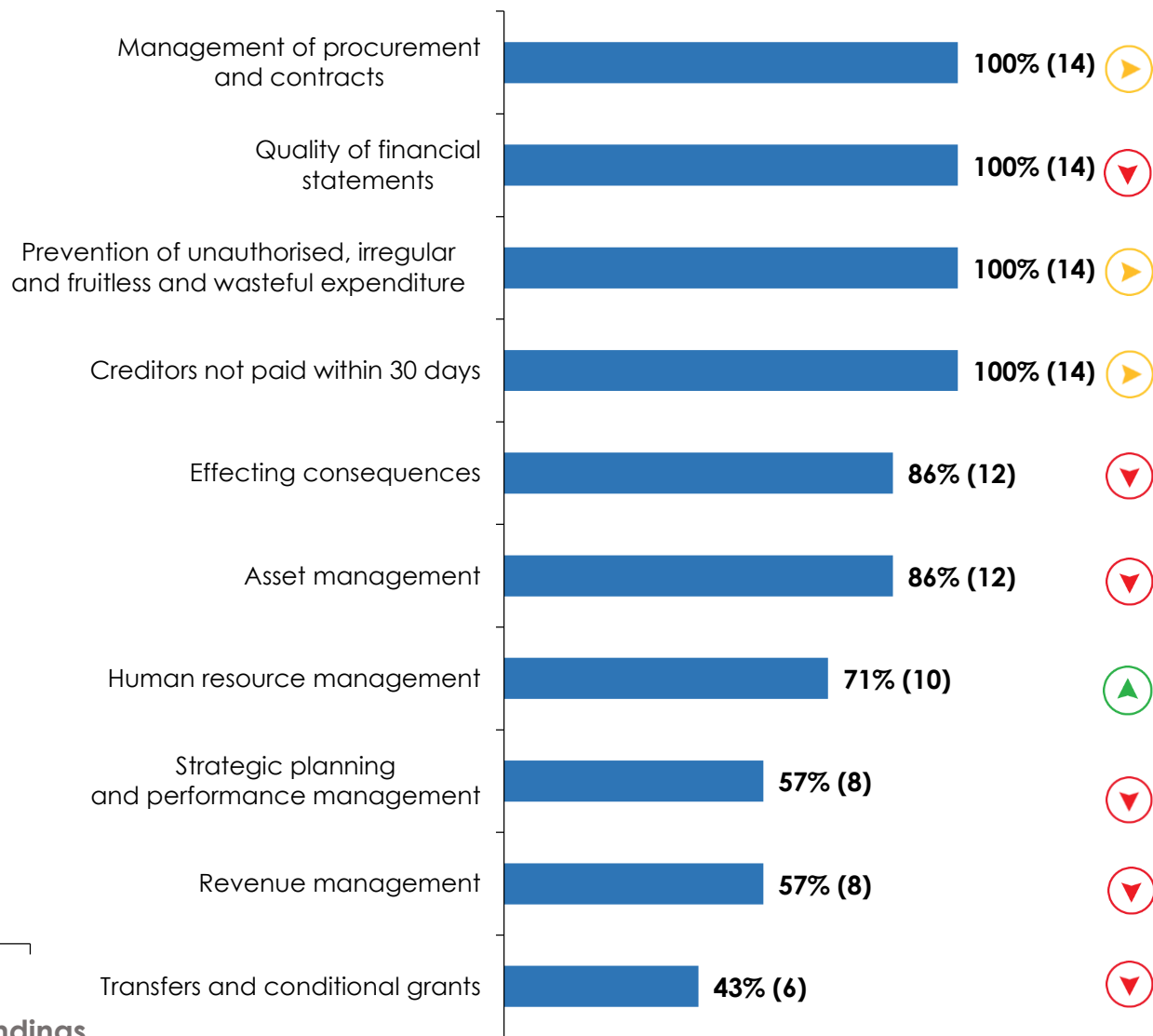


Disregard for compliance with legislation continues

Findings on compliance with key legislation



Most common non-compliance areas

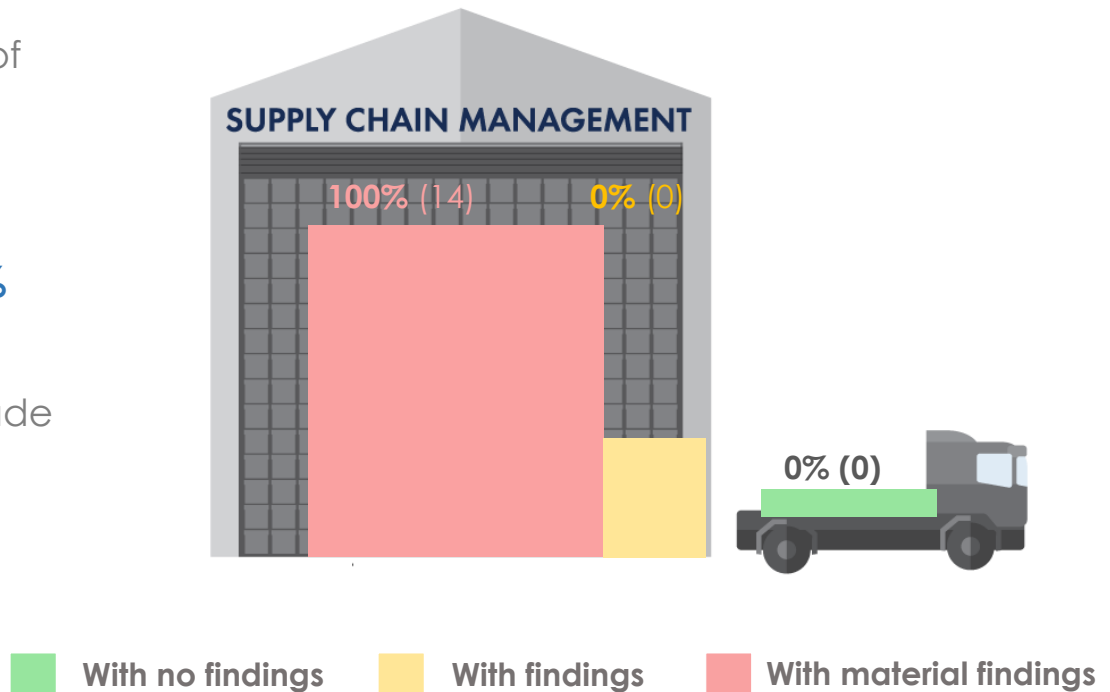


Non-compliance with supply chain management legislation is widespread



Stagnation in supply chain management compliance

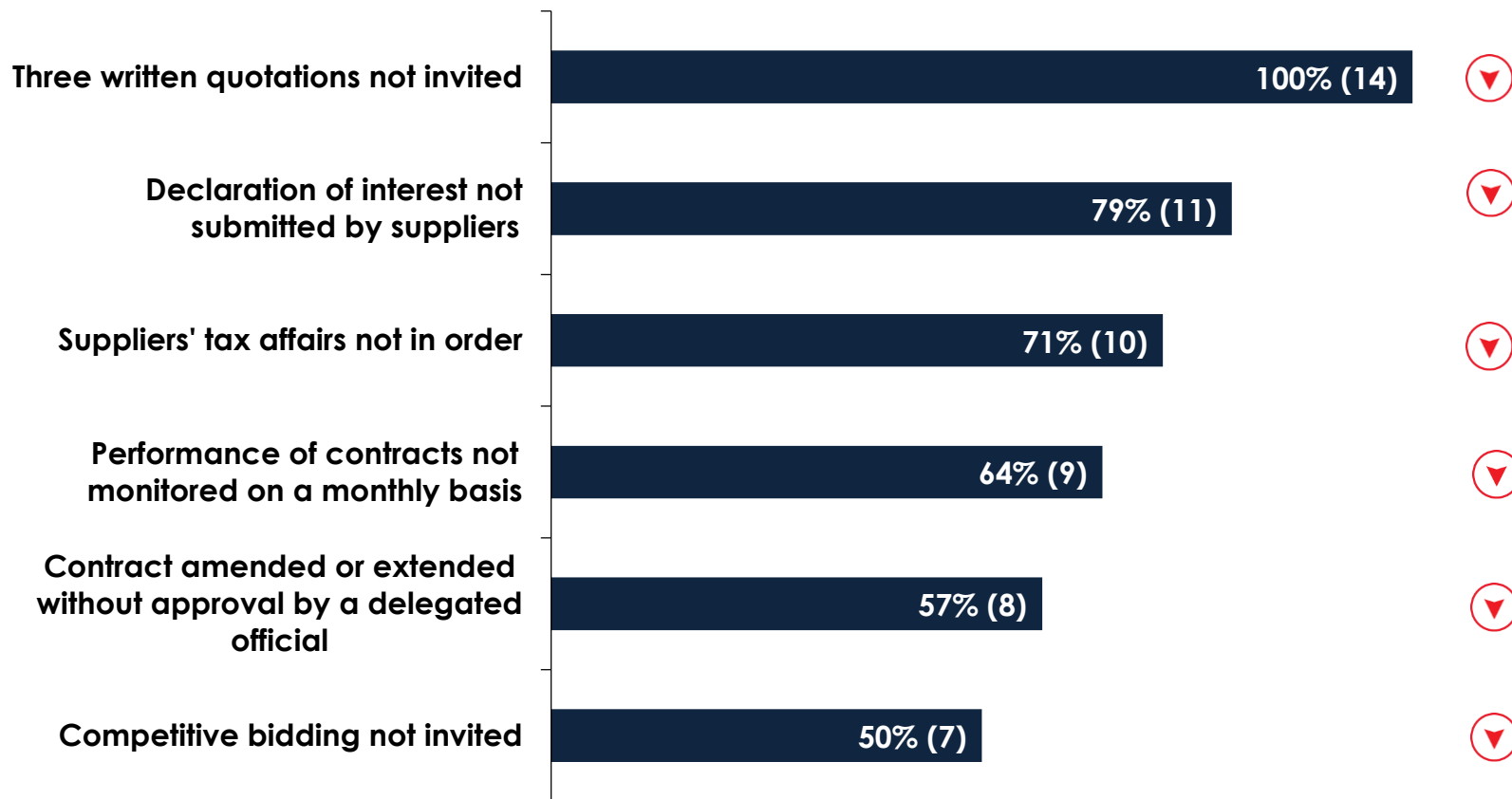
- Not able to audit procurement of **R187 million** due to **missing or incomplete information**
- **Uncompetitive and unfair procurement** processes at **100% of municipalities**
- **False declarations** of interest made by **10 suppliers**
- **R150 000** in an award to a councillor



Non-compliance with supply chain management legislation is widespread (*continued*)

Unfair or uncompetitive procurement processes – most often lead to **higher prices or potential losses** and exclusion of preferential suppliers (including local suppliers), which undermine the country's **social transformation goals**

The **most common findings** were:



Irregular expenditure remains high

Annual irregular expenditure increased from R677 million to R913 million*

* The figure above is not complete. Irregular expenditure of **R233 million (2016-17: R173 million)** is disclosed in the unaudited, submitted financial statements of 6 municipalities, while 3 municipalities have not yet submitted AFS in the current year and is therefore excluded in the current and prior year figures. **Four municipalities (29%)** were also qualified on the incomplete disclosure of irregular expenditure in the current year.

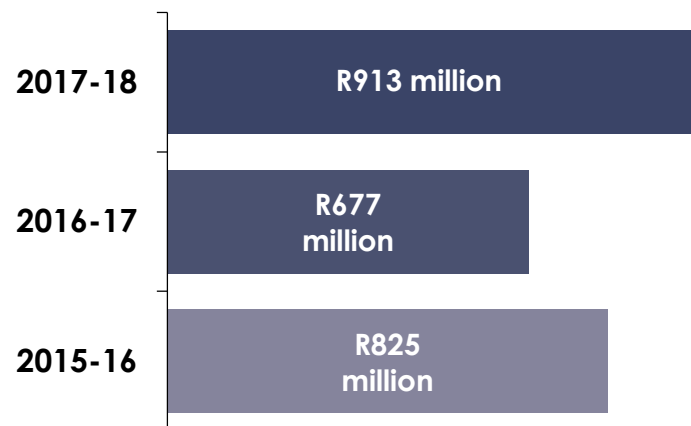
- **97%** (R883 million) were for payments or expenses in 2017-18
 - **R585 million** represents non-compliance in 2017-18
 - **R298 million** is expenditure on ongoing multi-year contracts, of which Matjhabeng contributed R147 million

How can irregular expenditure on multi-year contracts be reduced?

Through **condonement** or **cancellation** of contracts irregularly awarded

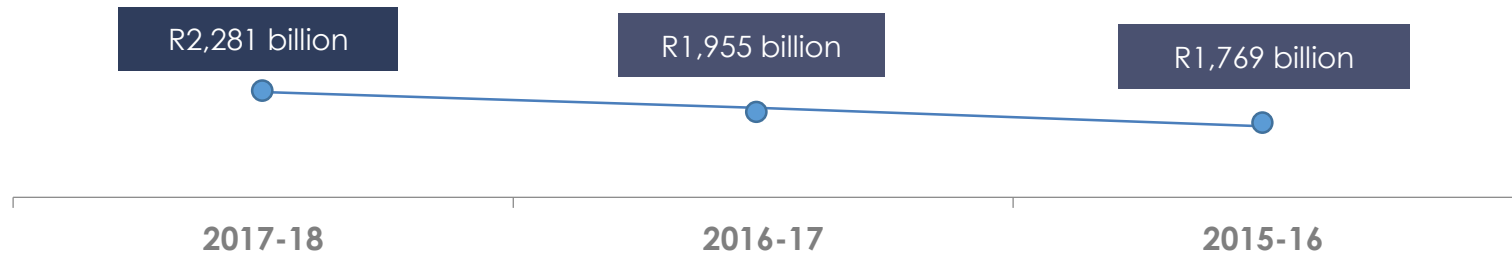
- **3%** (R30 million) were for payments or expenses in previous years only uncovered and disclosed in 2017-18

Annual irregular expenditure



Irregular expenditure remains high (*continued*)

Closing balance of irregular expenditure



Irregular expenditure of previous years is not properly dealt with through investigation; followed by **condonement**, **recovery** or **write-off** of the expenditure

Top 5 contributors to the accumulated irregular expenditure (constituting 69% of the R2,281 billion), include:

- Moqhaka Local Municipality – R478 million
- Matjhabeng Local Municipality – R293 million
- Ngwathe Local Municipality – R273 million
- Tokologo Local Municipality – R269 million
- Metsimaholo Local Municipality – R255 million

Four of these municipalities also **did not investigate all instances** of prior year irregular expenditure, while Matjhabeng investigated some instances.

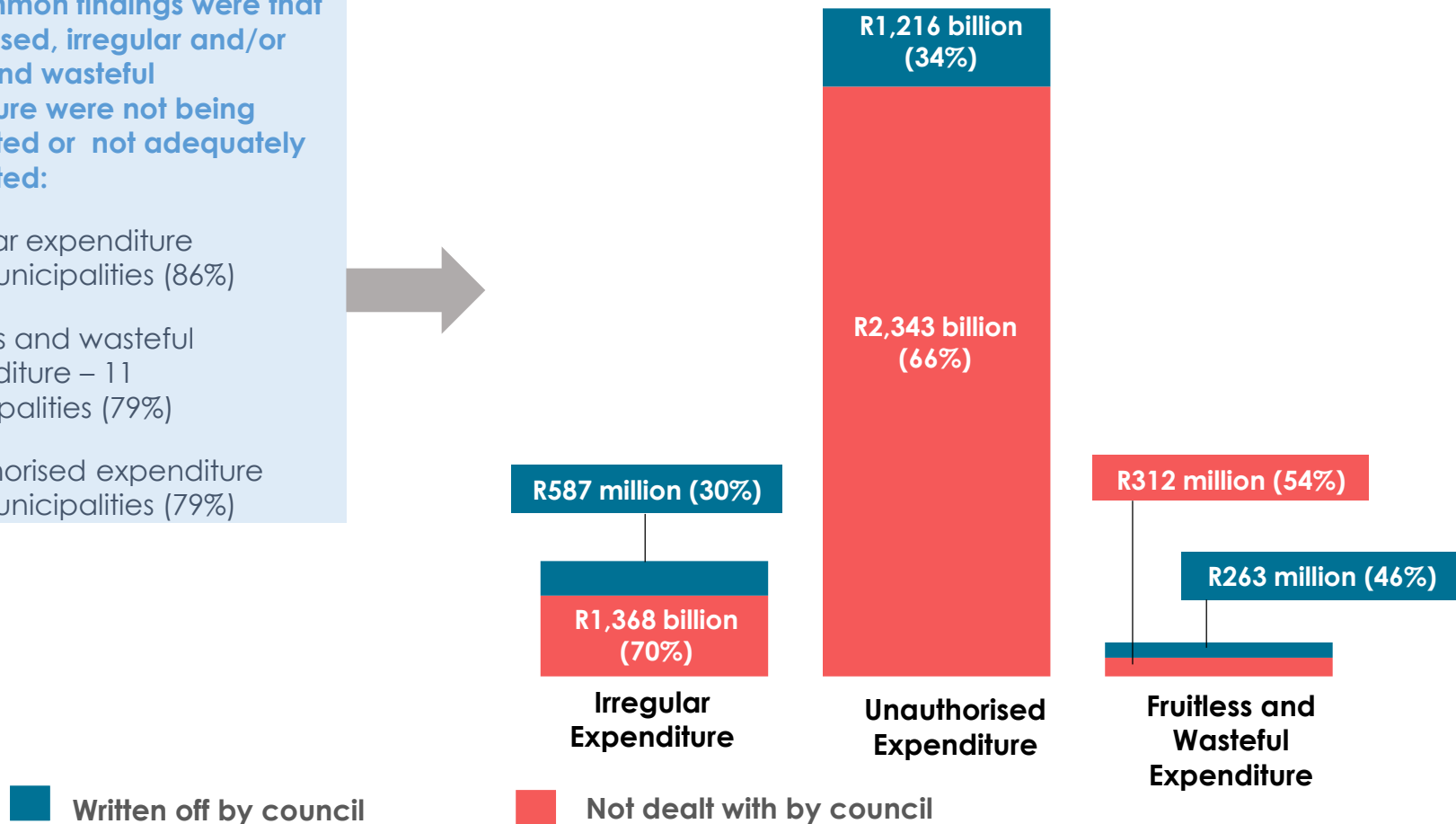


Material non-compliance with legislation on implementing consequences increased from 79% to 86%

How councils dealt with all the unauthorised, irregular and fruitless and wasteful expenditure to date

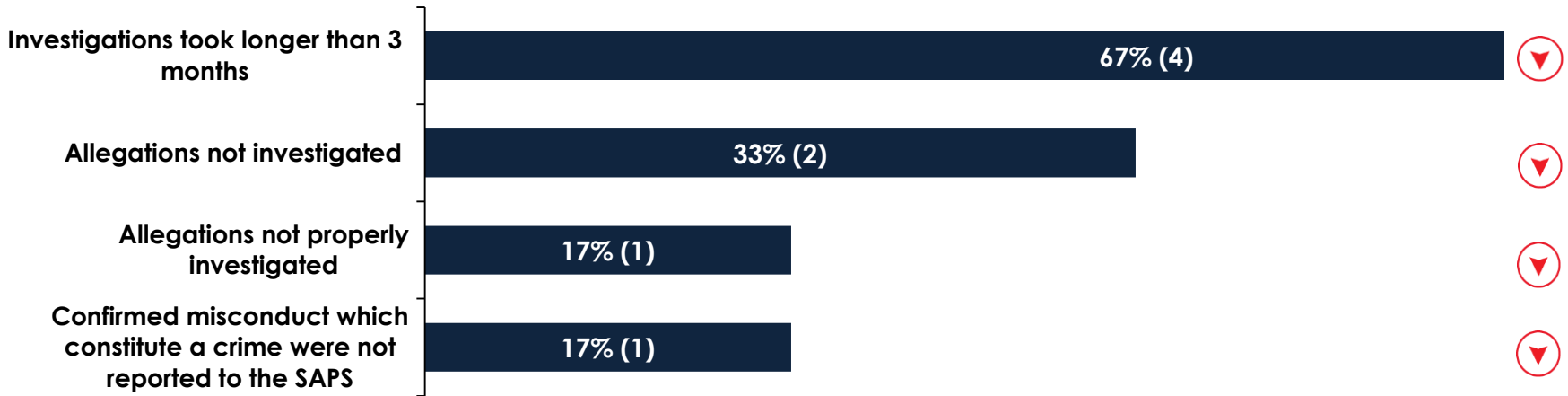
Most common findings were that unauthorised, irregular and/or fruitless and wasteful expenditure were not being investigated or not adequately investigated:

- Irregular expenditure – 12 municipalities (86%)
- Fruitless and wasteful expenditure – 11 municipalities (79%)
- Unauthorised expenditure – 11 municipalities (79%)

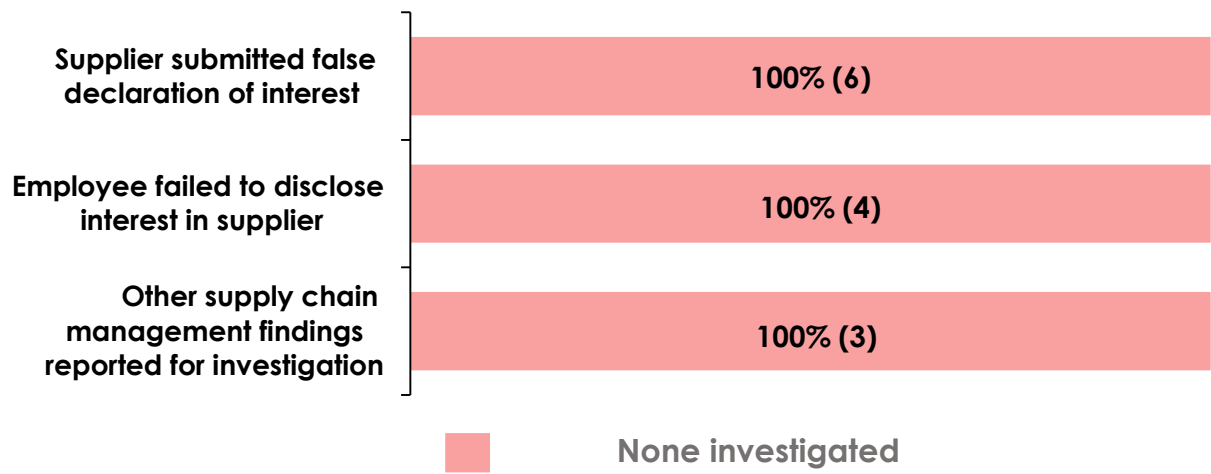


Inadequate investigations are being performed

Inadequate follow-up of allegations of financial and supply chain management misconduct and fraud



Follow-up by municipalities of supply chain management findings we reported for investigation in the previous year



Increasingly difficult environment for auditors and other role players in accountability

Our experience

- ▼ Protest actions at municipalities had an impact on audit process and delayed finalisation of audits
- ▼ Recommendations made in previous years to improve outcomes and/or investigate irregularities not implemented
- ▼ Status of records review and engagements with municipal managers yielded no benefit as recommendations were not implemented – audit outcomes of nine municipalities regressed
- ▼ No response to our messages by both leadership and oversight.

Other role players

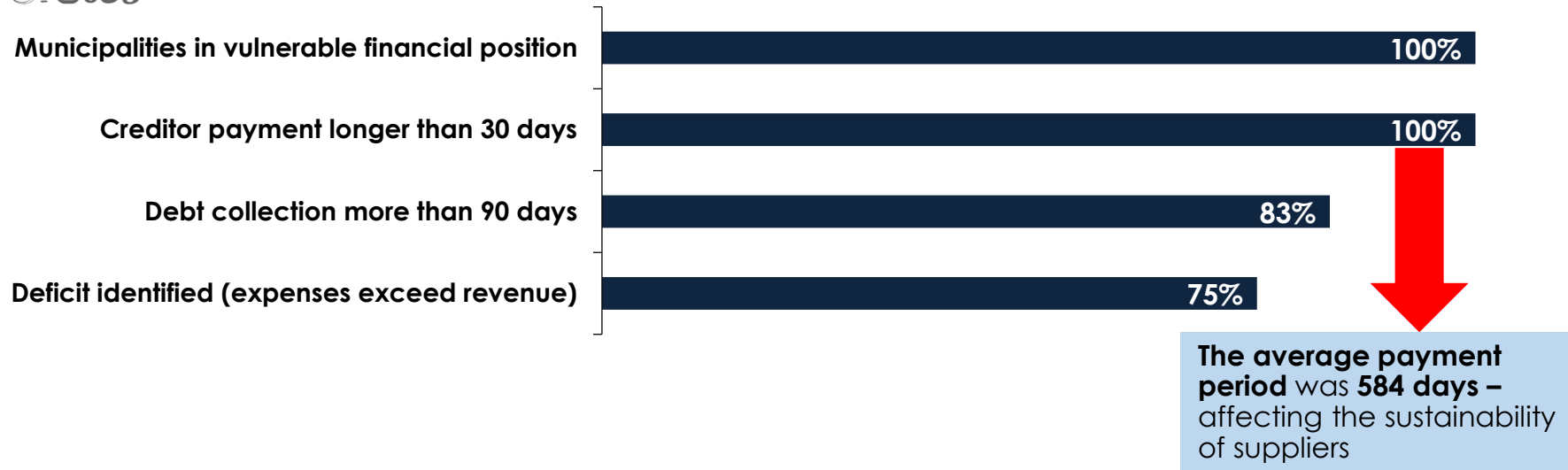
- ▼ **Internal audit units:** 50% of internal audit units provided limited or no assurance, while 50% provided some assurance.
- ▼ **Audit committees:** 64% of audit committees provided limited or no assurance, while 36% provided some assurance.
- ▼ **Municipal public accounts committees:** 100% provide limited or no assurance through their oversight function



Declining financial health and losses

53257
58768
260935
960835

What the numbers say



- Financial health continued to deteriorate from a **net current liability position** (where current liabilities exceed current assets) of R4,8 billion in the prior year to **R6,1 billion** in the current year.
- Municipalities faced significant cash-flow constraints, as they **did not maximise the billing of revenue** from service charges and rates nor the collection of amounts outstanding from consumers. Municipalities had an opening debtors book of **R6,8 billion** and billed **R4,3 billion** for services and rates during the year but only collected **R3 billion**.
- Municipalities also incurred **significant electricity and water distribution losses** due to theft, illegal connections, poor monitoring of indigents' consumption, and poorly maintained infrastructure.
- Some municipalities **failed to pay over contributions to third parties**, such as the pension and/ or medical aid funds which **resulted in litigation and protest actions** by affected employees.



Impact of financial health on payment of utilities – completed municipalities

Eskom arrears

0 - 30 days R	31 - 60 days R	61 - 90 days R	91 - 120 days R	Over 120 days R	2017-18 Amounts owed (as at June 2018) R	2016-17 Amounts owed (as at June 2017) R
175 473 713	74 319 057	101 792 111	236 453 813	3 265 730 386	3 853 769 080	3 107 608 150

91% > 90 days

Top contributors to the debt

Municipality	0 - 30 days R	31 - 60 days R	61 - 90 days R	91 - 120 days R	Over 120 days R	2017-18 Amounts owed (as at June 2018) R	2016-17 Amounts owed (as at June 2017) R
Matjhabeng	60 836 186	35 840 070	30 770 407	31 389 795	1 737 057 822	1 895 894 280	1 464 169 380
Ngwathe	2 704 995	142 670	2 884 987	12 456 140	913 716 696	931 905 488	758 940 364
Moqhaka	41 424 726	11 470 909	41 424 726	173 422 721	0	267 743 082	195 747 224
Dihlabeng	1 646 653	0	159 097	1 615 573	193 366 178	196 787 501	172 364 929
Nala	17 303 228	5 528 155	5 614 962	5 346 159	162 973 503	196 766 006	184 770 655



Impact of financial health on payment of utilities – completed municipalities (continued)

Water boards arrears

0 - 30 days R	31 - 60 days R	61 - 90 days R	91 - 120 days R	Over 120 days R	2017-18 Amounts owed (as at June 2018) R	2016-17 Amounts owed (as at June 2017) R
32 257 866	10 876 073	14 948 909	16 443 303	2 840 050 891	2 914 577 042	2 380 608 349

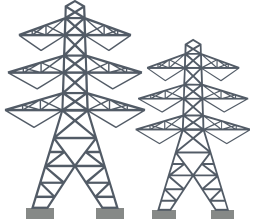
98% > 90 days

Top contributors to the debt

Municipality	0 - 30 days R	31 - 60 days R	61 - 90 days R	91 - 120 days R	Over 120 days R	2017-18 Amounts owed (as at June 2018) R	2016-17 Amounts owed (as at June 2017) R
Matjhabeng	2 910 092	2 699 260	2 707 520	3 125 639	2 287 725 355	2 299 167 866	1 886 452 833
Kopanong	6 314 049	6 314 049	5 056 069	4 704 455	227 645 461	198 241 083	195 408 466
Nala	8 502 166	51 659	4 016 416	4 296 366	135 455 264	152 321 871	132 866 310
Ngwathe	3 423 445	624 265	1 988 847	861 919	86 132 080	93 030 556	86 587 268
Phumelela	3 521	595 597	595 597	2 956 158	59 327 415	63 478 287	52 816 049



Municipal infrastructure projects and maintenance are affected



Planned targets / key milestones **not achieved by 19% of the projects that we audited**

Conditional grants were not used for their intended purpose at Kopanong, Matjhabeng, Metsimaholo, Phumelela and Tokologo.

Conditional grants were materially underspent at Kopanong, Matjhabeng, Ngwathe, Phumelela, Tokologo and Tswelopele.



Water infrastructure



Sanitation infrastructure



Road infrastructure

- 92% (11) of the municipalities audited **disclosed water losses** in their financial statements.
- 67% (8) of the municipalities **did not develop or approve** a policy on routine maintenance for water infrastructure.
- 58% (7) of the municipalities audited **did not achieve** their target for the provision of water services.
- 42% (5) of the municipalities audited **did not perform** a conditional assessment of water infrastructure to inform the routine water maintenance infrastructure plan.
- 42% (5) of the municipalities audited **did not establish** the standard procedures on conditional assessments or the standard procedures were **inadequate**.

- 58% (7) of the municipalities audited **did not develop or approve** a policy on routine maintenance for sanitation infrastructure.
- 58% (7) of the municipalities audited **did not achieve** their target for the provision of sanitation services.
- 42% (5) of the municipalities audited **did not perform** a conditional assessment of sanitation infrastructure to inform the routine water maintenance infrastructure plan.
- 42% (5) of the municipalities audited **did not establish** the standard procedures on conditional assessments or the standard procedures were **inadequate**.

- 58% (7) of the municipalities audited **did not develop or approve** a road maintenance plan (RMP) for renewal and routine maintenance of road infrastructure.
- The backlog in renewal and routine maintenance for roads infrastructure **was not determined** in 50% (6) of the municipalities audited.
- The priority list for roads infrastructure renewal and routine maintenance projects **was not developed or approved** in 33% (4) of the municipalities audited.
- The roads infrastructure included in the asset register **was not included** in the road maintenance plan for 33% (4) of the municipalities audited.



Examples of project deficiencies

Matjhabeng

Rehabilitation and restoration of the Witpan Waste Water Treatment Works (WWTW)

Matjhabeng entered into a contract for the rehabilitation and restoration of the WWTW in 2009. During construction the site was flooded by water from a nearby pan, submerging the work-in-progress, resulting in the project being halted and the contractor abandoning the site. A second contractor was appointed in June 2011 for R60,5 million. The total payments made to the second contractor was R112,2 million, resulting in an overspending of R51,7 million, without the project being completed. Additionally, in July 2016 the Department of Water Affairs advised the municipality that the Witpan WWTW should be decommissioned as it would only be usable for eight more years. The department also indicated that the effluent from the Witpan WWTW did not meet the department's required standards. During a site visit, it was also noted that one of the recently upgraded tanks was leaking, which may result in further cost to the project.

Metsimaholo

Refengkgotso wastewater treatment works project

Refengkgotso WWTW project was initially budgeted for at an amount of R6 million with the appointment of a consulting engineer in December 2014. The scope of the work of the consulting engineer, which was based on the initial appointment was expanded several times. During May 2017, the municipality issued a new appointment letter to the same consulting engineers for a budgeted amount of R15,9 million to oversee the same revised project. A contractor was also appointed at a budgeted cost of R148,6 million with an original planned completion date of November 2018. As at 30 June 2018, the municipality had made payments of R47,8 million relating to this project but it could not be confirmed that services were actually delivered for all the amounts spent on the project.

The project is currently under investigation.

Metsimaholo

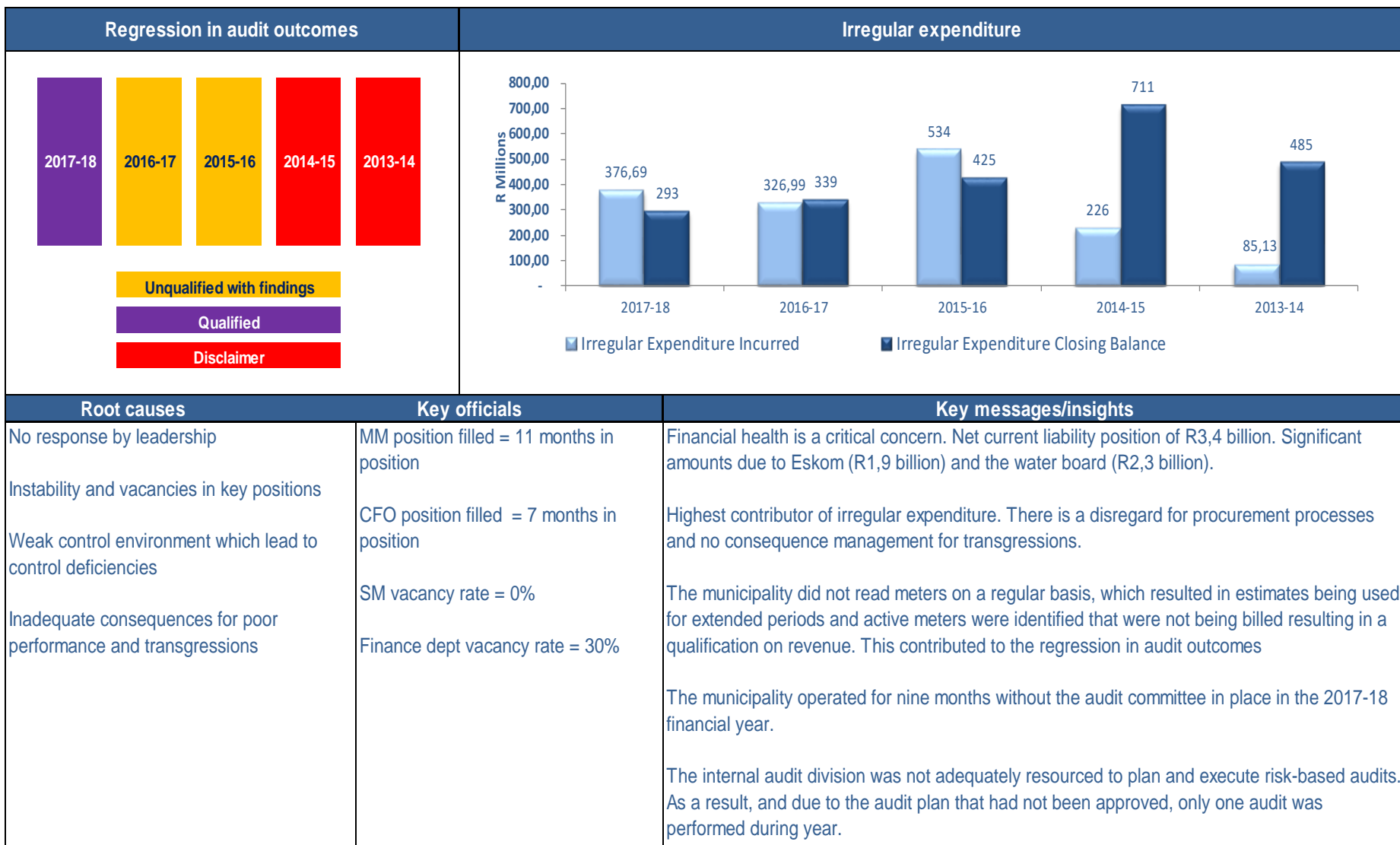
Oranjeville sports complex project

The Oranjeville sports complex project at Metsimaholo was budgeted for at a cost of R21,9 million. As at 30 June 2018, the municipality had spent R21,7 million relating to this project, which is 99,1% of the budgeted amount. Supporting evidence could not be provided to confirm that payments were only made for actual work performed, while a notable discrepancy has been identified, during a site visit, between the actual progress of the project compared to the percentage of the amount spent.

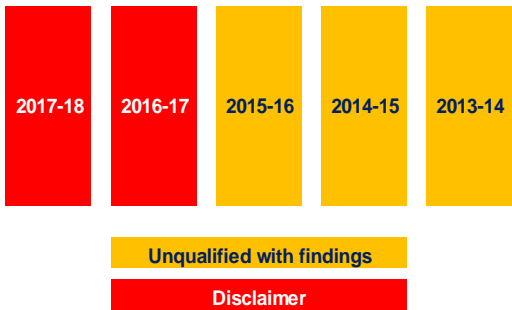
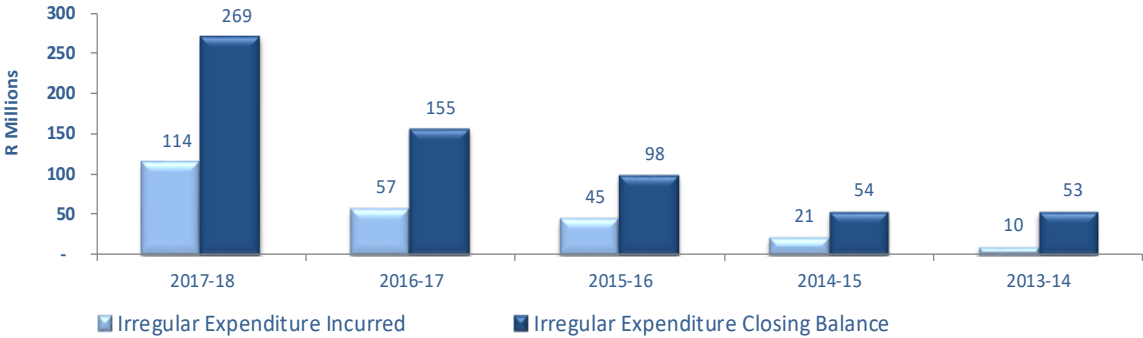
The project is currently under investigation.



Municipalities in focus – Matjhabeng

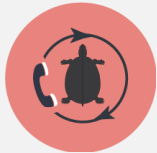


Municipalities in focus – Tokologo

Regression in audit outcomes over 5 years		Irregular expenditure																			
 <p>2017-18 2016-17 2015-16 2014-15 2013-14</p> <p>Unqualified with findings</p> <p>Disclaimer</p>		 <table border="1"> <caption>Irregular Expenditure (R Millions)</caption> <thead> <tr> <th>Year</th> <th>Irregular Expenditure Incurred</th> <th>Irregular Expenditure Closing Balance</th> </tr> </thead> <tbody> <tr> <td>2017-18</td> <td>114</td> <td>269</td> </tr> <tr> <td>2016-17</td> <td>57</td> <td>155</td> </tr> <tr> <td>2015-16</td> <td>45</td> <td>98</td> </tr> <tr> <td>2014-15</td> <td>21</td> <td>54</td> </tr> <tr> <td>2013-14</td> <td>10</td> <td>53</td> </tr> </tbody> </table>		Year	Irregular Expenditure Incurred	Irregular Expenditure Closing Balance	2017-18	114	269	2016-17	57	155	2015-16	45	98	2014-15	21	54	2013-14	10	53
Year	Irregular Expenditure Incurred	Irregular Expenditure Closing Balance																			
2017-18	114	269																			
2016-17	57	155																			
2015-16	45	98																			
2014-15	21	54																			
2013-14	10	53																			
Root causes	Key officials	Key messages/insights																			
<p>No response by leadership</p> <p>Vacancies in key positions and lack of competencies</p> <p>Weak control environment which lead to control deficiencies</p> <p>Inadequate consequences for poor performance and transgressions</p>	<p>MM position filled = 66 months in position</p> <p>CFO position vacant = 14 months</p> <p>SM vacancy rate = 75%</p>	<p>Except for the municipal manager, Tokologo did not have any permanently appointed senior managers at year-end, which contributed to the poor audit outcomes.</p> <p>Second highest contributor of irregular expenditure in the province. 70% of the 17-18 budget was irregular and they were also qualified on completeness of irregular expenditure.</p> <p>It is concerning that the majority of findings during the audit were mostly repeat findings from the prior year which can imply that the municipality is not actively addressing the issues from last year.</p> <p>Also there is a major concern on current controls in place for proper record keeping to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Procurement and payment documents had also been stolen.</p> <p>There was no consequence management to hold staff accountable for the irregular, unauthorised and fruitless and wasteful expenditure, as well as for poor performance. A proper performance management system was also not in place to evaluate staff's performance.</p> <p>The internal audit section was also not functioning effectively as most of the planned audits as per the internal audit plan was not executed during the 2017-18 financial year.</p>																			



Root causes of the accountability failure



Slow or no response



**Instability/
vacancies/
competencies**



Inadequate consequences



- Management (municipal managers and senior management), political leadership (mayors) and oversight bodies (municipal councils and portfolio committees) do not **respond with the required urgency** to our messages about **addressing risks and improving internal controls** – this **no response** from management was evident at **100% (14)** of municipalities with unfavourable outcomes.
- **Vacancies and instability** slow down systematic and disciplined improvements and was evident at **93% (13)** of municipalities.
- **Lack of oversight** by the council (including the mayor) at all municipalities, and insufficient implementation and maintenance of financial and performance management systems by the administration at all municipalities.
- **Political infighting** at council level and **interference** in administration weaken oversight, hinder the effecting of consequences, and make local government less attractive for professionals to join.
- Leadership's inaction / inconsistent action creates a culture of '**no consequences**', often due to inadequate performance management systems and processes was evident at **100% (14)** of the municipalities. Leadership is often involved in irregularities and therefore does not hold staff accountable which also contributes to the no consequences culture.
- **Blatant disregard** for controls, compliance with legislation, and AGSA recommendations.
- Focus is on **unqualified financial statements** by using consultants and auditors, at great cost and to the detriment of credible reporting on performance and compliance with legislation.
- Provincial and national role players **do not sufficiently support** municipalities.

ACCOUNTABILITY ↓ = **Instability, skills gaps,
political interference
and corruption** ↑

The role of leadership

Mayor and council

Municipal manager and senior managers

Provincial leadership



Tone at the top – ethical leadership, good governance and accountability



Capacitate and stabilise administration – free from political interference



Enable and insist on robust financial and performance management systems



Consistent, appropriate and swift consequences for irregularities



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ACCOUNTABILITY = PLAN + DO + CHECK + ACT

