



FOREWORD

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I have the pleasure to present to Parliament my general report on local government audit outcomes for the year ended 30 June 2014. This report covers the audit outcomes of municipalities and municipal entities, totalling 325 auditees (268 municipalities [with a total budget of R315 190 million] and 57 municipal entities) for the 2013-14 financial year.

As in previous years, our annual audits have once again examined the following three areas:

1. Fair presentation and absence of material misstatements in financial statements.
2. Reliable and credible performance information for purposes of reporting on predetermined performance objectives.
3. Compliance with key laws and regulations governing financial matters.

This year's audit outcomes show a noticeable increase in the number of municipalities and municipal entities that received financially unqualified audit opinions with no findings (commonly known as a *clean audit*). This is certainly a laudable step towards wholesale good governance for our public sector.

The continuing improvement in municipal audit outcomes is largely due to the political and administrative leadership starting to set the right tone and leading by example in ensuring that the basics of good governance are in place and implemented rigorously. This has been our message on good administration in the public sector over the past few years.

Those municipalities and municipal entities that have progressed to a clean audit or have maintained their previous year's clean audit status are the ones that have, among other actions, implemented rudimentary tasks such as introducing basic accounting and daily control disciplines; enforcing

compliance with key legislation; employing and retaining staff in accounting and financial management positions with the required level of technical competence and experience; and allowing the chief financial officer to be in charge of the financial administration function and report thereon to the municipal manager.

The overall provincial outcomes can broadly be categorised as follows:

1. The first category includes municipalities in the provinces of Gauteng, KwaZulu-Natal and the Western Cape – most of their municipalities displayed fairly strong financial management and control disciplines. However, areas of control deficiency, even in these provinces, remained a common challenge.
2. The second category includes municipalities in the provinces of the Eastern Cape, Mpumalanga and the Northern Cape – which showed limited positive movement with significant financial management and control deficiencies. It is important to note that deficient controls render the system vulnerable to widespread abuse and sometimes a loss of adequate audit trails to substantiate transactions.
3. The third and last category includes municipalities in the provinces of the Free State, Limpopo and North West – where financial management disciplines are very poor with significant control weaknesses in most municipalities. Once more, deficient controls render the system vulnerable to widespread abuse and often a loss of adequate audit trails to substantiate transactions.

Financially unqualified opinions with no findings

Auditees that received a financially unqualified opinion with no findings (depicted in green in this report) are those that have passed the audit test in each of the three areas mentioned above.

In the 2013-14 financial year, the total number of municipalities and municipal entities with clean audits increased to 58 from the 30 in 2012-13.

This represents 40 (14%) of the municipalities and 18 (32%) of the municipal entities in the country. It is noteworthy that 27 of these auditees had also received clean audit opinions in 2012-13. This is an encouraging sign that the improvements at these auditees are indeed sustainable.

The 40 municipalities with clean audits represent 27% of the total local government expenditure budget of R315 190 million. Auditees in the clean audit category demonstrated impeccable levels of discipline and oversight in their financial management and operational activities. These auditees share similar characteristics and disciplines that they constantly maintain, including the following:

- Produce financial statements that are free from material misstatements (material misstatements mean errors or omissions that are so significant that they affect the credibility and reliability of the financial statements).
- Comply with key legislation.
- Measure and report on their performance in their annual performance report in accordance with the predetermined objectives in their integrated development plan and/or annual service delivery and budget implementation plan in a manner that is useful and reliable.
- Have good controls or work on the areas that need further attention to ensure that their clean audit status is maintained. This includes the leadership creating an environment that supports internal control and oversight; senior management ensuring that controls are in place for robust financial and performance management; and basic disciplines

and controls being implemented for daily and monthly processing and recording of transactions.

- Have key role players that work together to provide assurance on the credibility of the financial statements and performance reports and to ensure compliance with key legislation. These auditees understood that assurance on the credibility of the information in the financial statements and performance reports came primarily from the actions of management and the leadership – together with their governance partners, namely internal audit units and audit committees.
- Ensure that vacancies in key positions are limited, with stability at the level of municipal manager or chief executive officer, chief financial officer and head of the supply chain management unit.

Strong financial management and control disciplines

All provinces showed an improvement in their audit outcomes, with the biggest contributors to the total number of clean audits being the Western Cape with 18 (55% of their auditees); Gauteng with 13 (39% of their auditees); and KwaZulu-Natal with 20 (28% of their auditees).

While acknowledging that there is a valid reason to celebrate their audit achievements, it was encouraging to note during our regular interactions with the leadership in these provinces that they have accepted that there is an even greater task ahead. This relates to sustaining and improving their results but also assisting other municipalities in their provinces to progress towards the desired audit outcome. My office is content that the leadership at all levels in these provinces is championing the cause of wholesale clean audits.

Most municipalities and municipal entities in these provinces had good internal controls or were working on the areas that needed further attention. These controls were underpinned by most positions being filled by key officials that have already achieved the prescribed competency requirements. This has enabled most of these auditees to produce financial statements that were free from material misstatements and to comply with key legislation.

I acknowledge the role played by internal audit units, audit committees, councils and municipal public accounts committees and coordinating institutions through exercising their oversight responsibilities in improving governance of local government in these provinces.

However, even though audit outcomes have improved – and is something that should be celebrated – some of these improvements were achieved through the over-reliance on consultants and the correction of errors identified by the auditors during the audit process, while the number of auditees with supply chain management findings remained high in this category of provinces, incurring irregular expenditure of R3 643 million.

Limited positive movement with significant financial management and control deficiencies

The Eastern Cape, Mpumalanga and the Northern Cape have the highest number of municipalities and municipal entities in this category. Each of these provinces had one district municipality that attained a clean audit outcome for the first time or that had retained its clean audit status.

The quality of the financial statements submitted for auditing remained a concern in these provinces, which highlights the auditees' continued reliance on the audit process to ultimately achieve unqualified audit opinions. This, together with the over-reliance on consultants to assist with financial and performance reporting, indicates that concerns regarding internal controls and the skills gaps at these auditees had not been adequately addressed.

I am particularly concerned about the high level of supply chain management transgressions that are driven by uncompetitive or unfair procurement processes, conflicts of interest and internal control failures that have contributed to the R4 179 million in irregular expenditure incurred by these provinces. All levels of the leadership should set the tone by dealing decisively with transgressions of legislation in this area.

The results of our assessment of key controls and the level of assurance provided by the key role players indicate that there have been inadequate consequences for poor performance and a lack of decisive leadership interventions to address the previous year's root causes.

It is encouraging, though, to note the commitments of the political leadership of these provinces to improve the audit outcomes. Some of the interventions included harmonising the roles of the provincial departments of cooperative governance and of finance as well as capacitating district municipalities to improve their local municipalities' audit outcomes.

Weak financial management disciplines with significant control weaknesses

The auditees in this category are concentrated in the Free State, Limpopo and North West. None of the auditees in these provinces attained clean audit opinions, while the majority received qualified, adverse or disclaimed audit opinions. Overall, most of these auditees had deficient controls that rendered the system vulnerable to widespread abuse and often a loss of adequate audit trails to substantiate transactions.

The quality of the financial statements submitted for auditing remained poor at 92% to 97% of the auditees in these provinces, pointing to a poor internal control environment at most municipalities. Vacancies in key positions must continue to receive attention in the Free State and North West, particularly the positions of head of the supply chain management unit that had vacancy rates in excess of 50%. Most of the auditees used consultants at a significant cost for financial and performance reporting, but this did not improve the audit outcomes due to the poor control environment.

Supply chain management remained a challenge, with these three provinces incurring irregular expenditure of R3 651 million. The lack of consequences for transgressions continued to be the key driver of the non-compliance. The leadership had not taken any visible actions to improve this situation and address the root causes of audit findings.

The legislature and provincial coordinating departments provided limited or no assurance in each of these provinces. They must improve their oversight, while the offices of the premier must strengthen intergovernmental relations, as they all have a direct bearing on municipal functions.

Visits to clean audit municipalities

In the first three months of 2015, I visited different municipalities across the country that had received clean audits. The visits included municipalities in KwaZulu-Natal, the Western Cape, Mpumalanga, Gauteng and the Eastern Cape.

These visits were partly aimed at congratulating the municipalities on their clean audits, while also enabling my office to understand the link between the achievement of a clean audit and the delivery of services.

Together with the leadership of these municipalities, I had an opportunity to reflect on the importance of clean administration as a catalyst to drive service delivery. The municipalities also had a chance to showcase their governance structures as a critical area in ensuring the attainment of clean audit outcomes. The political and the administrative leadership accompanied us on visits to some key projects, where they provided us with detailed information on how these projects are managed for the benefit of local communities. This report contains a detailed section on these visits.

Key leadership initiatives towards improving audits and ensuring good governance

My office is further encouraged by national government initiatives such as the local government back-to-basics strategy, as they are likely to have a positive impact on improving audit outcomes and good governance when fully implemented. The positive responses and involvement of premiers, speakers and members of executive councils responsible for finance and local government have already had a positive impact on the 2013-14 audit results.

These leaders have thrown their weight behind the drive towards wholesale clean audits and good governance in general. By championing the implementation of basic disciplines at their municipalities, the future audit results can only move to the desired space – wholesale clean administration. My office will continue to work closely with these leaders by drawing from their experiences and sharing our knowledge towards improved financial management and performance reporting in local government.

Other significant audit observations

Further improvements in the timeous submission of financial statements

This report shows that 323 auditees (96%) submitted their financial statements for auditing by 31 August 2014 (or by 30 September 2014 in the case of consolidated financial statements), as required by legislation. Only 10 reports were outstanding at the cut-off date for inclusion of reports in this general report, eight of which have since been finalised.

Improvement in the management of consultants

The report also shows that 84% of the auditees used consultants to assist them with either financial reporting or the preparation of performance information, or with both these areas, which is an increase from the 80% in the previous year.

The estimated cost of consultancy services in respect of financial or performance reporting was R821 million, which includes the amounts spent by treasuries and departments of cooperative governance. The amount increased from R725 million in the previous year, and represents only a portion of the estimated R3 151 million spent on consultancy services by local government.

Overall, 55% of the assisted auditees received financially unqualified audit opinions – a significant improvement compared to the 46% in 2012-13. Similarly, 58% avoided material findings on the quality of their annual performance reports – an improvement from the 55% in 2012-13.

My office's audits of the management of consultants at 293 auditees revealed weaknesses at 184 (63%) of these auditees, which is a significant improvement compared to the 197 (79%) in 2012-13. Our findings included skills not being transferred, poor performance management and monitoring, as well as inadequate planning processes.

Reduction in irregular as well as fruitless and wasteful expenditure, but increase in unauthorised expenditure

Irregular expenditure of R11 473 million was incurred by 264 auditees – an improvement from the R12 228 million incurred by 270 auditees in 2012-13. Non-compliance with procurement process requirements was the main contributor to the irregular expenditure.

My office did not perform any investigations into irregular expenditure, as that is the role of the council. Through our normal audits, we did determine though that goods and services were received for R6 598 million (58%) of the supply chain-related irregular expenditure despite the normal processes governing procurement not having been followed. However, we cannot confirm that the goods and services had been delivered at the best price and that value was received.

Fruitless and wasteful expenditure of R687 million was incurred by 250 auditees – an improvement from the R860 million incurred by 222 auditees in the previous year.

Unauthorised expenditure of R11 402 million was incurred by 190 municipalities (71%) – a significant increase compared to the R8 502 million incurred by 175 municipalities in the previous year. In total, 61% of the unauthorised expenditure related to non-cash items, meaning accounting estimates such as impairments and provisions.

Once more, I wish to reiterate my office's commitment to continuously contribute towards the clean audit journey. I also take this opportunity to thank the audit teams from my office and the audit firms that assisted with the auditing of local government for their efforts in fulfilling our constitutional mandate of strengthening our democracy through auditing.

Auditor-General

**Auditor-General
Pretoria
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