

UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE: COMPLIANCE ISSUES

CIGFARO CONFERENCE
13 JULY 2021



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



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NATIONAL TREASURY'S OBSERVATIONS ON EXPENDITURE MANAGEMENT



CONTINUED FAILURE TO DECISIVELY DEAL WITH STUBBORNLY HIGH FRUITLESS AND WASTEFUL EXPENDITURE

1. Audit action plans are not adequate and not effectively implemented and monitored, despite concerns raised to implement appropriate preventative and detection controls
2. Deficiencies in the control environment persist and culture of non-compliance due to inadequate consequence management
3. Supply chain management transgressions remain a significant concern due to a lapses in oversight, preventative controls and lack of consequences
4. Ineffective structures and processes to investigate UIFW expenditure
5. The financial health of municipalities is not improving.

STATUS OF COMPLIANCE: UIFW EXPENDITURE

Continued widespread non-compliance

Areas of non-compliance	2019-20*	2018-19#
Prevention of unauthorised, irregular and fruitless and wasteful expenditure	76% (152)	75% (171)
Effecting consequences	57% (114)	61% (139)
Procurement and contract management (<i>contributing to irregular expenditure</i>)	74% (148)	79% (181)
Payments to creditors not settled within 30 days from receipt of an invoice (<i>contributing to fruitless and wasteful expenditure</i>)	45% (90)	89% (173)

Source: 2019-20 MFMA General Report

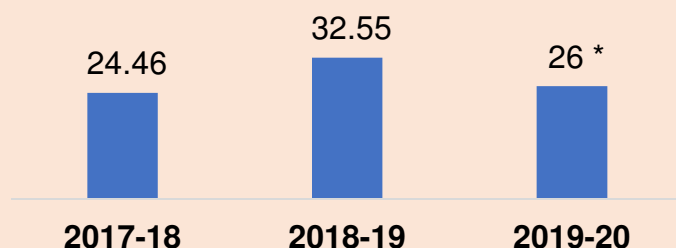
* Reporting on 200 municipalities

Reporting on 229 municipalities

s38: Stopping of funds for persistent material breach

IRREGULAR EXPENDITURE TRENDS

**Irregular expenditure trends#
(R' billion)**



*Annual irregular expenditure R26 billion incurred by 246 municipalities (consisting of R6.43 billion and R19.31 billion incurred by municipalities with outstanding audits and completed audits, respectively) due to SCM non-compliance

But irregular expenditure is incomplete:

- 73 (37%) municipalities were qualified on completeness of their disclosure and/or did not know total amount
- The AGSA could not audit selected contracts valued at R1.43 billion.

Top contributors#

R (billion)

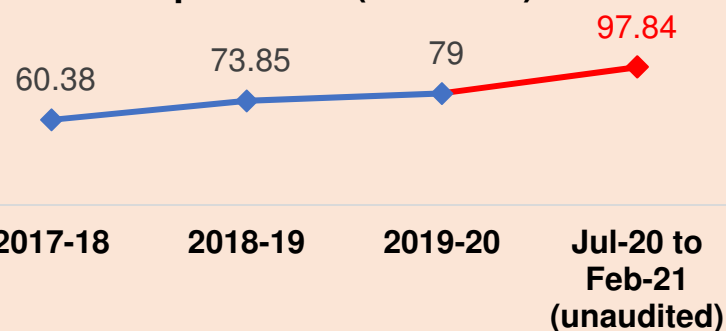
City of Tshwane Metro (GP)	2.53
Mangaung Metro (FS)*	1.60
Nelson Mandela Bay Metro (EC)	1.37
eThekweni Metro (KZN)	1.07
City of Johannesburg Metro (GP)	1.05
Ngaka Modiri Molema District (NW)*	0.87
OR Tambo District (EC)	0.70
City of Cape Town Metro (WC)	0.67
Moses Kotane (NW)	0.62
Rustenburg (NW)*	0.57

* Audits still outstanding or finalised after cut-off date of General Report

#Source:2019-20 MFMA General Report

GROWING IRREGULAR EXPENDITURE CLOSING BALANCES

Growing closing balance of irregular expenditure (R' billion)#



- Closing balance of irregular expenditure continues to increase, yet municipalities are slow in dealing with it as per MFMA section 32, which is affected by:
 - MPACs are not adequately capacitated and supported
 - Lack of supporting documentation and institutional knowledge
 - Lack of consequence management
 - Internal capacity and funding constraints

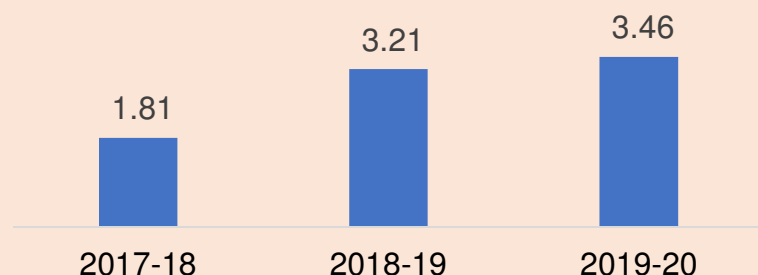
Top contributors to irregular expenditure not dealt with constitutes R37.93 billion or 63% of R60,63 billion #

	R (billion)
Nelson Mandela Bay Metro (EC)	16.54
City of Tshwane Metro (GP)	3.97
City of Johannesburg Metro (GP)	3.48
eThekweni Metro (KZN)	2.44
uMkhanyakude District (KZN)	2.33
JB Marks (NW)	2.17
Buffalo City Metro (EC)	2.08
Mogalakwena (LP)	1.86
City of Ekurhuleni Metro (GP)	1.71
OR Tambo District (EC)	1.35

Source:2019-20 MFMA General Report

FRUITLESS AND WASTEFUL EXPENDITURE TRENDS

Fruitless and wasteful expenditure trends# (R' billion)



The F&W expenditure for audits not completed by the cut-off date amounted to R1,97 billion. F&W expenditure could be higher due to nine municipalities qualified on incompleteness.

F&W expenditure incurred by 174 municipalities with completed audits due to:

- Interest and penalties (69%) – R1.35b
- Litigation and claims (2%) – R0,04b
- Other (e.g., payments to suspended employees and write-off of assets that were never used) (29%) – R0.58b

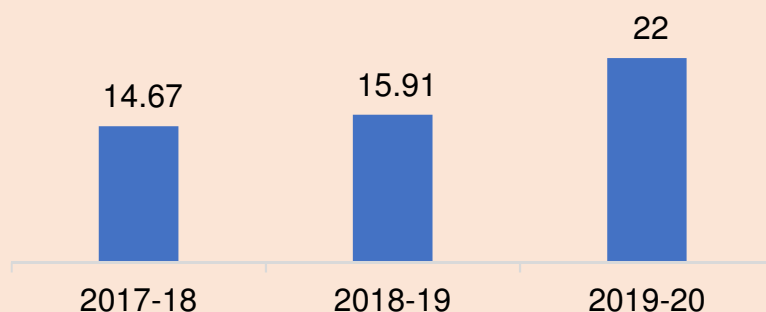
Top contributors#	R (billion)
Emalahleni (MP)*	0.33
City of Tshwane Metro (GP)	0.30
Matjhabeng (FS)	0.28
Emfuleni (GP)*	0.23
Govan Mbeki (MP)	0.20
Naledi (NW)*	0.17
Lekwa (MP) – R0,12 billion *	0.12
Nelson Mandela Bay Metro (EC)	0.09
Mopani District (LP)*	0.07
Msukaligwa (MP)	0.07
Matlosana (NW)*	0.07

** Audits still outstanding or finalised after cut-off date of General Report*

#Source:2019-20 MFMA General Report

UNAUTHORISED EXPENDITURE TRENDS

**Unauthorised expenditure trends#
(R' billion)**



2019-20 includes 175 municipalities, including 40 (R7.39b) outstanding audits, based on unaudited financial statements, as well as audits subsequently finalised.

2019-20 includes non-cash items of R9.27b of 104 municipalities – these are items not correctly budgeted for.

Unauthorised expenditure could be higher due to 14 municipalities qualified on incompleteness.

Top contributors#

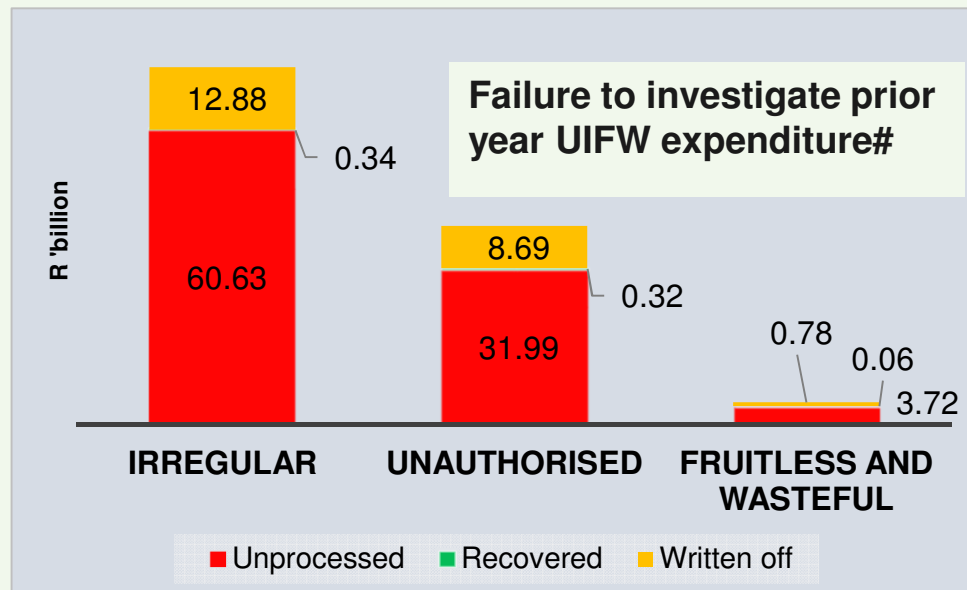
R (billion)

City of Tshwane Metro (GP)	2.25
eThekweni Metro (KZN)	1.78
Emfuleni (GP)*	1.65
Matjhabeng (FS)	1.50
Mangaung Metro (FS)*	1.17
Vhembe District (LP)	0.73
Msunduzi (KZN)	0.56
Govan Mbeki (MP)	0.55
Enoch Mgijima (EC)	0.48
Matlosana (NW)*	0.48

* Audits still outstanding or finalised after cut-off date of General Report

#Source:2019-20 MFMA General Report

CONSIDERATION OF UIFW EXPENDITURE BY MUNICIPAL COUNCILS



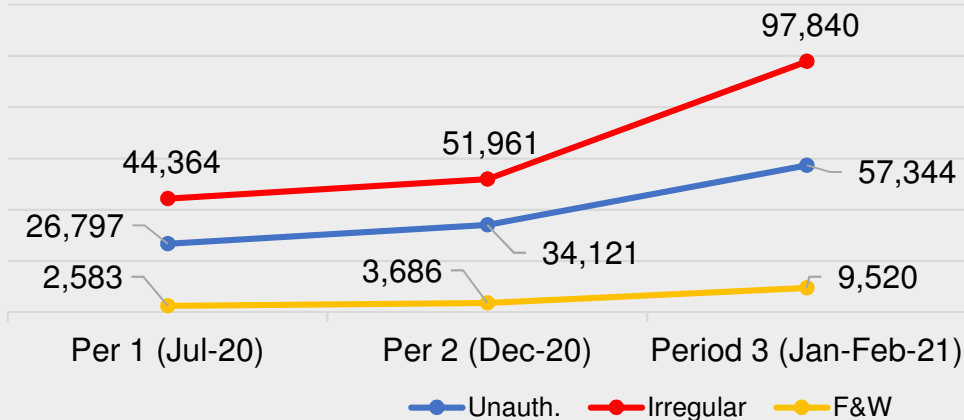
#Source: 2019-20 MFMA General Report

It is concerning that 57% municipalities had material findings relating to consequence management, i.e., sufficient steps were not taken to recover, write off, authorise or condone such UIFW expenditure, as per section 32 of the MFMA.

- NT observed that UIFW expenditure balances that accumulated are not being dealt with due to:
 - Poor control environments
 - Ineffective MPACs and investigations
 - Deadlines for investigations and processing of UIFW expenditure not achieved / monitored
 - High tolerance for non-compliance with little or no consequences

NEGATIVE IN-YEAR TRENDS IN UIFW EXPENDITURE (UNAUDITED)

**Trends in UIFW expenditure for MTSF
(Jul-20 to Feb-21)
(R' million)**



**Uncontrolled
UIFW
jeopardise
service delivery
and financial
health**

**MATTERS
ARE NOT
IMPROVING**

Unauthorised expenditure

Overspending of budget

- Actual payments in excess of budget
- Poor expenditure control and some budgets not locked

Irregular expenditure

- Non-compliance with SCM Regulations and inadequate contract management
- No competitive bidding or quotations
- Poor internal controls

Fruitless and wasteful

- Penalties and interest** on overdue accounts and late payments
- Cash flow constraints

Note:

The figure excludes NDMs, Mbombela and Rustenburg for Jan-Feb-21.

MEDIUM-TERM STRATEGIC FRAMEWORK GOALS 2019-24

MTSF 2019-24

Government's
five-year
implementation
plan and an
integrated
monitoring
framework

- Includes seven priorities and mechanisms to monitor outcomes, indicators and targets towards the achievement of the priorities
- Priority 1: To build a capable, ethical and developmental state**

Some key outcomes of priority 1

- Improve governance and accountability
- Improve financial management capability in the public sector
- Eliminate wasteful, fruitless and irregular expenditure in the public sector**
- Reduction of qualified audits
- Programme to prevent and fight corruption in government



Outcome	Outcome indicator	Baseline	Five-year target
Sound financial controls and management of public Finances	Percentage elimination of wasteful and fruitless expenditure in public sector institutions	2018 Baseline	100% elimination of wasteful and fruitless expenditure in the public sector institutions incrementally from baseline of 2019 by 2024
	Percentage reduction of irregular expenditure in public sector institutions	2018 Baseline	75% reduction of irregular expenditure in public sector institutions incrementally from baseline of 2019 by 2024

ADDRESSING UIFW EXPENDITURE: IF&W REDUCTION STRATEGY

All municipalities are required to develop and **implement appropriate strategies to reduce and prevent IFW expenditure** to achieve the 2019-24 MTSF targets

Strategy must address **historical figures**, including figures subsequent to the 2018/19 financial year

Strategy must **identify root causes and provide clear and realistic timelines** for conclusion

Develop and implement **preventative internal controls and intensify oversight and monitoring** to ensure **prompt implementation** of the UIFW reduction strategy

Accounting officers & municipal councils

- Set a zero tolerance for non-compliance
- Implement strong preventative controls
- Establish outstanding DC boards and capacitate all to act strongly
- Set clear medium-term goals to achieve the targets
- Update UIF&W register to monitor progress
- Identify risks and implement mitigating measures
- Report progress quarterly to NT and PTs



MPACs and audit committee
to hold administration accountable for implementation of the UIFW reduction strategy

UIF&W LEGAL FRAMEWORK

UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE

- MFMA Section 62 - the Accounting Officer **MUST**:
 - Take all reasonable steps to ensure that the resources of the municipality are used **effectively, efficiently and economically**
 - Take all reasonable steps to ensure that **unauthorised, irregular or fruitless and wasteful expenditure** and other losses are prevented
- MFMA section 32(2)(b)
 - A municipality must **recover** UIFW expenditure from the person liable for that expenditure unless the expenditure is, **after investigation** by a council committee, **certified by the council as irrecoverable** and written off by the council
- MFMA Section 32(4) - Accounting Officer **MUST** promptly inform the mayor in writing, of—
 - any unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality;
 - whether any person is responsible or under investigation for such unauthorised, irregular or fruitless and wasteful expenditure
 - the steps that have been taken—
 - to recover or rectify such expenditure; and
 - to prevent a recurrence of such expenditure

FINANCIAL MISCONDUCT

- Chapter 15 of the MFMA provides the legal framework for financial misconduct and financial offences
- Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014

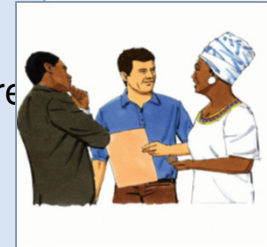


INVESTIGATION: SECTION 32(2)(A) OF THE MFMA

Section 32(2)(a) of the MFMA:

A municipality must recover UIFW expenditure from the person liable for that expenditure unless the expenditure, in the case of **unauthorised expenditure**:

- authorised in an adjustments budget; or
- certified by the municipal council, after investigation by a council committee, as irrecoverable and written off by the council; and
- in case of **irregular or fruitless and wasteful expenditure**, is, after investigation by a council committee, certified by the council as irrecoverable and written off by the council



Matters for considerations

- Has the UIFW expenditure report been submitted to council and referred to MPAC for investigation?
- Does the report provide MPAC with the necessary information to conduct its investigation into recoverability?
- Was an adjustment budget tabled in council to authorise the unauthorised expenditure?
- Has the council resolution on irregular and fruitless and wasteful expenditure been implemented?

**Was
action
taken
to address
UIFW
expenditure?**

**Are
internal
controls in
place to
prevent
UIFWE?**

ADDRESSING UIFW EXPENDITURE: ROLE OF MUNICIPALITIES AND TREASURIES

Role of municipalities

- Municipal managers to **address conditions that result in slow investigation** of UIFW expenditure
- Establish **robust preventative internal controls** to enable compliance with SCM legislation that will prevent UIFW expenditure
- Set a **tone of zero tolerance** for non-compliance
- **Develop and implement a clear strategy to reduce UIFW expenditure** to achieve the MTSF goals
- Establish **functional disciplinary boards**, as soon as practically possible (applicable to non-compliant municipalities) with **council-approved terms of reference**
- **Undertake probity audits** in relations to contracts exceeding R10m – internal audit to be utilised to provide assurance

Role of treasuries

- Develop a **clear strategy and plan to support** its municipalities in **reducing UIFW expenditure**, given the MTSF priority 1 indicators
- More actively **support MPACs**, as a key player in the UIFW value chain, to address **conditions that result in the slow investigation** of UIFW expenditure
- Actively support **establishment of disciplinary boards and provide capacity-building**
- **Work more closely with strategic partners** who also has a key role to play in the UIFW value chain albeit from a different perspective
- Promote the implementation of **consequence management**

ADDRESSING UIFW EXPENDITURE: MATTERS FOR CONSIDERATION BY MPACS

- Does MPAC understand its role in dealing with UIFW?
- Do the terms of reference clearly define the role of the MPAC?
- Is there a clear role separation and definition between MPAC and other council committees to avoid duplication?
- How often does MPAC meet to deliberate on UIFW?
- Was a report submitted to MPAC clearly detailing:
 - ✓ Extent of UIFW?
 - ✓ **Whether there was value for money?**
 - Whether goods and service have been received?
 - Whether such goods and services were at market value?
 - Whether the services received were aligned to the specification?
 - ✓ Whether any action has been taken to recover the UIFW?
 - ✓ How much it would cost the municipality to recover?
- Has MPAC concluded their investigations and has council resolved on UIFW to inform the AFS disclosure?



ADDRESSING UIFW EXPENDITURE: ROLE OF INTERNAL AUDIT AND AUDIT COMMITTEE

Internal audit

- Established i.t.o section 165 of the MFMA
 - Provides independent, objective assurance and consulting to add value to and improve an organisation's operations
 - It evaluates and improve the effectiveness of risk management, control and governance processes
 - Must be alert to fraud risks and design audit procedures and indicators that would reasonably assist in preventing and detecting potential or actual fraud and corruption.
- Internal audit can advise and provide assurance on the development and implementation of the IF&W reduction strategy

Audit committee

- Established i.t.o section 166 of the MFMA
 - Advises the municipal manager and council on governance, risk management and control frameworks, compliance and performance management
 - Assist in following up on implementation of financial misconduct regulations and make recommendations to council.
 - May investigate municipal financial affairs, but not similar in nature to the disciplinary board investigation, which relates to the conduct of individuals.
- Can advise municipal manager on the implementation of the IF&W reduction strategy and provides assurance on the adequacy, reliability and accuracy of the strategy.

ADDRESSING UIFW EXPENDITURE- FINANCIAL MISCONDUCT: DISCIPLINARY BOARD'S ROLE

- Must conduct a **preliminary investigation** into the allegations
- If allegation is **frivolous, vexatious, speculative or obviously unfounded**, terminate investigation
- If allegations are founded, **conduct full investigation** by:
 - the disciplinary board
 - an independent person with specialist expertise who is not an official
 - an independent team of investigators appointed in accordance with the SCM prescripts with a defined terms of reference
- Provides **recommendations** to council on further steps to be taken regarding **disciplinary proceedings**, or any other relevant steps to be taken.
- **Monitor** the institution of **disciplinary proceedings** against an alleged transgressor.

Matters for considerations

- ✓ Does **reasonable cause** exist that an act of financial misconduct has been committed **before** reporting it to the disciplinary board?
- ✓ Has the matter been reported to the disciplinary board **after** receiving a report on alleged financial misconduct that was tabled in council?
- ✓ Disciplinary board must be **effective**.

This is where the cost, the seniority of the alleged transgressor and seriousness or sensitivity of investigating the alleged financial misconduct, warrants such a step.

RECOMMENDATIONS

- Municipalities should:
 - Implement appropriate controls to prevent and detect UIFW expenditure – this includes the prevention of non-compliance with the relevant legislation, in particular, SCM Regulations and expenditure management
 - Maintain complete, accurate and reliable UIFW expenditure registers supported by sufficient appropriate supporting documentation
 - Undertake probity audits in relations to contracts exceeding R10m – internal audit to be involved to provide assurance on compliance with SCM Regulations and related legislation.
 - Expedite the development and implementation of a UIFW expenditure reduction strategy to meet the MTSF goals.
 - Implement appropriate internal control measures to respond to the guidance and support from the treasuries to achieve the MTSF targets.
 - Conduct Investigations into the historical UIFW expenditure should be done in an objective and diligent manner.
- Councils should:
 - Address conditions, which adversely affect the investigation of UIFW expenditure, including addressing instability in municipal and political leadership, where applicable
 - Not write off UIFW expenditure without ensuring that losses had not been suffered or that any such losses cannot be recovered and that goods and services have been delivered
 - Adequately capacitate and resource the MPACs to expedite investigations into unauthorised, UIFW expenditure and prioritise the establishment of disciplinary boards and

CONTACT



All enquiries to be submitted to MFMA helpdesk
Email: mfma@treasury.gov.za
Mark subject email -
Name of Municipality : IF&W Reduction Strategy and
Consequence Management