



Local government audit outcomes | **MFMA**
2018-19

OR Tambo District Municipality

The high cost of accountability failures in local government

*Portfolio Committee on Co-operative Governance
and Traditional Affairs - 21 August 2020*



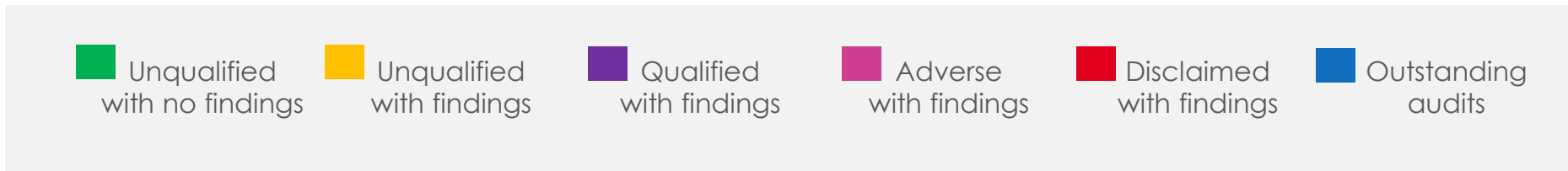
AUDITOR - GENERAL
SOUTH AFRICA

Important to note

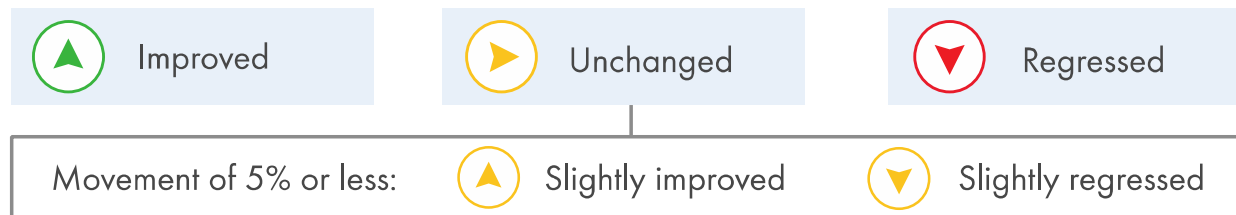
Local government in the Eastern Cape consists of 49 auditees, broken down into 33 local municipalities, six district municipalities, two metropolitan municipalities and 10 municipal entities. The municipal entities are classified as small entities and therefore are not included in this analysis. Two audits were outstanding at the cut-off date.

Therefore the percentages in this presentation are calculated based on the **completed audits of 37 municipalities as at 31 January 2020**, unless indicated otherwise.

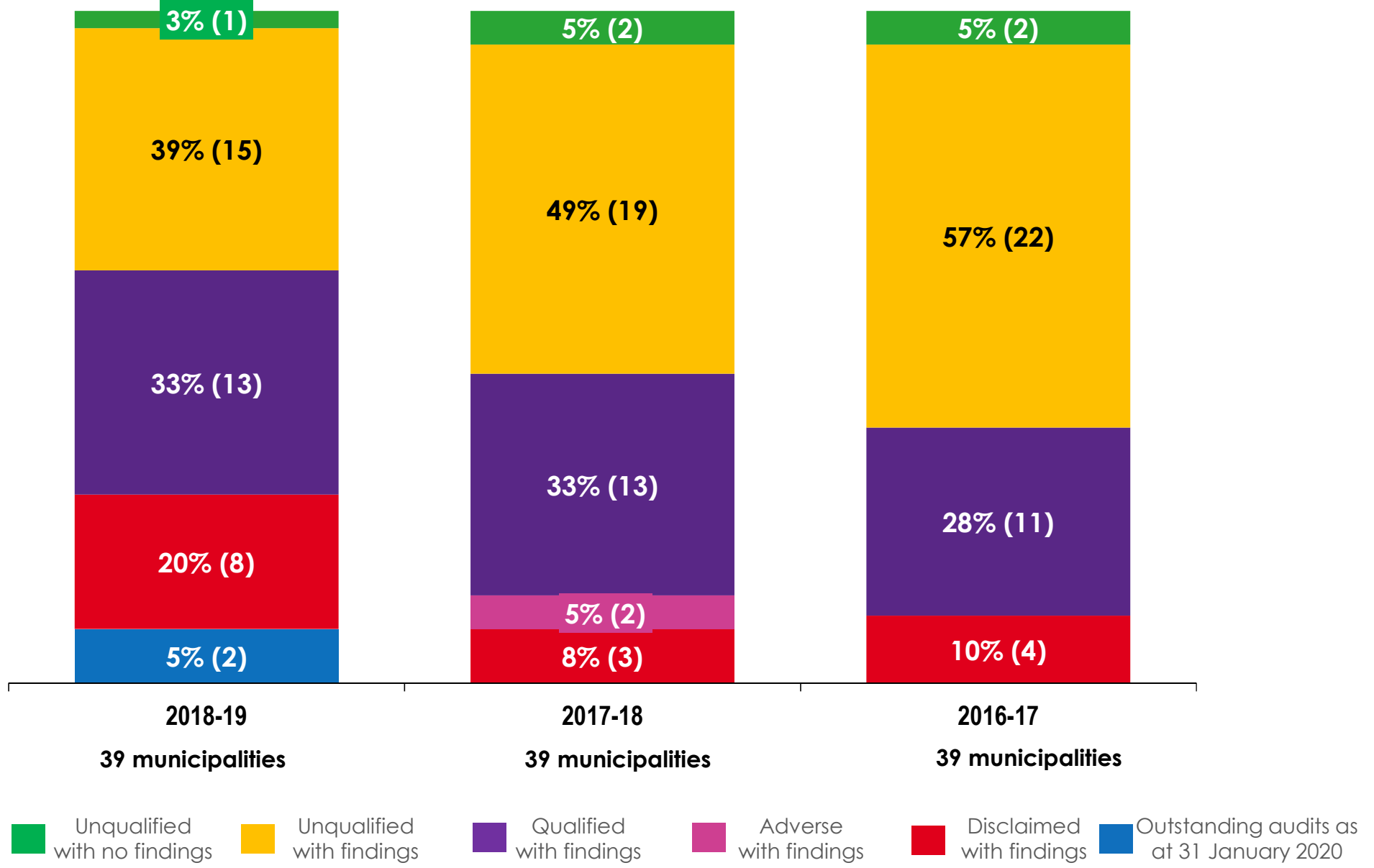
Audit outcomes are indicated as follows:



Movement from the previous year is depicted as follows:



Regression in municipal audit outcomes – All municipalities EC



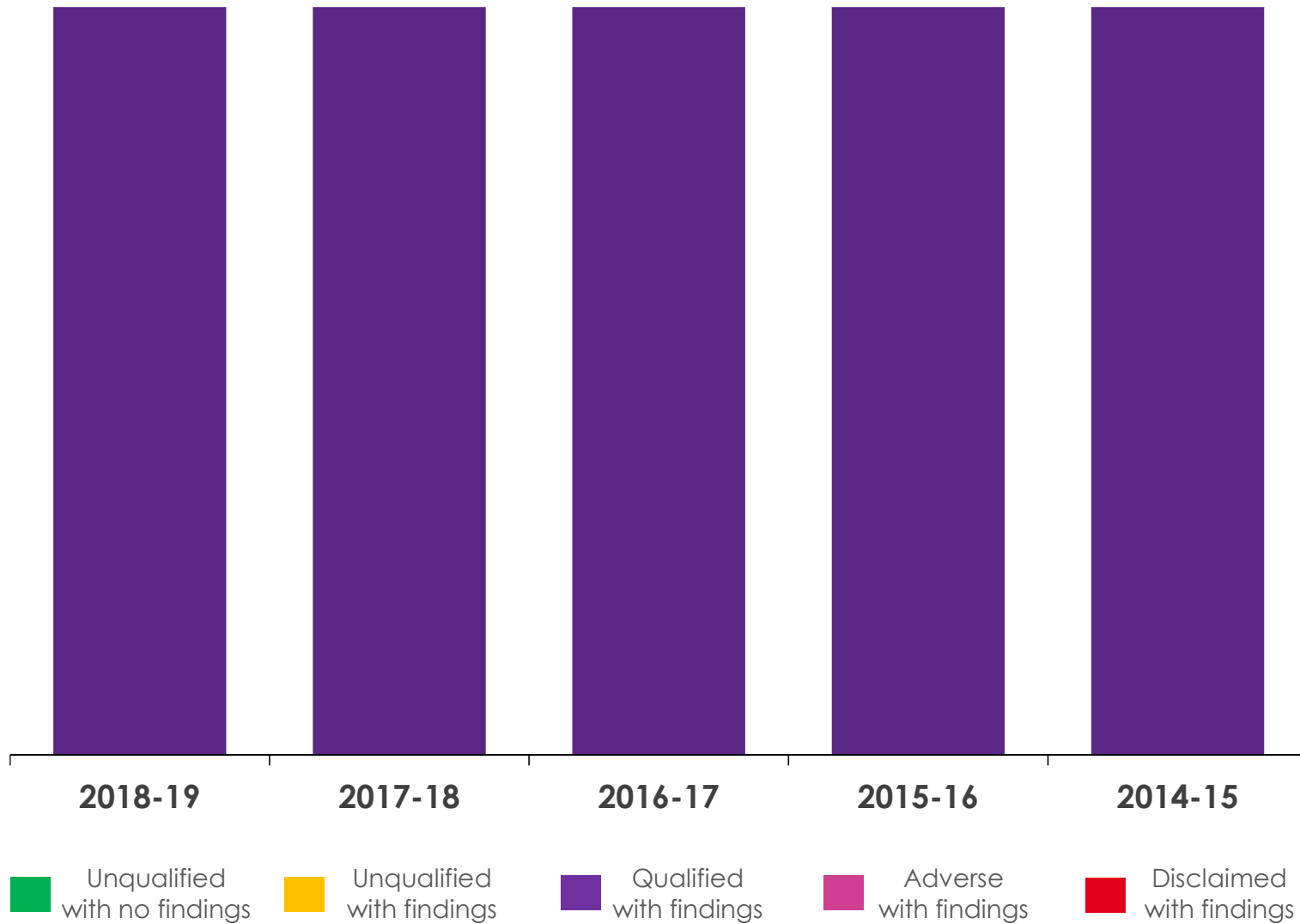
2018-19 39 municipalities 2017-18 39 municipalities 2016-17 39 municipalities

■ Unqualified with no findings
 ■ Unqualified with findings
 ■ Qualified with findings
 ■ Adverse with findings
 ■ Disclaimed with findings
 ■ Outstanding audits as at 31 January 2020



The cut-off date for reporting of audit outcomes is set as 31 January 2020

OR Tambo District Municipality – Five consecutive years of qualified opinion



Qualification areas

| | |
|--|---|
| <p>Property, plant and equipment</p> | <ul style="list-style-type: none"> • Infrastructure assets that were not completed (Infrastructure Work-in-progress) were incorrectly disclosed as completed infrastructure assets, and some infrastructure assets that were completed in the prior year were incorrectly disclosed as transfers in the current year. Some of these infrastructure assets were further recorded at incorrect amounts. • Controls over the preparation, reconciling and review of the fixed asset register were not adequate and the municipality continued to rely on the audit process to identify errors. Consequently, the municipality was unable to correctly account for infrastructure assets and work-in-progress which is used for service delivery. |
| <p>Commitments – restatement of corresponding amounts</p> | <ul style="list-style-type: none"> • In the previous year’s audit report, the municipality received a qualified opinion on commitments due to the lack of systems and processes to ensure the accuracy thereof. A restatement was made in the year under review, but the adjustment could be substantiated by adequate supporting documents. |
| <p>Irregular Expenditure</p> | <ul style="list-style-type: none"> • The municipality did not fully record irregular expenditure in the notes to the financial statements, as required by section 125(2)(d)(1) of the MFMA. This was due to the expenditure incurred in contravention of the supply chain management (SCM) requirements not being detected and appropriately disclosed in the financial statements. Consequently, we were unable to determine the full extent of the irregular expenditure stated at R1,4 billion. • Please see next slide |



The usage of consultants for financial reporting.

The audit included an assessment of the effective use of consultants. In the local government environment, the partnership between the private and public sectors has become important in driving strategic goals.

The municipality did not use consultants during the period under review, and prepared the financial statements as well as the performance report in-house. In prior years extensive use was made of consultants to assist in this regard.

| Financial Year | Financial Consultants R | Performance Reporting R | Total R |
|----------------|----------------------------|----------------------------|------------|
| 2018-19 | None | None | None |
| 2017-18 | 20 150 614 | 4 000 000 | 24 150 614 |
| 2016-17 | 13 230 676 | None | 13 230 676 |





Supply chain management non-compliance is the main cause of irregular expenditure

Balance of unresolved irregular expenditure increased to **R1,4 billion**

| Annual irregular expenditure | 2018-19 | 2017-18 | 2016-17 |
|------------------------------|--------------|--------------|--------------|
| Irregular expenditure | R1,4,billion | R3,2 billion | R2,6 billion |

The reported irregular expenditure is however based on financial statements and therefore not a true reflection of the full extent of the irregular expenditure as the balance on irregular expenditure was qualified due to incomplete disclosure of all irregular expenditure incurred.

- The municipality did not adequately plan for the procurement of their goods and services, which then resulted in **deviations from supply chain management legislation** by using numerous instances of emergency procurement without adequate justification. This non-compliance also occurred in prior years. The municipality further awarded a number of tenders for infrastructure development when **the committees that adjudicated those bids were not always correctly constituted in terms of SCM regulation 29(2)**.
- These transgressions contributed to the disclosed irregular expenditure incurred of R981 million with a cumulative balance amounting to R1,4 billion, which accounted for **39% of the total irregular expenditure in the province** (excluding that of the two outstanding municipalities). This figure could potentially be higher, as the municipality did not have controls in place to identify and correctly disclose all prior year irregular expenditure.
- These transgressions occurred due to **the poor control environment and a culture of non-compliance** resulting from the lack of consequence management.



Supply Chain Management findings

- ❑ Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of the SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
- ❑ Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
- ❑ Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). Similar non-compliance was also reported in the prior year.
- ❑ Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and Preferential Procurement Regulations.
- ❑ Contracts were awarded to bidders based on pre-qualification criteria that were not stipulated or differed from those stipulated in the original invitation for bidding and quotations, in contravention of the 2017 preferential procurement regulation 4(1) and 4(2). Similar non-compliance was also reported in the prior year.
- ❑ The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.
- ❑ Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).



Consequence Management

A disciplinary board was not established to investigate allegations of financial misconduct and monitor the institution of disciplinary proceedings against an alleged transgressor.

There was no hotline or similar process/mechanism for reporting financial misconduct/transgressions that are committed by officials and suppliers of the municipality.

The municipality wrote off irregular expenditure amounting to R2.8 billion after investigations were conducted by MPAC. There were no official/s that were held liable for the irregular expenditure as it was concluded by the investigation that the municipality did receive the benefit from the expenditure incurred, and that no money needed to be recovered.

One investigation was ongoing at year-end on allegations relating to fraud. The investigation has been ongoing for period of time that exceeds 3 months. The Municipal Regulations on Financial Misconduct, Procedures and Criminal Proceedings and the Disciplinary Regulations for Senior Managers require that each investigation must be completed within 30 days from the date of appointing the investigator.

During the previous year's audit, we reported findings relating to transgressions by officials or other role players, for management to investigate. These included instances where suppliers submitted false declarations of interest. No evidence was found that these instances were investigated during the year under review.



Shortcomings on infrastructure maintenance

- There is a lack of sufficient water infrastructure in most areas to meet the needs of the municipality.
- Water infrastructure is ageing and dilapidated.
- Maintenance of water infrastructure was not prioritised or budgeted for.
- There are insufficient qualified engineers/technical staff to conduct the condition assessments and oversee the work performed by consulting engineers due to vacancies in the water services department. The percentage/numbers of vacancies was not provided by management.



Bulk water losses decreased from the prior year, with a loss of **R11,1 million** (2017-18: R21,4 million) incurred, which represents **31%** (2017-18: 47%) of the total bulk water purchased.

Water quality

- The actions taken by management did not result in an improvement of the water quality results during the period under review.
- The actions taken did not prevent or minimise further water shortages and disruptions in water supply during the period under review.



Infrastructure

Findings on key water and sanitation projects tested

- A water supply project had been reported as complete in the annual financial statements and annual performance report, however it was not yet completed as there was no supply/provision of water to the intended community.
- There is no evidence that the progress on the project was monitored / frequently monitored as the monthly progress reports were not submitted for audit purposes.
- There is no evidence that a feasibility study was conducted for two of the projects. This was due to non-submission of information and the fact that only a preliminary report was done.
- The construction of the project was not completed within the defined duration.
- Bids were awarded by a bid adjudication committee that was not properly constituted as required by SCM regulation 29(2), and resulted in irregular expenditure of R94 million for the projects that we evaluated.



What do the financial statements say?

53257
58768
260935

Income statement



Revenue

Total =
R2,2 billion

Of their total revenue of **R2,2 billion**, **R1,8 billion (82%)** was from government grants and subsidies.



Expenditure

Total =
R1,6 billion

Of their total expenditure of **R1,6 billion**, **R561 million (34%)** was for employee cost of the municipality.



Net result

The municipality incurred a surplus (revenue exceeded expenditure) of **R564,6 million** for the year

- Or Tambo District is a water services provider and billed residents of the district for water and sanitation services; however, they were having trouble in collecting money owed by customers. It took the municipality's collection department **119 days** to collect monies owed for these services, and **82% of their debtors** (R359 million) **were not expected to pay** their bills at all. Currently the lack of collection of outstanding debt is affecting service delivery and the cash flow.
- Outstanding payables totalling **R392 million** exceeded the cash available of R270 million to pay them. Outstanding creditors further represented one third of the next year's budgeted resources, which would now be used to pay those creditors instead of funding the next year's service delivery priorities. The municipality took on average 163 days to pay their creditors.
- From the above it is apparent that although the municipality made a surplus in terms of revenue billed, they then struggle to collect the debts owed and convert the debtors to cash in the bank, and this results in cash flow constraints. Furthermore the municipality's liabilities exceeded its assets.
- The municipality should improve their debt collection processes to ensure that cash will be available to fund future operations.

Concluding remarks

The key messages included in this report highlight the deteriorating state of affairs in local government in the province and the impact of accountability failures at municipalities.

Leadership should establish an effective compliance- and performance-driven culture within the municipality. They should also appropriately monitor the implementation of policies and procedures to support the achievement of credible reporting and compliance with legislative requirements. Progress on the municipality's audit intervention plan was slow to adequately address issues raised in the previous year.



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