

## 6

# The status of controls

## Back-to-basics:

Be well governed and demonstrate good governance and administration

Figure 1: Some improvement in drivers of internal control

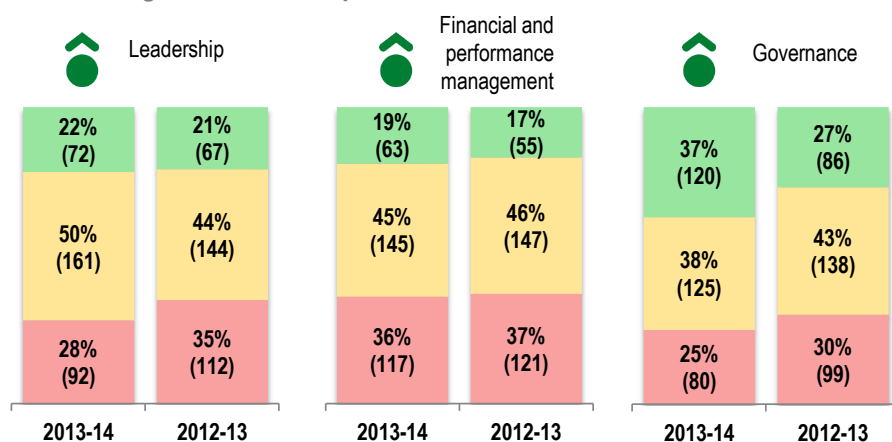


Figure 2: Attention should be paid to basic controls

## Audit areas and percentage of auditees

	Financial statements			Performance reports			Compliance with legislation		
Effective leadership	49%	31%	20%	44%	31%	25%	41%	35%	24%
HR controls	29%	41%	30%	32%	34%	34%	28%	40%	32%
Audit action plans	31%	46%	23%	32%	33%	35%	26%	44%	30%
IT governance and controls	12%	53%	35%	Not assessed			Not assessed		
Proper record keeping	32%	41%	27%	32%	26%	42%	33%	39%	28%
Daily and monthly controls	28%	40%	32%	34%	27%	39%	31%	36%	33%
Review and monitor compliance	24%	38%	38%	27%	31%	42%	14%	35%	51%

Good

Concerning

Intervention required

(Legend also applies to the remainder of this section)

Table 1: Progress made in improving drivers of internal control

Province	Leadership	Financial and performance management	Governance
Eastern Cape	⬆️	⬆️	⬆️
Free State	⬆️	⬆️	⬆️
Gauteng	⬆️	⬆️	⬆️
KwaZulu-Natal	⬆️	⬆️	⬆️
Limpopo	⬆️	⬆️	⬆️
Mpumalanga	⬆️	⬆️	⬆️
Northern Cape	⬆️	⬆️	⬆️
North West	⬆️	⬆️	⬆️
Western Cape	⬆️	⬆️	⬆️

## 6.1 Status of internal control

A key responsibility of municipal managers, CEOs, senior managers and municipal officials is to implement and maintain effective and efficient systems of internal control.

We assessed the internal controls to determine the effectiveness of their design and implementation in ensuring reliable financial and performance reporting and compliance with legislation. To make it easier to implement corrective action, we categorise the principles of the different components of internal control under leadership, financial and performance management, or governance. We call these the *drivers of internal control*.

### Status of the drivers of internal control

Figure 1 shows the status of the different drivers of internal control and their overall movement since the previous year. Table 1 indicates the progress provinces have made in increasing the number of auditees with a 'good' rating in the specific area.

The **leadership** driver for 'good' auditees only improved from 21% to 22%, but the number of auditees with an 'intervention required' status decreased significantly from 35% to 28%. Most provinces maintained the number of auditees with 'good' ratings.

The following controls fall within this area:

- Provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the best interests of the auditee.
- Exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
- Implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.
- Establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities.
- Develop and monitor the implementation of action plans to address internal control deficiencies.
- Establish an IT governance framework that supports and enables the business, delivers value and improves performance.

The **governance** driver for 'good' auditees improved significantly from 27% to 37%, with the number of auditees that required intervention in this area decreasing from 30% to 25%. Most of the provinces improved in this area and none regressed. The movement was mostly as a result of improvements in the effectiveness of internal audit units and audit committees, as detailed in sections 7.4 and 7.5.

The following controls fall within this area:

- Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.
- Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively.
- Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation.

There was a slight improvement in the status of the **financial and performance management** driver, with the number of 'good' assessments increasing from 17% to 19% (the lowest of all three areas) and the number of auditees that required intervention decreasing slightly from 37% to 36%, which is still the highest of all three areas.

The following controls fall within this area:

- Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting.
- Implement controls over daily and monthly processing and reconciling of transactions.
- Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.
- Review and monitor compliance with applicable legislation.
- Design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

We assess and report on all these controls. We also regularly remind municipal managers, CEOs and mayors that all these controls should be in place to improve and sustain audit outcomes, financial and performance management as well as governance.

For purposes of this report, we highlight the status of seven basic controls that should receive specific attention by all role players – both within local government as well as at a provincial and national level.

Figure 2 shows the status of these basic controls in the three areas that we audit and report on. In sections 3.1, 3.2 and 4.1 we recommend how these basic controls should be implemented to improve and sustain the audit outcomes.

The remainder of this section discusses the basic controls and disciplines that need to be strengthened to improve the quality of the financial and performance reports and to prevent non-compliance with key legislation. We look at five of the seven basic controls here, while HR management and IT controls are discussed in sections 5.1 and 6.2, respectively. Please note that the percentage in brackets in the graphics below relates to the previous year's figures.

Basic controls and disciplines

Providing effective leadership



In order to improve and sustain audit outcomes, auditees require effective leadership that is based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the auditee.

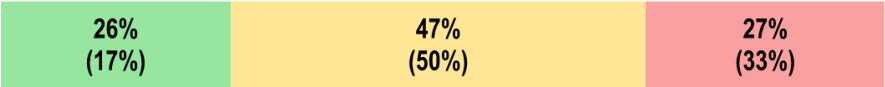
Effective leadership controls improved significantly but still require attention at 58% of the auditees. The following are some of the key aspects that should be considered:

- Implement formal codes of conduct and regularly communicate their existence and continued applicability to officials.
- Monitor the performance of key officials relating to the maintenance of adequate systems of internal control that ensure credible monthly financial reporting, reliable reporting against predetermined objectives, and compliance with key legislation.
- Establish clear lines of accountability.

- Take corrective or disciplinary action against key officials for misconduct.
- Honour commitments for interventions made after the 2012-13 audit outcomes.

Effective leadership controls were in place at 37% of the municipalities and 63% of the municipal entities.

Audit action plans to address internal control deficiencies



Developing and monitoring the implementation of action plans to address identified internal control deficiencies is a key element of internal control.

The MTSF defines the implementation of audit action plans and the quarterly monitoring thereof by a coordinating structure in the province as key measures to support financial management and governance at municipalities. It is also echoed in CoGTA's back-to-basics strategy, which tasks local government with addressing post-audit action plans and the National Treasury, provincial treasuries and departments of cooperative governance with assessing the capacity of municipalities to develop and implement such plans.

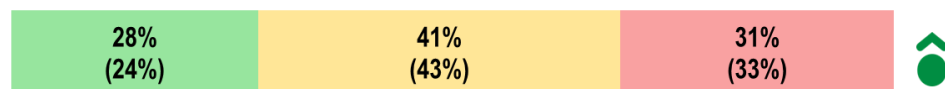
Internal controls in the form of audit action plans were assessed as being 'good' at only 23% of the municipalities and 42% of the municipal entities. It needs to be improved across all three audit areas, as can be seen in figure 2.

The matters requiring attention include the following:

- Set action plans to specifically address the external and internal audit findings.
- Assign clear responsibility to specific staff members to carry out action plans.
- Ensure that the responsibilities assigned are carried out effectively and consistently through monitoring.
- Develop audit action plans early enough in the financial year to resolve matters by year-end.
- Ensure that audit action plans address all three areas of audit outcomes, namely qualifications, findings on APRs and non-compliance with legislation.

- Focus the actions to be taken on the root causes of the findings, thereby ensuring that sustainable solutions are found.

### Proper record keeping and document control



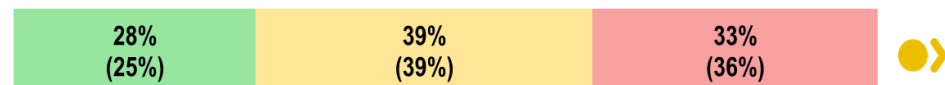
Proper and timely record keeping ensures that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. A lack of documentation affected all areas of the audit outcomes. In section 3.2.1, we also raise specific concerns regarding the lack of supporting documentation in procurement processes.

Some of the matters requiring attention include the following:

- Establish proper record keeping so that records supporting financial and performance information as well as compliance with key legislation can be made available when required for audit purposes.
- Implement policies, procedures and monitoring mechanisms to manage records, and make staff members aware of their responsibilities in this regard.

We assessed record keeping and document control as being 'good' at only 24% of the municipalities and 47% of the municipal entities. Overall, there has been no improvement in record keeping in local government.

### Implement controls over daily and monthly processing and reconciling of transactions



Controls should be in place to ensure that transactions are processed in an accurate, complete and timely manner, which in turn will reduce errors and omissions in financial and performance reports.

Some of the matters requiring attention include the following:

- Daily capturing of financial transactions, supervisory reviews of captured information, and independent monthly reconciliations of key accounts.

- Collect performance information at intervals appropriate for monitoring, set service delivery targets and milestones, and validate recorded information.
- Confirm that legislative requirements and policies have been complied with before initiating transactions.

Good processing controls had been established at 25% of the municipalities and 42% of the municipal entities. Overall, these controls have not improved significantly since the previous year.

### Review and monitor compliance with legislation



Auditees need to have mechanisms that identify applicable legislation as well as changes to legislation, assess the requirements of legislation, and implement processes to ensure and monitor compliance with legislation.

As detailed in section 3.2, many auditees did not comply with legislation. Most of the irregular expenditure incurred was again only identified during the audit process. This indicates that the internal controls of most auditees not only failed to prevent non-compliance with legislation, but also failed to timeously detect the deviations, with some deviations only being detected and responded to following our audits.

At only 15% of the municipalities and 35% of the municipal entities, controls to prevent or detect non-compliance with legislation are at the required level. Overall, these controls have not improved significantly since the previous year.

As the effectiveness of internal control is significantly influenced by root causes, section 6.3 describes the most common root causes that should be addressed if the systems of internal control are to be improved significantly.

Annexure 3 details the status of auditees' key controls and the movement since the previous year.

Figure 1: Status of information technology controls

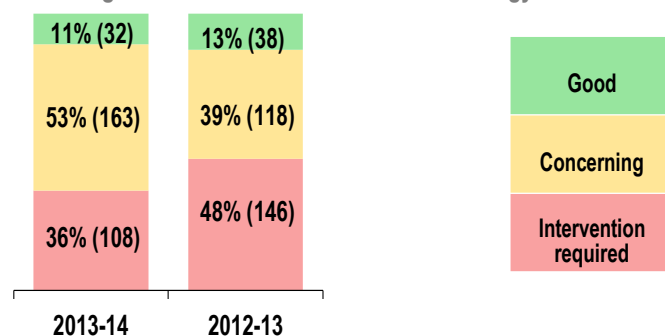
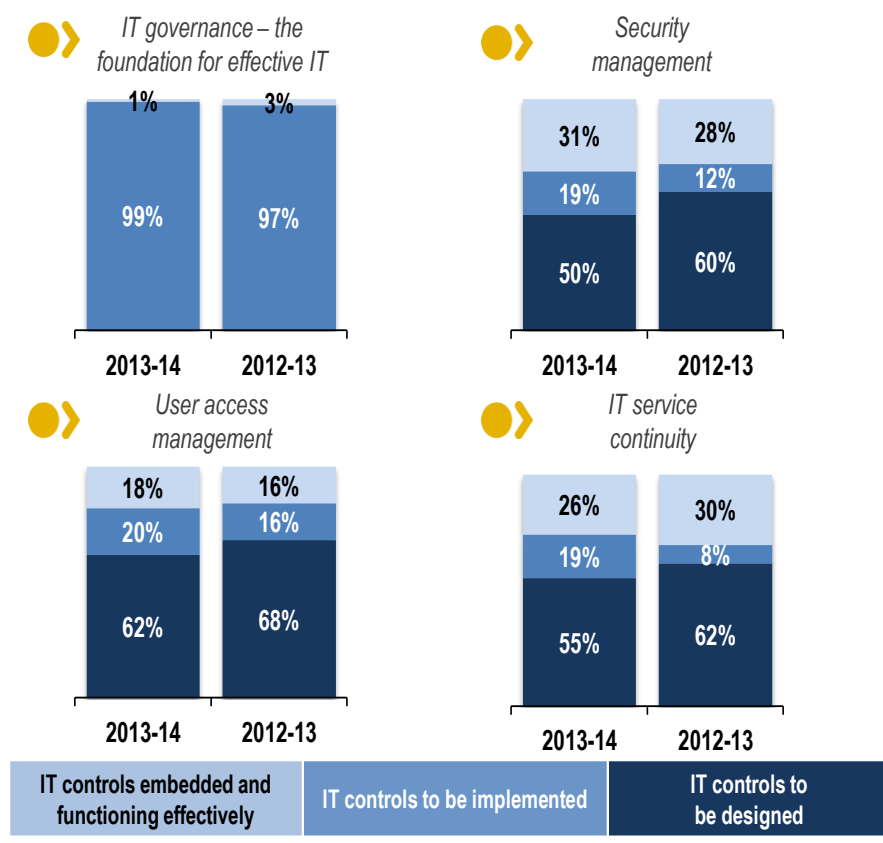


Figure 2: Findings on information technology controls



## 6.2 Information technology

IT controls ensure the confidentiality, integrity and availability of state information, enable service delivery, and promote national security. It is thus essential for good IT governance, effective IT management and a secure IT infrastructure to be in place.

During our audits, we assessed the IT controls that focus on IT governance, security management, user access management and IT service continuity. Figure 1 shows that there has been a regression in the number of auditees with no findings on IT controls. However, fewer auditees required intervention in addressing findings.

To evaluate the status of the IT controls in the areas we audited, we grouped them into the following three categories, with reference to the control measures that should be in place:

**Where IT controls are being designed**, management should ensure that the controls would lessen risks and threats to IT systems.

**Where IT controls are being implemented**, management should ensure that the designed controls are implemented and embedded in IT processes and systems. Particular attention should be paid to ensuring that staff members are aware of, and understand, the IT controls being implemented, as well as their roles and responsibilities in this regard.

**Where IT controls have been embedded and are functioning effectively**, management should ensure that the IT controls that have been designed and implemented are functioning effectively at all times. Management should sustain these IT controls through disciplined and consistently performed daily, monthly and quarterly IT operational practices.

Figure 2 indicates the status of the IT controls in the areas we audited and the movement since the previous year. It also shows the number of auditees where the IT controls were either not in place (not designed) or not implemented, as well as those where IT controls were functioning effectively.

### Information technology governance

Effective **IT governance** is essential for the overall well-being of an auditee's IT function and ensures that the auditee's IT control environment functions well and enables service delivery. In response to a directive from the minister of CoGTA, a national coordinating and monitoring structure has been established to oversee 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. Key stakeholders in

the local government sector form part of this ICT coordinating and monitoring structure.

In the 2014-15 year, the national coordinating and monitoring structure customised the corporate governance of ICT policy framework (CGICTPF) for local government and drafted a municipal CGICTPF. Municipal managers and different forums, such as municipal councils and the forum for municipalities and MECs, are currently consulting on the draft municipal CGICTPF. The municipal CGICTPF is planned to be implemented from the 2015-16 financial year.

## Security management

A secure IT environment ensures the confidentiality, integrity and availability of critical IT systems and business processes.

While 31% of the auditees had IT controls that were embedded and functioning effectively, 50% of the auditees continued to experience challenges with the design and 19% with the implementation of security management policies.

The most common findings were the following:

- Most municipalities still experienced challenges due to a lack of adequately designed security policies and procedures. We also found that some municipalities that had already designed adequate security policies and procedures had not succeeded in implementing them successfully.
- The lack of adequately designed and implemented security policies and procedures contributed to weaknesses such as password and firewall parameter settings not being effectively configured and security logs not being frequently reviewed. The IT infrastructure was consequently not protected from vulnerabilities and unauthorised access.

## User access management

User access controls are measures designed by business management to prevent and detect the risk of unauthorised access to, and the creation or amendment of, financial and performance information stored in the application systems.

While 62% of the auditees continued to experience challenges with the design of user access policies, 20% are struggling to implement certain aspects of the policy.

The most common findings were the following:

- Administrator activities and user access rights were not reviewed.
- Formal user access request documentation was not completed for registering users, changing access rights, effecting password resets and terminating access rights.

- Users were being granted access without obtaining management authorisation and, in some instances, the access granted to users was not in line with their job descriptions.
- Segregation of duties was not maintained.

## Information technology service continuity

IT service continuity controls enable auditees to recover critical business operations and application systems that would be affected by disasters or major system disruptions within a reasonable time.

While 26% of the auditees had IT controls that were embedded and functioning effectively, 55% continued to experience challenges with the design and 19% with the implementation of adequate IT service continuity controls.

The most common findings were the following:

- Most of the municipalities experienced challenges with the design and implementation of appropriate business continuity plans (BCPs) and disaster recovery plans (DRPs).
- The management of backups remained a challenge, as most of the municipalities did not test their backups to ensure that they could be restored when required. Backups were also not stored at secure off-site facilities to ensure that they could be retrieved in the event of a disaster at auditees' premises.

## Most common root causes and actions taken to address them

A lack of skills to design and implement appropriate controls for IT systems to regulate security management, user access management and IT service continuity remained a challenge. This challenge was made worse by the following inefficiencies:

- Municipalities experienced budget constraints, which limited the development of IT policies and procedures. In other instances, already developed IT policies and procedures were still awaiting management and council approval.
- Service level agreements with vendors did not include the development or management of IT policies and procedures.
- District municipalities did not provide adequate guidance and support to the local municipalities under their jurisdiction.
- Officials did not fulfil their responsibilities in terms of ensuring compliance with the controls established to secure and regulate municipalities' IT

environments. They were, moreover, not held accountable for not addressing previously raised findings.

The following actions have been taken to address the root causes:

- A national coordinating and monitoring structure has been established for ICT in local government, in response to a directive from the minister of CoGTA. 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, which should assist in addressing repeat findings.
- Key stakeholders in local government form part of this ICT coordination and monitoring structure.
- Government has realised that many of the financial management systems (computer packages) used by municipalities do not support the complex and sophisticated business environment of local government, which has previously contributed to poor audit outcomes. The standard chart of accounts project being implemented by the National Treasury is expected to improve the quality of the financial management systems of local government.

## Recommendations

The following actions should still be taken to address the root causes:

- Management should reallocate the budget to make funds available to develop the skills of IT staff. This should enable the implementation of key controls, such as the development of IT policies and procedures and the implementation of DRPs and backup procedures.
- Management should enforce consequence management where repeat IT findings are not addressed.
- Management should ensure that service providers transfer IT skills to municipal officials to build capacity at municipalities.
- District municipalities should provide support and guidance to local municipalities with regard to IT controls, and this process should be formalised and regularly tracked.
- Internal audit units and audit committees should play a more effective role in tracking the progress made in implementing management commitments in respect of previously raised IT audit findings.

## 6.3 Summary of root causes

Our audits included an assessment of the root causes of audit findings, based on identifying the internal controls that had failed to prevent or detect the error or non-compliance. These root causes were confirmed with management and shared in the management report with the municipal managers or CEOs and the mayors. We also included the root causes of material findings reported in the audit report as internal control deficiencies in the audit report, classified under the key drivers of leadership, financial and performance management, or governance.

Figure 1: Status of overall root causes

### Slow response in improving internal controls and addressing risk areas



Slow response include that of:

- management (accounting officers and senior management)
- political leadership (mayors and councils)
- oversight (MPACs and portfolio committees)

### Key positions vacant or key officials lacking appropriate competencies



### Inadequate consequences for poor performance and transgressions



Figure 1 shows the most common root causes we had identified that affect the rate at which audit outcomes are improving. The rest of this section summarises the three most common root causes and provides recommendations to address them.

## Slow response in improving internal controls and addressing risk areas

### Details of root cause

We identified the slow response by management (accounting officers and senior management), the political leadership (mayors and councils) as well as oversight (MPACs and portfolio committees) to our messages about addressing weaknesses in internal controls and the six risk areas as a root cause of poor audit outcomes at 69% of the auditees, which has changed little from the 71% in the previous year.

As shown in section 6.1, we found that key controls were not in place at most of the auditees to support the preparation of financial statements and APRs of a high quality and to ensure compliance with legislation. Mayors, councils and coordinating institutions can contribute positively to an auditee's control environment. However, it is the responsibility of municipal managers or CEOs and senior management to design and implement the controls and to ensure that they work effectively and consistently. As discussed in sections 7.1 and 7.2, senior management and municipal managers also did not provide the required level of assurance and, while the assurance levels of MPACs have improved, portfolio committees did not yet provide the required level of assurance.

We regularly assess the status of key controls and discuss it with the accounting officers and key senior management officials. We specifically audit the six risk areas annually. We report all our findings in a management report that includes the root causes of the findings and our recommendations. Our message and its delivery have been consistent for a number of years, but the slow response to this message by the mentioned role players is standing in the way of improvements in audit outcomes.

### Recommendations

The following actions should be taken to address the root cause:

- Accounting officers should view internal audit units, audit committees, risk management functions and ourselves as important partners in fulfilling their legislated responsibilities. They should pay attention to the reports of these assurance providers and regularly interact with them.
- Accounting officers should ensure that senior management has action plans to address the internal control deficiencies identified by our reports as root causes of audit findings. The action plans should focus on the root causes of audit outcomes and not only on addressing specific findings, as this

would prevent new or similar findings in future. Accounting officers should monitor the implementation of the plans.

- Mayors and councils should hold accounting officers responsible for control weaknesses that are not addressed, as it points to the neglect of their legislated duty to ensure that there are effective, efficient and transparent systems of financial and risk management and internal control. In turn, accounting officers should ensure that senior managers are fulfilling their duties and address any negligence in this regard.
- In sections 7.13 and 7.14, we set out recommendations for improved oversight by MPACs and portfolio committees.
- The treasuries and departments of cooperative governance should intensify their current initiatives to support auditees in improving their controls through guidance, interactions, capacity building and monitoring.

## Key positions vacant or key officials lacking appropriate competencies

### Details of root cause

Our analysis in section 5.1 shows that there has been an overall reduction in the vacancies of key municipal officials, while stability in these positions has also improved since the previous year. However, the inability of auditees to timeously fill key positions and retain officials in such positions, together with the inappropriate competencies of officials in these positions, remains a root cause of poor audit outcomes.

We evaluated the appropriate competencies of key officials based on (i) key accounting and financial reporting functions not being performed adequately; (ii) auditees' own assessment of the competency levels of key officials; and (iii) auditees' repeated use of consultants to assist with financial and performance reporting.

We identified vacancies in key positions or key officials lacking appropriate competencies to be a root cause of poor audit outcomes at 63% of the auditees, which is at the same level as in the previous year.

Leadership positions in the municipal administration should be filled with people who have the qualifications, experience and competency levels to fulfil their responsibilities and exercise their functions and powers effectively.

Although the positions were filled at most auditees, the appointed officials did not always have the appropriate competencies to ensure financial statements and performance reports of a high quality as well as compliance with legislation. The high demand for consultants and support from national and provincial

government is further evidence of the competency gap. Sections 5.1 and 5.2 detail the competency levels and effective use of consultants.

## Recommendations

The following actions should be taken to address the root cause:

- Auditees should fill vacancies at senior management level as soon as the position becomes vacant, using a maximum period of 12 months for the recruitment process. Municipalities should pay particular attention to the appointment and retention of CFOs, heads of SCM units and senior management responsible for strategic planning as well as monitoring and evaluation.
- Auditees should continually assess the effectiveness of their staff retention strategies and practices, to reduce the rate of vacancies at senior management level.
- Auditees should implement the *Municipal regulations on minimum competency levels*.
- Auditees should adhere to the requirements of the MSA regarding the appointment processes for municipal managers and senior managers.
- Auditees should develop strategies to ensure that skills are transferred from consultants to municipal staff and that consultancy contracts include specific clauses and plans for the transfer of skills.
- There should be a better coordinated and focused approach and higher levels of collaboration, especially by the treasuries, the South African Local Government Association (SALGA) and the departments of cooperative governance, to ensure the success of the many capacity-building programmes, commitments and action plans.

## Inadequate consequences for poor performance and transgressions

### Details of root cause

We identified inadequate consequences for poor performance and transgressions to be a root cause of poor audit outcomes at 50% of the auditees, which is a significant improvement from the previous year.

The 2013-14 audits again confirmed weaknesses in the performance management processes. The low level of action in response to the high levels of non-compliance, poor audit outcomes, SCM transgressions and unauthorised, irregular as well as fruitless and wasteful expenditure also demonstrates a lack

of consequences for transgressions. Section 3.2 includes more information in this regard.

Leaders and officials who deliberately or negligently ignore their duties and contravene legislation should be decisively dealt with through performance management and by enforcing the legislated consequences for transgressions. If they are not held accountable for their actions, the perception is created that such behaviour and its results are acceptable and tolerated.

## Recommendations

The following actions should be taken to address the root cause:

- Municipal managers should ensure that non-compliance findings are investigated to determine whether there are indicators of financial misconduct or misconduct in the SCM processes, followed by disciplinary hearings where misconduct has been confirmed.
- All unauthorised, irregular as well as fruitless and wasteful expenditure should be investigated timeously, as required by the MFMA, to determine whether such expenditure should be recovered from the responsible official. The council should insist on such investigations and ensure that they are conducted. It is also the responsibility of the council to determine, based on the outcome of the investigation, whether money should be recovered.
- In order to improve the performance and productivity of officials, the leadership should set the tone by implementing sound performance management processes, evaluating and monitoring officials' performance, and consistently demonstrating that poor performance has consequences.
- Municipal managers, senior managers, mayors and other council members should demonstrate their commitment to integrity and ethical values through their own actions and behaviour, and clearly communicate acceptable standards of conduct. The leadership should also ensure that deviations from expected standards are identified and addressed in a timely manner.
- Auditees that do not have the required policies and procedures should put them in place as a matter of urgency. Where these do exist, municipal managers and senior management should ensure that they are implemented.