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Executive summary

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Introduction

The **medium term strategic framework** (MTSF) for the 2014-19 period defines the overall outcome for local government (outcome 9) to be 'a responsive, accountable, effective and efficient developmental local government system'. The following sub-outcomes were developed to address the constraints in local government and achieve this vision:

- Members of society have sustainable and reliable **access to basic services**.
- Intergovernmental and democratic governance arrangements for a **functional system of cooperative governance** strengthened.
- Sound **financial and administrative management**.
- Promotion of **social and economic development**.
- Local public employment programmes expanded through the **community work programme**.

The MTSF emphasises that the implementation of these five sub-outcomes will require involvement and collaboration by various role players in national and provincial government in addition to the municipalities. These include the Department of Cooperative Governance and Traditional Affairs (CoGTA) and the National Treasury as well as the provincial departments of cooperative governance, provincial treasuries and offices of the premier.

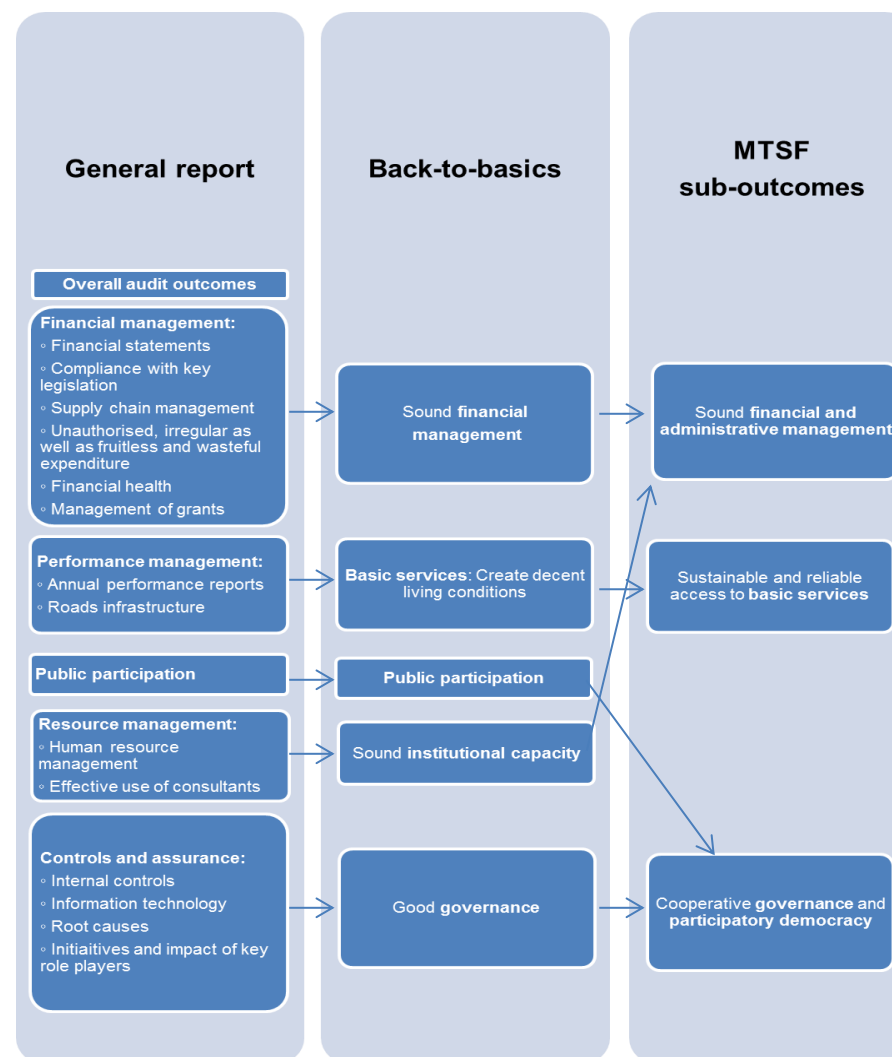
The minister of CoGTA launched the **back-to-basics** strategy in September 2014. The strategy supports and complements the achievement of the outcomes of the MTSF.

In response to, and in support of, the initiatives of government to build a responsive, accountable, effective and efficient developmental local government system, we have aligned our report to the five key performance areas of the back-to-basics approach, namely:

- Ensure sound **financial management and accounting** and prudent management of resources to sustainably deliver services and bring development to communities.
- **Create conditions for decent living** by consistently delivering municipal services of the right quality and standard.
- Put people and their concerns first and ensure constant contact with communities through effective **public participation** forums.
- Build and maintain **sound institutional and administrative capabilities**, administered and managed by dedicated and skilled personnel at all levels.
- Be **well governed** and demonstrate good governance and administration.

The links between our report, the key performance areas of the back-to-basics strategy and the sub-outcomes of the MTSF's outcome 9 can be demonstrated as follows:

Figure 1: Link between this report, the back-to-basics strategy and the medium term strategy framework



Our audit and reporting process

We audit every municipality and municipal entity in the country, also called *auditees* in this report, so that we can report on the **quality of their financial statements** and **annual performance reports** (APRs) and on their **compliance with key legislation**.

We also assess the root cause of any error or non-compliance, based on the internal control that had failed to prevent or detect it. We report in the following three types of reports:

- We report our findings, root causes and recommendations in **management reports** to the senior management and municipal managers, or chief executive officers (CEOs) in the case of municipal entities, which are also shared with the mayors and audit committees.
- Our opinion on the financial statements, material findings on the APR and compliance with key legislation as well as significant deficiencies in internal control are included in an **audit report**, which is published with the auditee's annual report and dealt with by the municipal council.
- Annually, we report on the audit outcomes of all auditees in nine provincial **general reports** and a **consolidated report** (such as this one), in which we also analyse the root causes that need to be addressed to improve audit outcomes. Before the general reports are published, we share the outcomes and root causes with the national and provincial leadership, Parliament and the legislatures as well as key role players in national and provincial government.

Over the past few years, we have intensified our efforts to assist in improving audit outcomes by identifying the **key controls** that should be in place at auditees; assessing these on a regular basis; and sharing the assessment with mayors, municipal managers, CEOs and audit committees.

We further identified the following **key risk areas** that need to be addressed to improve audit outcomes as well as financial and performance management, and we specifically audit these so that we can report on the status thereof: ■ quality of submitted financial statements and performance reports ■ supply chain management (SCM) ■ financial health ■ human resource (HR) management (including the use of consultants) ■ information technology (IT) controls.

During the audit process, we work closely with the municipal managers, CEOs, senior management, audit committees and internal audit units, as they are **key role players** in providing assurance on the credibility of the auditee's financial statements, performance report as well as compliance with legislation.

We also continue to strengthen our relationships with the mayors, ministers and members of the executive council (MECs) responsible for local government,

premiers, treasuries, departments of cooperative governance as well as Parliament and provincial legislatures, as we are convinced that their involvement and oversight have played – and will continue to play – a crucial role in the performance of local government. We share our messages on key controls, risk areas and root causes with them, and obtain and monitor their commitments to implement initiatives that can improve audit outcomes.

Figure 2 that follows gives an **overview of our message** on the 2013-14 audit outcomes, which is a continuation of what we had reported and recommended in our last report on the audit outcomes.

The overall audit outcomes in figure 2 show our opinion on auditees' financial statements and whether we had raised material audit findings on the quality of their APR and compliance with key legislation. If municipalities have municipal entities under their control, the audit opinion on their financial statements is that of the consolidated financial statements.

The **audit outcomes of 325 auditees** (268 municipalities and 57 municipal entities) are included in this general report. The audit outcomes of 10 municipalities were outstanding on 20 January 2015 (the cut-off date we had set for this report), while the audit outcomes of six municipal entities are not included in this report.

The overall audit outcomes fall into five categories:

1. Auditees that received a **financially unqualified opinion with no findings** are those that were able to:
 - produce financial statements 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)
 - measure and report on their performance in accordance with the predetermined objectives in their integrated development plan (IDP) and/or annual service delivery and budget implementation plan (SDBIP) in a manner that is useful and reliable
 - comply with key legislation.
2. Auditees that received a **financially unqualified opinion with findings** are those that were able to produce financial statements without material misstatements, but are struggling to:
 - align their performance reports to the predetermined objectives they had committed to in their IDP and/or SDBIP
 - set clear performance indicators and targets to measure their performance against their predetermined objectives

This audit outcome is also commonly referred to as a *clean audit*.

- report reliably on whether they had achieved their performance targets
 - determine which legislation they should comply with, and implement the required policies, procedures and controls to ensure that they comply.
3. Auditees that received a **financially qualified opinion with findings** face the same challenges as those that were financially unqualified with findings in the areas of reporting on performance and compliance with key legislation. In addition, they were unable to produce credible and reliable financial statements. There are material misstatements in their financial statements, which they could not correct before the financial statements were published.
 4. The financial statements of auditees with an **adverse opinion with findings** include so many material misstatements that we disagree with virtually all the amounts and disclosures in the financial statements.
 5. Those auditees with a **disclaimed opinion with findings** could not provide us with evidence for most of the amounts and disclosures in the financial statements. We were unable to conclude or express an opinion on the credibility of their financial statements.

Auditees with adverse and disclaimed opinions are typically also:

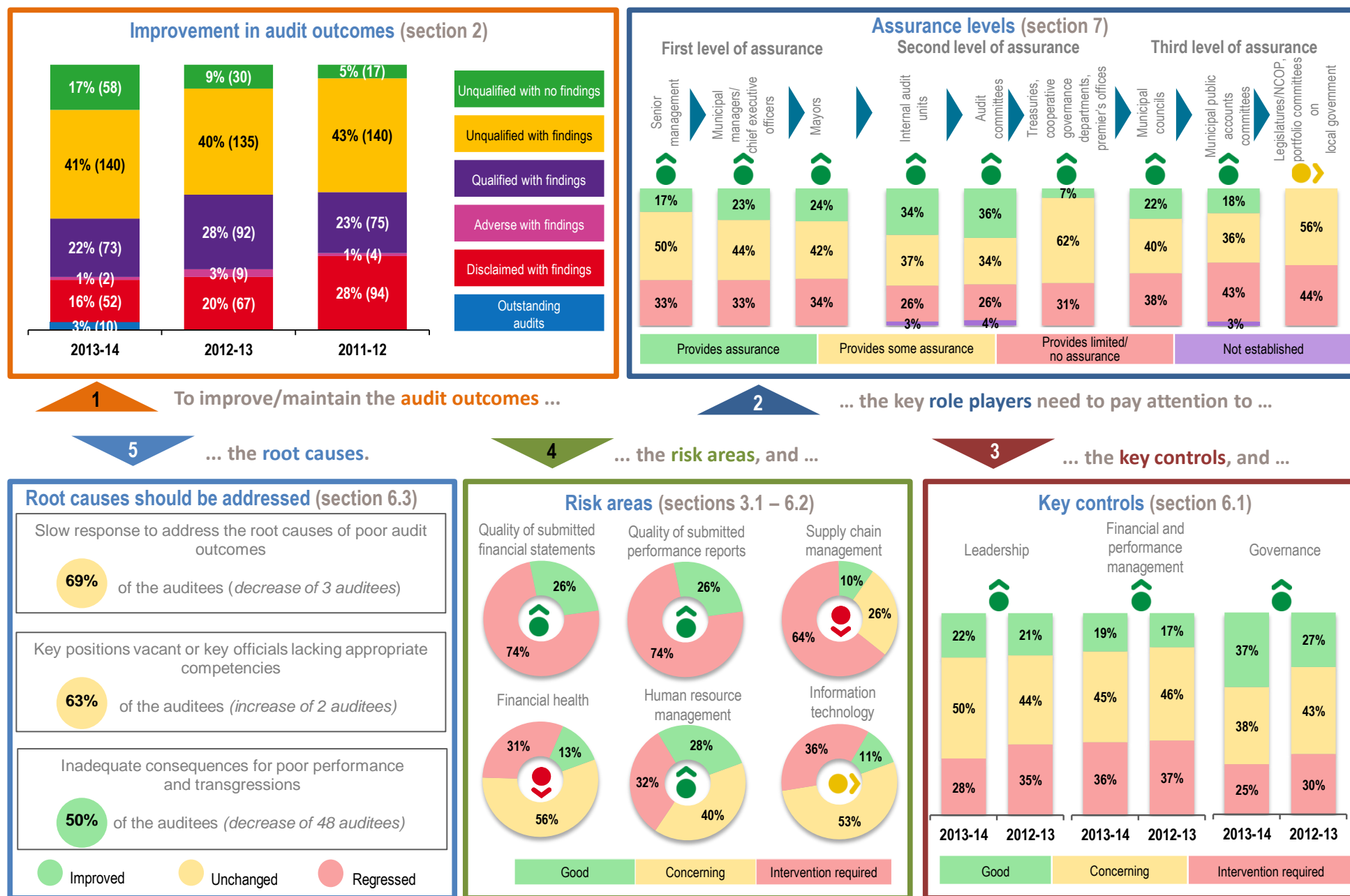
- unable to provide sufficient supporting documentation for the achievements they report in their APRs
- not complying with key legislation.

When studying the figures and reading the report, please note that the percentages are calculated based on the 325 completed audits, unless indicated otherwise. Only a movement of more than 5% (in the number of auditees) is regarded as an improvement or a regression. Movement is depicted as follows:



The rest of this section summarises the audit outcomes, our key recommendations for improvement and the characteristics of auditees within the different categories of audit outcomes.

Figure 2: Overview of audit outcomes and key recommendations for improvement



Audit outcomes are improving

The number of auditees that received a financially unqualified opinion with no findings (**clean audits**) **increased** from 30 (9%) to 58 (17%), which represent 40 (14%) of the municipalities and 18 (32%) of the municipal entities in the country. Of these auditees, 27 also had clean audit opinions in 2012-13, which is an encouraging sign that the improvements at these auditees are sustainable.

Metros and district municipalities should be leading by example in the local government sphere, but only two metros (25%) and 12 district municipalities (27%) obtained clean audit opinions.

The 40 municipalities with clean audit opinions represent 27% of the total local government expenditure budget of R315 190 million.

All provinces showed an improvement in their audit outcomes, with the biggest contributors to the total number of clean audits being Gauteng (13, or 39% of their auditees), KwaZulu-Natal (20, or 28% of their auditees) and the Western Cape (18, or 55% of their auditees). Even though the audit outcomes have improved, which should be celebrated, most provinces improved from a very low base (disclaimed, adverse and qualified opinions with findings) and most of these improvements were achieved through the over-reliance on consultants and the correction of errors identified by auditors during the audit process. Failure by auditees to strengthen their internal control environments and address the lack of skilled key officials poses a risk to continued improvements in audit outcomes.

The figure on the next page shows the number of auditees per audit opinion per province.

The status of financial management

Further improvement in timeous submission of financial statements

In total, 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.

Local government has made great strides in improving its capacity to produce financial statements on a timely basis. The rate of timely submissions has improved from 93% in 2012-13, and is a major improvement from the 78% in 2007-08.

Improvement in quality of financial statements

The number of **unqualified audit opinions on financial statements improved to 58%** from 49% in the previous year. The auditees with financially unqualified opinions represent 76% of the total local government expenditure budget.

Countrywide, 68 municipalities received a qualified audit opinion, two an adverse audit opinion, and 50 a disclaimed audit opinion. Two municipal entities are in the disclaimed category, with five being qualified. A total of 25 auditees have had a disclaimed opinion for the past five years.

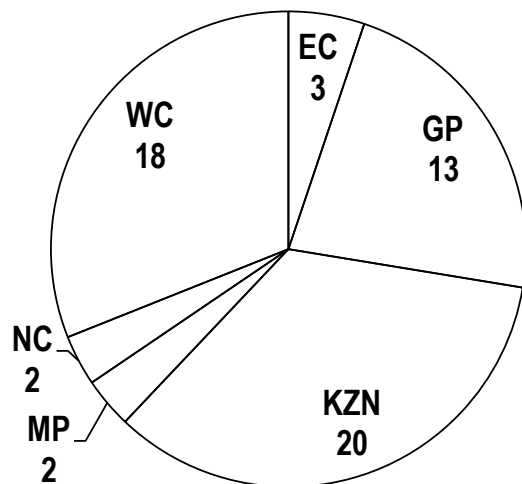
In total, 114 auditees (35%) received a financially unqualified audit opinion only because they corrected all the misstatements we had identified during the audit. Only 26% (and not 58%) of the auditees would have received an unqualified audit opinion had we not identified the misstatements and allowed them to make the corrections. It is encouraging that this is **an improvement from the 17% last year**.

The main reason for qualified, adverse and disclaimed opinions was **inadequate or missing supporting documentation** for the values included in the financial statements. The financial statement item **property, infrastructure and equipment** has in the past few years consistently been the item most commonly qualified. The number of auditees with this qualification has decreased from 118 to 95 since the previous year. Fewer auditees also had qualifications in the areas of **revenue** and **receivables**, the other two most common qualification areas. It is furthermore clear that there was a concerted effort to address the qualifications on **irregular expenditure**, as auditees qualified in this area decreased from 100 to 74; however, the quantum (R11 473 million) is still unsustainably high.

Figure 3: Audit opinions per province

Unqualified with no findings

No auditees with clean audits in FS, LP and NW



EC – Eastern Cape

FS – Free State

GP – Gauteng

KZN – KwaZulu-Natal

LP – Limpopo

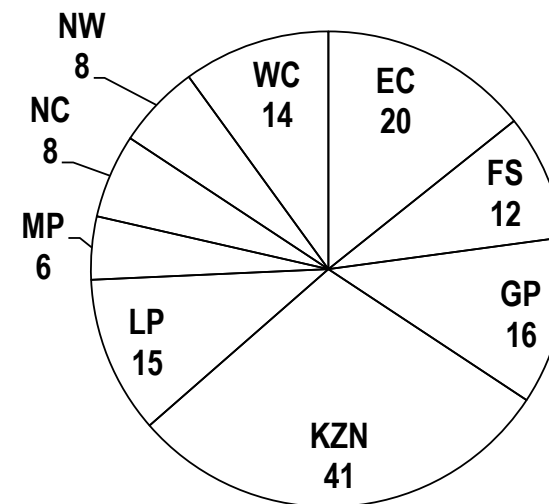
MP – Mpumalanga

NC – Northern Cape

NW – North West

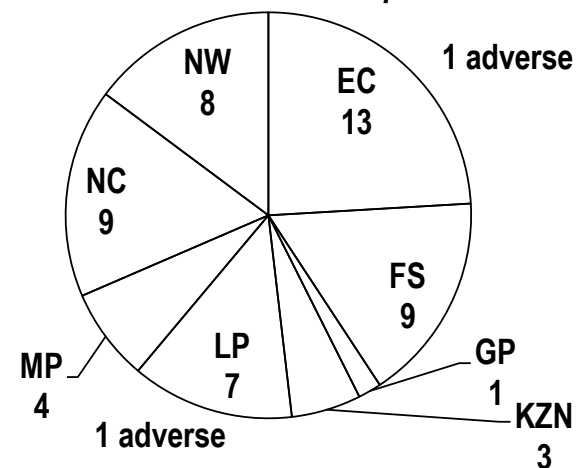
WC – Western Cape

Unqualified with findings



Adverse/ Disclaimed with findings

No auditees with disclaimed opinion in WC



The number of municipalities with unqualified audit opinions increased by 54% from 2007-08 (from 96 to 148) when government launched **operation clean audit**. However, this falls short of the goal set for 2013-14 of 100% of the municipalities achieving unqualified audit opinions, with only 53% of the municipalities being able to do so.

The MTSF set new targets for improving the audit outcomes in pursuit of sound financial and administrative management. The **targets set by government for the financial audit opinions for the 2018-19** financial year are as follows:

- No municipalities with disclaimed or adverse opinions.
- A maximum of 25% of the municipalities with qualified opinions.
- At least 75% of the municipalities with unqualified opinions.

The continuous improvement in the opinions on the financial statements, especially in the past year, is an encouraging sign that these targets are not out of reach.

Non-compliance with key legislation remains at high levels, but is improving

The number of auditees with material compliance findings **decreased** from 90% to 79%. There was an improvement in all the areas that we audit apart from compliance with legislation on consequence management, which is at the same level as in the previous year.

In the past three years, **material misstatements in submitted financial statements, SCM** and the prevention of **unauthorised, irregular as well as fruitless and wasteful expenditure** have consistently been the areas in which most non-compliance occurred.

Findings on supply chain management remain high

There was a **slight increase** in the number of auditees with findings on SCM from 278 (87%) to 290 (90%). Although there was a reduction in the number of auditees with material findings (from 224 to 205), it is of concern that **68% of the municipalities and 42% of the municipal entities had material findings on compliance with SCM legislation**.

We again experienced **limitations in auditing SCM** this year, although at fewer auditees. A total of 73 auditees (23%) (2012-13: 98 [31%]) could not provide us with evidence that all their procurement processes to the value of R1 344 million (2012-13: R2 834 million) complied with SCM legislation.

Even though prohibited by legislation, there was an increase in the value and extent of the contracts and quotations awarded to suppliers in which employees

and councillors had an interest (R60 million at 72 auditees) and in which other state officials had an interest (R3 731 million at 221 auditees).

We found non-compliance with legislation that resulted from uncompetitive or unfair procurement processes at 69% of the auditees, with one of the most common findings being that suppliers submitted false declarations of interest or did not declare such interest at all. Inadequate contract management was also identified at 36% of the auditees.

The high levels of non-compliance with SCM legislation were the cause of 98% of the irregular expenditure incurred.

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 the previous year. As described above, non-compliance with procurement process requirements was the main contributor to the irregular expenditure. We did not perform any investigations into the 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 irregular expenditure related to the supply chain, 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** from the R8 502 million incurred by 175 municipalities in the previous year. In total, R6 955 million (61%) of the unauthorised expenditure related to non-cash items, meaning accounting estimates such as impairments and provisions.

Inadequate consequences for transgressions

The Municipal Finance Management Act (MFMA) and its regulations clearly stipulate that matters such as incurring unauthorised, irregular as well as fruitless and wasteful expenditure, the possible abuse of the SCM system (including fraud and improper conduct) and allegations of financial misconduct should be investigated.

We reported material **non-compliance with legislation on consequence management** at 137 (42%) of the auditees, which is slightly more than in the previous year.

We reported in the audit reports that many auditees did not comply with the requirement that the council should investigate unauthorised, irregular as well as fruitless and wasteful expenditure to determine if any official is liable for the expenditure. The council did not investigate all of the incidents at 44% of the auditees in 2013-14.

We report all our findings on SCM non-compliance and weaknesses to management for follow-up. If there are indicators of possible fraud or improper conduct in the SCM processes, we recommend an investigation by management. In 2012-13, we reported such findings for investigation at 99 auditees. The management of only 12 (12%) of these auditees did not investigate all of the incidents, which is an encouraging sign that action is being taken. However, these **findings continued to increase**. Furthermore, 87 of the auditees that had such findings in 2012-13 again had similar findings in 2013-14. This means that even though investigations are taking place, it is not yet having the desired impact by discouraging fraud and improper behaviour.

Allegations of financial misconduct were reported at 50 auditees in 2013-14 (812 cases). At 12 auditees, these allegations were either not investigated by management or not tabled in the council as required for senior managers.

Financial health of auditees is deteriorating

The number of auditees with a good financial health status, as determined by a high-level analysis of auditees' financial health indicators, decreased. The financial health of **87% of the auditees** was rated as either concerning or requiring intervention.

Countrywide, 70 auditees (22%) were in a particularly **poor financial position** with material uncertainty with regard to their ability to continue operating in the foreseeable future.

Important findings arising from our analyses included the following:

- In total, 36% of the auditees **spent more than the resources they had** (and therefore a net deficit occurred), while for almost 40% the value of their current assets was less than that of their current liabilities at year-end (**net current liability** position). The year-end bank balance was in **overdraft** at 24 auditees.
- Just over 80% of the auditees estimated in their financial statements that **more than 10% of the outstanding debt owed to them would not be paid**, which is a significant increase from the previous year. Almost 40% of the auditees had an **average debt-collection period of over 90 days**.

- A total of 40% of the auditees took **more than 90 days to pay their creditors**.
- Over half of the auditees **underspent their capital budgets** and 44% their **grants** by more than 10%. Furthermore, a quarter of auditees **overspent their operating budget** by more than 10%.

Weaknesses in the effective utilisation of grants

The underspending of grants, as reported above, has been a recurring theme in our reports for the past few years. We also continue to identify municipalities that do not comply with the requirement for using the grants as defined by the annual Division of Revenue Act (DoRA); with 26% of the municipalities that received grants not complying this year. The non-compliance included 27 municipalities (10%) that **used their grant allocations for purposes other those allowed by DoRA** and 51 (19%) that **did not evaluate the performance** of the programmes funded by the allocations.

We broadened our scope in the past audits to consider the impact that the grants have had on the operations of municipalities. The grants we covered were the **municipal infrastructure grant (MIG)** and the **municipal systems improvement grant (MSIG)** (both allocated by CoGTA), as well as the **financial management grant (FMG)** (allocated by the National Treasury).

The planned impact **targets for the grants were, however, not achieved** or not assessed by the municipality. We could also not audit this at 29% of the municipalities for the MSIG and 20% for the FMG. Although conditional grant allocations of R629,3 million were spent on improving financial and performance management, the audit outcomes of 160 municipalities (59%) remained stagnant and those of 21 (8%) regressed. This means that only a third of the municipalities took advantage of the allocations to improve their audit outcomes.

CoGTA introduced the MIG with the core outcome of improving access to basic service infrastructure for poor communities. Of the R15,5 billion available to 239 municipalities in 2013-14, R13,6 billion (88%) was spent. A total of 43% of the municipalities that received MIG allocations **did not achieve their planned targets**. Municipalities that did not achieve the targets spent the bigger part of the allocations (54%).

Municipalities identified poor planning and project management as well as inadequate capacity to deliver on the projects funded by these grants as the main reasons for not achieving targets, while using the grants for purposes other than those intended also contributed.

The status of performance management

Steady progress in quality of annual performance reports

Overall, 19 auditees **did not prepare APRs**, which is a slight improvement from the 26 in the previous year.

The **quality of APRs improved**, with the number of auditees with no material findings in this regard increasing from 103 (32%) to 126 (39%).

Although 39% of the auditees had no material findings, only 26% of the auditees submitted APRs without material misstatements. This means that 13% of the auditees had **good outcomes only because they corrected the misstatements identified during the audit**.

The most common findings on **usefulness** reported at 55% of the auditees that had prepared APRs were that they reported on indicators that were not well defined or verifiable. Some targets were also not measurable or specific enough to ensure that the required performance could be measured and reported in a useful manner. A total of 52% of the auditees had findings on the **reliability** of the information on which they reported.

The improvement in the quality of APRs is encouraging. However, the inability of over **60% of local government** to plan, manage and report on their performance, combined with **the financial health concerns at 87%** of the auditees, raises concerns regarding the ability of local government to report effectively on service delivery to their communities.

The management of roads infrastructure needs attention

The condition of roads directly affects road safety. It has an impact on all citizens and, as such, poor road conditions create challenges for many with unnecessary time delays, increased transportation costs, and reduced access to education, health care and social services. The 212 municipalities classified as roads authorities were slow to address the warning signals for roads infrastructure we had identified in the previous year, as 46% of the findings were repeated. These included the following:

- **Policies on roads infrastructure** were not in place (at more than 50% of the municipalities), or were not implemented.
- **Key performance indicators (KPIs) were not set** for the maintenance, construction and upgrading of roads. Where municipalities had KPIs, at least 42% did **not achieve their targets**.

- Municipalities did not always **budget** for planned maintenance in their operational budget.
- Most municipalities did not have an approved **road maintenance plan** and did not have a **road asset management system**.

Public participation

The MTSF defines indicators, targets and actions to improve local government's focus on citizens' priorities and participatory democracy. We audit compliance with the requirements of the Municipal Systems Act (MSA) relevant to community participation, and reported that 22 municipalities (2012-13: 17) did not consult the local community in drafting and implementing the IDP, while 18 municipalities (2012-13: 33) did not grant the community at least 21 days to comment on the IDP.

The status of resource management

Human resource management showed some improvement

The number of auditees whose HR management controls we assessed as being good increased from 72 to 90 (25%). The most notable **improvements** related to **vacancies and stability in key positions**. The improvement is an encouraging sign, but findings in this area remained too high for municipal managers (12%), CEOs (22%), chief financial officers (CFOs) (13% at municipalities and 31% at municipal entities) and especially heads of SCM units (24% at municipalities and 36% at municipal entities). The average number of months that these officials remained in their positions was between 32 months (CFOs at municipalities) and 39 months (CFOs at municipal entities).

The vacancy levels overall (20%) and at senior management level (18%) remained pronounced. The resourcing of the finance units of 140 (43%) of the auditees requires attention to improve and maintain good financial management.

We also considered whether there were senior managers at the auditees that were responsible for **strategic planning** and for **monitoring and evaluation**, as these functions are crucial for effective strategy planning, performance management and reporting. Only 72% of the municipalities had a senior manager responsible for strategic planning and 66% for monitoring and evaluation. There were also prolonged vacancies in these positions.

At 120 auditees (37%), all of the senior managers **had not yet met the minimum competency requirements as prescribed by the *Municipal***

regulations on minimum competency levels by 30 June 2014. Auditees have until 30 September 2015 to fully comply with these regulations. At 135 auditees (42%), all finance officials had not met the requirements.

The number of **key officials with the minimum competencies increased** from the previous year. Those without the required competencies or where it was not assessed or could not be audited by us remained too high, with municipal managers and CEOs at 23%, CFOs at 26%, and heads of SCM units at 28%.

The main reason why key officials had not met the requirements was that they were not yet at the level of proficiency required in the **competency areas** applicable to the position. Around 30% of these officials also did not have an appropriate higher education qualification.

Although there has been some improvement, there were still weaknesses in the **performance management** of senior management, such as performance contracts of key officials and other senior managers not being in place.

Improvement in the management of consultants

In total, 84% of the auditees used **consultants to assist them with either financial reporting or the preparation of performance information**, or both these areas (an increase from the 80% in the previous year). The estimated cost of the consultancy services 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 was 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 from the 46% in 2012-13. Similarly, 58% avoided material findings on the quality of their APRs – an improvement from the 55% in 2012-13.

Our audits of the management of consultants at 293 auditees identified weaknesses in the management of consultants at 184 (63%) of these auditees, which is an **improvement** from the 197 (79%) in 2012-13. Our findings included skills not being transferred, poor performance management and monitoring, as well as inadequate planning and appointment processes.

The status of controls and assurance

Internal control is improving but basic controls and disciplines require attention

As part of our audit process, we continue to assess internal controls to determine the effectiveness of their design and implementation in ensuring

reliable financial and performance reporting and compliance with legislation. Overall, there was an **improvement** in the number of auditees with good internal controls relating to **leadership and governance**, but **little improvement in financial and performance management controls**.

The following basic controls and disciplines should be strengthened to ensure that errors, omissions and non-compliance are prevented, or detected and corrected timeously:

- Effective leadership based on a culture of honesty, ethical practices and good governance – in place at 42% of the auditees.
- Use of audit action plans to address internal control deficiencies – in place at only 26% of the auditees.
- Proper record keeping and document control – in place at only 28% of the auditees.
- Controls over daily and monthly processing and reconciling of transactions – in place at only 28% of the auditees.
- Review and monitor compliance with legislation – in place at only 18% of the auditees.

Information technology controls continue to need attention

We assessed IT controls at 303 auditees and found that the **number of auditees who required intervention had decreased** significantly from 146 in 2012-13 to 108. However, the number of auditees with good IT controls regressed from 38 to 32.

The status of controls in the areas of security management, user access and IT service continuity still needed considerable attention, as over 50% of the auditees were still struggling to design these controls and had therefore not even begun to implement them. The lack of well-functioning controls poses a risk in terms of the confidentiality, integrity and availability of the information on the IT systems concerned. IT governance also remained an area of concern.

A government-wide IT governance framework was approved by Cabinet; and in response to a directive from the minister of CoGTA, a national coordinating and monitoring structure was established to oversee information and communications technology (ICT) in local government. The purpose of this initiative is to develop implementation requirements and a guideline specific to local government to structure the establishment of an IT governance framework. It is envisaged that this IT governance framework will be finalised and approved during the current financial year and be implemented from the 2015-16 financial year in a three-phased approach. When fully implemented, the IT governance

framework should have a positive impact on the functioning of the IT control environment and service delivery in the public service domain.

Continued focus on the root causes is required

Many auditees did not receive a clean audit opinion because their financial and performance reports were of a poor quality and they had high levels of non-compliance with legislation. The most common root causes of poor audit outcomes that need to be addressed remain the following:

- The **slow response of municipal managers, CEOs and senior managers** in addressing weaknesses in internal controls and the six risk areas.
- **Inadequate consequences** for transgressions and poor performance.
- Key officials that **lack appropriate competencies**.

All role players should increase the level of assurance they provide

To sustain improvements in audit outcomes, auditee management and leadership and those that perform an oversight or governance function should work towards improving the key controls. They should address the root causes we again highlight in this report and ensure that there is an improvement in the six key risk areas. This will provide assurance on the quality of the financial statements and performance reports as well as compliance with legislation. Although we assessed that there was an **overall improvement** in the assurance levels, still too few of the role players are providing the necessary assurance. Our assessment also showed the following:

- **Senior management** at 83% of the auditees did not provide assurance in that they did not ensure that the basic financial and performance management controls were in place.
- **Municipal managers and the CEOs** of municipal entities at 77% of the auditees did not provide assurance in that they did not (i) create strong control environments through their leadership and oversight; (ii) establish policies, procedures and action plans; and (iii) ensure that HR management, IT governance, risk management, internal audit units and audit committees were effective.
- The assurance provided by **mayors** was inadequate at 76% of the auditees, as there were significant weaknesses in the leadership controls at these auditees. Based on regular interactions with them and the status of the prior year commitments they had made to ensure that audit outcomes improve, we determined that the mayors at these auditees did not have the impact they should have had on the performance of their municipalities.

- Although the assurance provided by **internal audit units and audit committees** was higher than that of the other role players at 34% and 36% of the auditees, respectively, they were not yet effective in providing internal assurance and oversight. They did not focus enough on the reliability of performance information and the evaluation of IT controls and compliance.
- **Municipal councils** at 78% of the auditees did not provide assurance through their oversight and monitoring role. This includes investigating and acting on poor performance and transgressions such as financial misconduct and unauthorised, irregular as well as fruitless and wasteful expenditure. The instability in the councils of 42 municipalities requires attention.
- **Municipal public accounts committees** (MPACs) were not in place at 15 auditees and we found the impact of the established MPACs to be minimal in promoting transparency, good governance and public accountability at 79% of the auditees.
- **National and provincial government** has a constitutional responsibility to support and strengthen municipalities and to monitor compliance with the legislation that governs local government. Our assessment revealed that the departments with a direct role to play (the treasuries, departments of cooperative governance, and offices of the premier) were not yet providing sufficient assurance through their mandated functions, although the level of assurance they provided had improved from the previous year.
- **Provincial legislatures** were also not providing assurance, as they performed only limited oversight of local government through the portfolio committees.

Clean audit outcome and service delivery

In the first three months of 2015, the auditor-general (AG), Kimi Makwetu, 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.

Partly, these visits were aimed at congratulating the municipalities with their clean audits; while also enabling the AG to understand the link between the achievement of a clean audit and the delivery of services.

The AG and the municipal leadership had an opportunity to reflect on the importance of **clean administration as a catalyst to drive service delivery** during these visits. 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 the AG and his team on visits to some key projects, where they provided him with detailed information on how these projects are managed for the benefit of local communities.

As part of the exercise, the projects visited were linked to the objectives of the municipalities' APRs as well as the key performance areas (KPAs) or KPIs in their 2013-14 annual reports.

Characteristics of each of the categories of audit outcomes

The table provided on the following pages summarises the characteristics of auditees that fall within the different categories of audit outcomes. The purpose of this summary is the following:

- Assist the reader to understand the different audit outcomes.
- Highlight the good practices of auditees with clean audit opinions.
- Emphasise that auditees with an unqualified audit opinion with findings still have serious weaknesses that should be dealt with.
- Explain why auditees with qualified, adverse and disclaimed opinions are failing.

Area	Clean (58)	Unqualified with findings (140)	Qualified with findings (73)	Adverse or disclaimed with findings (54)
<i>Financial statements</i>	Produced financial statements free from material misstatement .	<p>A total of 114 (81%) produced financial statements with material misstatements, but corrected these during the audit process.</p> <p>The most common areas in which auditees made corrections were:</p> <ul style="list-style-type: none"> property, infrastructure and equipment contingent liabilities and commitments irregular expenditure receivables revenue. 	<p>Produced financial statements with material misstatements, which they could not correct before the financial statements were published.</p> <p>The most common areas in which they could not make corrections were:</p> <ul style="list-style-type: none"> property, infrastructure and equipment receivables revenue. 	<p><u>Adverse</u>: Produced financial statements that included so many material misstatements that we disagreed with virtually all the amounts and disclosures in the financial statements.</p> <p><u>Disclaimed</u>: Could not provide us with evidence for most of the amounts and disclosures in the financial statements. We were unable to conclude or express an opinion on the credibility of their financial statements.</p>
<i>Annual performance report</i>	Measured and reported on their performance (in the APR) in accordance with the predetermined objectives in their IDP and/or SDBIP and in a manner that was useful and reliable .	<p>Seven (5%) did not prepare an APR.</p> <p>The APRs of 74 (53%) were not useful and/or reliable.</p> <p>In total, 23 (16%) obtained good outcomes only because they corrected the misstatements identified during the audit.</p>	<p>Four (5%) did not prepare an APR.</p> <p>The APRs of 61 (84%) were not useful and/or reliable.</p>	<p>Eight (15%) did not prepare an APR.</p> <p>The APRs of 45 (83%) were not useful and/or reliable.</p>
<i>Compliance with key legislation</i>	Complied with key legislation.	<p>A total of 138 (99%) did not comply with key legislation.</p> <p>The only material instances of non-compliance we reported for seven of these auditees were the poor quality of the financial statements they had submitted for auditing. They would have received a clean audit outcome had it not been for this compliance finding.</p>	A total of 73 (100%) did not comply with key legislation.	A total of 54 (100%) did not comply with key legislation.

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Controls	<p>Had good controls and/or were working on the areas that needed further attention to ensure that their clean audit status was maintained:</p> <ul style="list-style-type: none"> The leadership created an environment conducive to internal control and oversight (97%). Senior management ensured that controls were in place for robust financial and performance management reporting systems (84%). They focused on governance through risk management activities and effective internal audit units and audit committees (100%). <p>Their continued focus on these basic controls contributed to their success:</p> <ul style="list-style-type: none"> The leadership established a culture of ethical behaviour, commitment and good governance (100%). Good HR practices ensured that adequate and sufficiently skilled officials were in place and that their performance was managed (90%). Attention to ICT ensured that it supported objectives and processes, and maintained the confidentiality, integrity and availability of information (only 34%). Audit action plans were used to address internal control weaknesses (97%). Proper record keeping ensured that information was accessible and available to support financial and performance reporting (90%). Basic disciplines and controls were in place for daily and monthly processing and reconciling of transactions (88%). Mechanisms were in place to identify applicable legislation, changes and processes to ensure and monitor compliance with legislation (83%). 	<p>Had good controls in some areas but attention should be paid to the basic controls, as the number of auditees with good controls in these areas was limited:</p> <ul style="list-style-type: none"> Effective leadership culture (54%) Good HR controls (27%) Good ICT governance and controls (7%) Effective audit action plans (21%) Proper record keeping (27%) Strong daily and monthly controls (26%) Review and monitor compliance (8%) 	<p>Very few auditees had good basic controls, ranging from 1% to 8%. There were no auditees with good controls in the areas of audit action plans or the review and monitoring of compliance.</p>	<p>The basic controls were in a poor state. We assessed the status of controls at most of these auditees as 'intervention required'.</p> <p>The poorest controls were in the following areas:</p> <ul style="list-style-type: none"> Proper record keeping (96% needed intervention) Review and monitor compliance (96% needed intervention) Daily and monthly controls (93% needed intervention)

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Assurance providers	<p>Key role players worked together to provide assurance on the credibility of the financial statements and performance reports and to ensure compliance with key legislation.</p> <p>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/leadership and their governance partners – internal audit units and audit committees.</p> <p>Their political leadership provided a strong monitoring and oversight role and held the administration to account.</p> <p>The number of auditees where role players provided full assurance was:</p> <ul style="list-style-type: none"> • Senior management (71%) • Municipal managers/CEOs (90%) • Mayors (84%) • Internal audit units (93%) • Audit committees (98%) • Municipal councils (91%) • MPACs (76%) 	<p>All role players did not provide the required level of assurance. As a result, the financial statements and APRs prepared, reviewed and signed off by senior management and the municipal manager/CEO of these auditees were materially misstated. The internal audit units and the audit committees did not add to the credibility of these reports, while monitoring and oversight by the political leadership did not have the desired results.</p> <p>These role players did also not ensure or insist on strong controls to ensure compliance with key legislation and to prevent, or detect and correct, material misstatements.</p> <p>The auditees where role players provided full assurance were limited:</p> <ul style="list-style-type: none"> • Senior management (10%) • Municipal managers/CEOs (15%) • Mayors (19%) • Internal audit units (36%) • Audit committees (39%) • Municipal councils (14%) • MPACs (10%) 	<p>The role players at very few auditees provided the required assurance: 1% of the municipal managers/CEOs, 4% of the mayors, 10% of the internal audit units, and 8% of the audit committees.</p> <p>The rest of the role players provided some or limited/no assurance. Internal audit units had not been established at 4% and audit committees at 8% of these auditees.</p>	<p>The contributions to assurance by the role players at these auditees were minimal. The role players that provided the least assurance were at the first and third level of assurance:</p> <ul style="list-style-type: none"> • Senior management (89% provided limited/no assurance) • Municipal managers/CEOs (89% provided limited/no assurance) • Mayors (85% provided limited/no assurance) • Municipal councils (85% provided limited/no assurance) • MPACs (89% provided limited/no assurance) – 2% did not have an MPAC <p>Internal audit units had not been established at 2% of these auditees, and provided limited or no assurance at 67%. In total, 6% of these auditees did not have audit committees, while the audit committees at 65% provided limited or no assurance.</p>

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Key officials	<p>There were limited vacancies in key positions, with the following vacancy rates at year-end:</p> <ul style="list-style-type: none"> • Municipal manager/CEO – 4% • CFO – 7% • Head of the SCM unit – 8% <p>There was stability at the level of municipal manager/CEO, CFO and head of the SCM unit – the officials had been in these positions between four to almost five years.</p> <p>The competencies of these officials were assessed and most had already achieved the competency requirements prescribed by the regulations – 85% of municipal managers, 87% of CFOs, and 80% of heads of SCM units.</p>	<p>The vacancies in key positions were more pronounced at these auditees:</p> <ul style="list-style-type: none"> • Municipal manager/CEO – 18% • CFO – 18% • Head of the SCM unit – 26% <p>There was less stability, with key officials being in these positions for just under three years on average.</p> <p>A higher number of officials had not achieved their minimum competency requirements yet or it had not been assessed – 16% of municipal managers, 19% of CFOs, and 23% of heads of SCM units.</p>	<p>The vacancies in key positions were at the same level as those of auditees with unqualified opinions with findings:</p> <ul style="list-style-type: none"> • Municipal manager/CEO – 15% • CFO – 17% • Head of the SCM unit – 34% <p>There was even less stability, with key officials being in these positions for two and a half years on average.</p> <p>An even higher number of officials had not achieved their minimum competency requirements yet or it had not been assessed – 26% of municipal managers, 34% of CFOs, and 27% of heads of SCM units.</p>	<p>The vacancies in key positions were the highest at these auditees:</p> <ul style="list-style-type: none"> • Municipal manager/CEO – 15% • CFO – 21% • Head of the SCM unit – 35% <p>These auditees had the least stability, with key officials being in these positions for less than two years on average.</p> <p>These were also the auditees where the most officials had not achieved their minimum competency requirements yet or it had not been assessed – 49% of municipal managers, 52% of CFOs, and 53% of heads of SCM units.</p>

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Use of consultants	<p>They used consultants for financial reporting services but utilised them effectively. Thirty-six (62%) of these auditees were assisted by consultants to the amount of R63 million.</p> <p>They appointed the consultants in time, provided them with the required records and documents, and managed the process effectively.</p>	<p>They widely used consultants for financial reporting services, but most could not produce financial statements without material misstatements – these material misstatements were corrected through the audit process.</p> <p>A total of 111 (79%) of these auditees were assisted by consultants to the amount of R307 million.</p> <p>Their practices in managing consultants (not limited to financial reporting) need attention:</p> <ul style="list-style-type: none"> • No transfer of skills at 34% • Poor performance management and monitoring at 30% • Inadequate planning and appointment processes at 24% 	<p>An even higher number of auditees were assisted by consultants – 66 (90%) to the amount of R204 million.</p> <p>They had poor audit outcomes in spite of using consultants, mainly due to the following:</p> <ul style="list-style-type: none"> • Poor project management by 32% of the auditees. • The records and documents consultants needed to perform their services could not be provided to them at 26% of the auditees. • The consultants were appointed too late at 19% of the auditees. <p>Poor practices in managing consultants (not limited to financial reporting) were widespread:</p> <ul style="list-style-type: none"> • No transfer of skills at 58% • Poor performance management and monitoring at 64% • Inadequate planning and appointment processes at 33% 	<p>The use of consultants was the most common in this category – 52 (96%) of these auditees were assisted by consultants to the amount of R192 million.</p> <p>They had poor audit outcomes in spite of using consultants, mainly due to the following:</p> <ul style="list-style-type: none"> • The records and documents consultants needed to perform their services could not be provided to them at 41% of the auditees. • The consultants were appointed too late at 21% of the auditees. • At 19% of the auditees, the consultants could not deliver on their contract. <p>They displayed the poorest practices in managing consultants (not limited to financial reporting):</p> <ul style="list-style-type: none"> • No transfer of skills at 83% • Poor performance management and monitoring at 76% • Inadequate planning and appointment processes at 50%

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<i>Utilisation of grants</i>	<p>The municipalities effectively utilised the grants aimed at improving financial and performance management (MSIG and FMG):</p> <ul style="list-style-type: none"> Only 3% of these grants were not spent. All the targets for the grants were achieved, except for 3% of the MSIG spent. <p>They were also able to use their MIG effectively:</p> <ul style="list-style-type: none"> Only 6% of the grant was not spent. The targets were achieved for 92% of the money spent. 	<p>The municipalities utilised the MSIG and the FMG but with a slightly higher underspending and lower achievement than auditees with clean audit opinions:</p> <ul style="list-style-type: none"> A total of 6% was not spent. Targets were not achieved for 24% of the MSIG spent and 9% of the FMG spent. <p>The weaknesses in the control environments of these municipalities also affected their ability to use the MIG effectively:</p> <ul style="list-style-type: none"> In total, 17% of the grants were not spent. The targets were not achieved for 35% of the money spent. 	<p>The utilisation of grants by municipalities was poorer in this category:</p> <ul style="list-style-type: none"> A total of 5% of the MSIG and the FMG were not spent. Targets were not achieved for 32% of the MSIG spent and 24% of the FMG spent. In total, 12% of the MIG was not spent but targets were not achieved for 73% of the money spent. 	<p>Municipalities in this category showed the least ability to utilise their grants effectively:</p> <ul style="list-style-type: none"> Only 10% of the MSIG and the FMG were not spent but the targets were not achieved for 54% of the MSIG spent and 45% of the FMG spent. For the MIG, only 9% was not spent but the targets were not achieved for 74% of the money spent.

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Supply chain management and irregular expenditure	<p>They had no material instances of non-compliance with SCM legislation; 26% had good SCM practices but 74% still needed to improve in some of the areas of SCM.</p> <p>Their irregular expenditure levels were low as a result of their good SCM practices. They incurred only 3% of the irregular expenditure of all auditees, but were responsible for 27% of the municipal budget.</p>	<p>In total, 64% of these auditees had material instances of non-compliance with SCM legislation. Only 10% had good SCM practices.</p> <p>Their irregular expenditure levels were high as a result of their poor SCM practices. They incurred 29% of the total irregular expenditure.</p> <p>At 30 auditees (21%), the municipal manager and council did not investigate the irregular expenditure of the previous year to determine if anyone was liable for the expenditure.</p>	<p>In total, 93% of these auditees had material instances of non-compliance with SCM legislation.</p> <p>Their irregular expenditure levels were high as a result of their poor SCM practices. They contributed the most to irregular expenditure at 51% of the total irregular expenditure, while being responsible for only 16% of the municipal budget.</p> <p>A lack of investigations was more pronounced – at 46 auditees (63%), the municipal manager and council did not investigate the irregular expenditure of the previous year to determine if anyone was liable for the expenditure.</p>	<p>In total, 89% of these auditees had material instances of non-compliance with SCM legislation.</p> <p>We experienced limitations in performing the SCM audits at 61% of these auditees.</p> <p>Their irregular expenditure levels were high as a result of their poor SCM practices; and was it not for the audit limitations, it could have been higher. Even though they were responsible for only 6% of the municipal budget, they incurred 17% of the total irregular expenditure.</p> <p>A lack of investigations was most common in this category – at 35 auditees (65%), the municipal manager and council did not investigate the irregular expenditure of the previous year to determine if anyone was liable for the expenditure.</p>

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