



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

Madibeng Local Municipality

Systemic breakdown in the discipline of financial controls

*Portfolio Committee on Co-operative Governance
and Traditional Affairs - 26 August 2020*



AUDITOR - GENERAL
SOUTH AFRICA




Our reputation promise/mission

The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.








Important to note

Audit outcomes are indicated as follows:

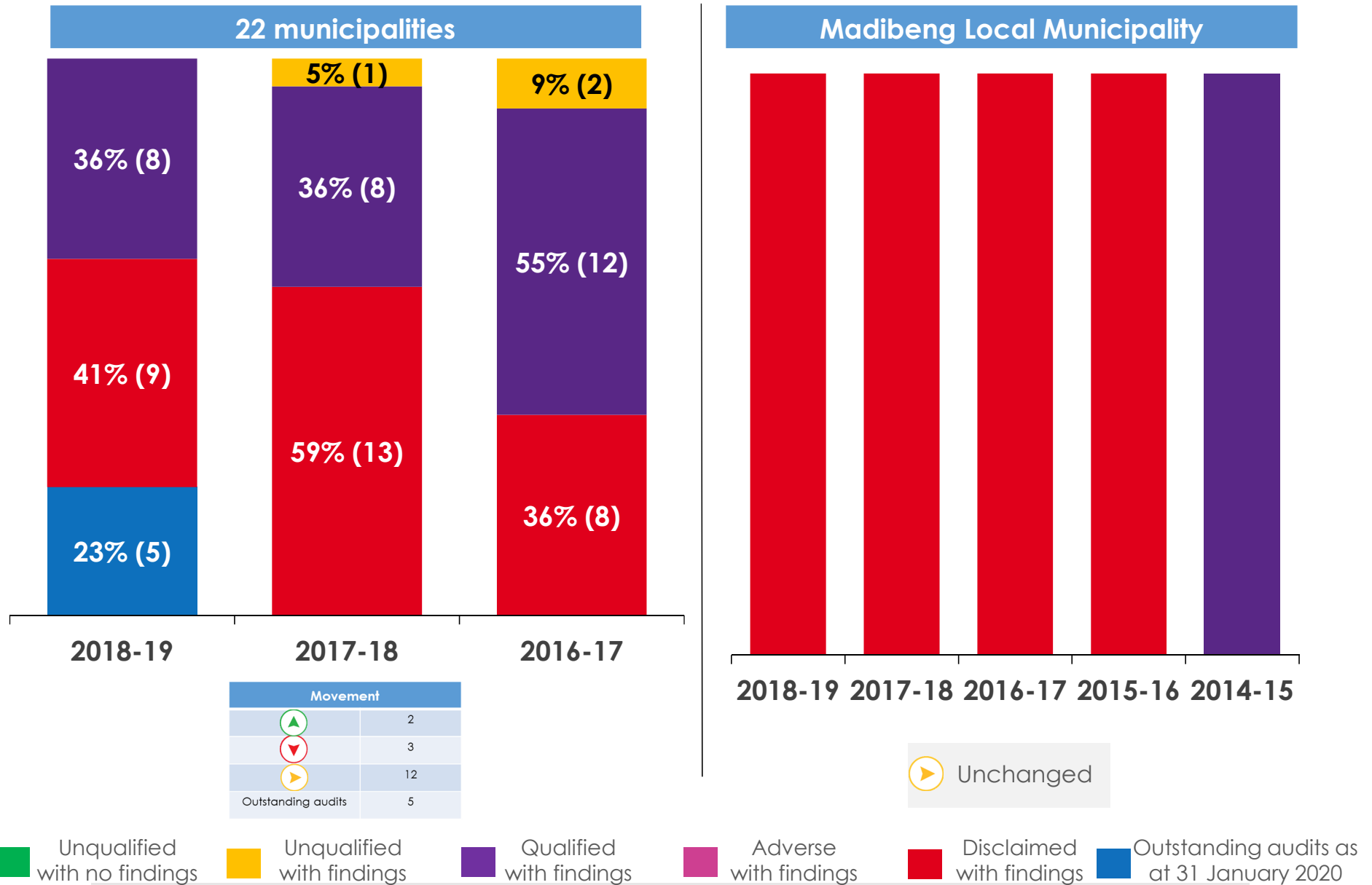
 Unqualified with no findings	 Unqualified with findings	 Qualified with findings	 Adverse with findings	 Disclaimed with findings	 Outstanding audits
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Movement from the previous year is depicted as follows:

 Improved	 Unchanged	 Regressed
Movement of 5% or less:		
 Slightly improved	 Slightly regressed	







Regression in municipal audit outcomes



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

What does the financial statements say? The stark reality

Income statement		Revenue	<ul style="list-style-type: none"> • Equitable share of R624,9 million (2017-18: R567,4 million) and conditional grants of R234 million (2017-18: R213 million) • Revenue of R1 billion (2017-18: R1,1 million) was generated from billing
		Expenditure	<ul style="list-style-type: none"> • Salary and wages (including councillors remuneration) of R531 million (2017-18: R456 million) • Average supplier payment period of 322 days (2017-18: 279 days) • Fruitless and wasteful expenditure of R6,3 million (2017-18: R21,5 million)
		Net result	<ul style="list-style-type: none"> • The municipality incurred a deficit (expenses exceeded revenue) of R1,12 billion for the year
Balance sheet			<ul style="list-style-type: none"> • The municipality also had a significant problem in terms of debt collection with R1,7 billion of the consumer debtors of R2,0 billion (approximately 85% of all debts) being impaired due to it being unlikely to be collected. • Added to this was the increase in outstanding payables to R1,1 billion with cash reserves of only R89,2 million at year-end. • The financial statements showed that the current liabilities exceeded current assets by R719,6 million; however, this was not the full picture because an overdue loan to the Public Investment Corporation (PIC) of over R1,1 billion was not included in the financial statements. This was despite the fact that the municipality lost a court case to the PIC when it was contesting the amount due. The inclusion of this loan in the financial statements changed the financial position of the municipality further into a net current liability position, indicating that the municipality did not have sufficient cash to deliver services to the community.

The result is that Madibeng has used **R1,0 billion of next years budget due to commitments and accruals**. Conditional grants were not used for their intended purposes.

Declining financial health and losses



What the numbers say



Creditor payment longer than 30 days

Yes

Debt collection more than 90 days

Yes

Deficit identified (expenses exceed revenue)

Yes

Municipalities in vulnerable financial position

Yes



The average payment period was **322 days** – affecting the sustainability of suppliers



The aging infrastructure contributed to **water and electricity distribution losses** incurred by the municipality:

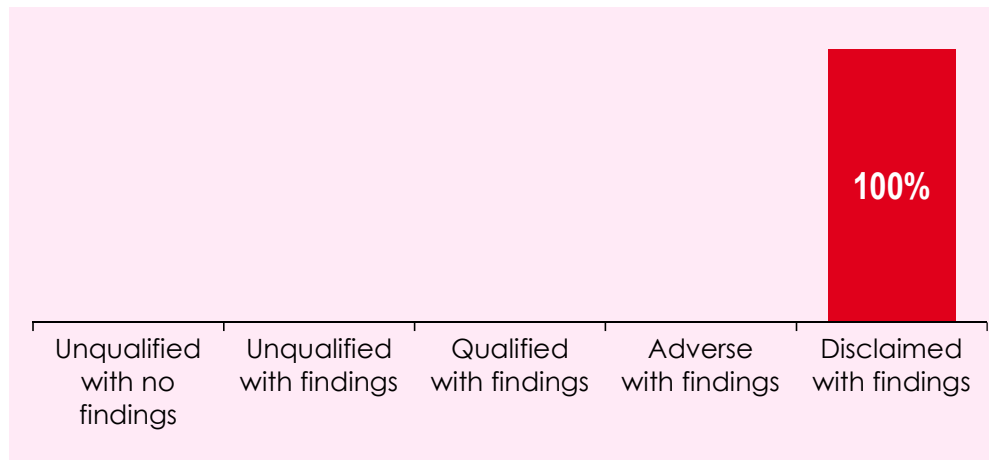
- The **total water distribution losses** for the year amounted to **R151,1 million - 65% (2017-18: R97,5 million - 66%)**. These losses were **in excess of the norm of 15% - 30%**.
- The **total electricity distribution losses** for the year amounted to **R176,3 million - 30% (2017-18: R188,8 million - 42%)**. These losses were also **in excess of the norm of 7% - 10%**.
- National Treasury's norm for maintenance of infrastructure assets is **8% of the carrying value of infrastructure assets**. Using this norm the municipality only incurred **R103,2 million (2017-18: R81,9 million)** on maintenance which equates **to only 1.9% (2017/18: 1.5%)** of their infrastructure assets.

These losses are not affordable given the huge outstanding amounts for bulk services such as water and electricity:

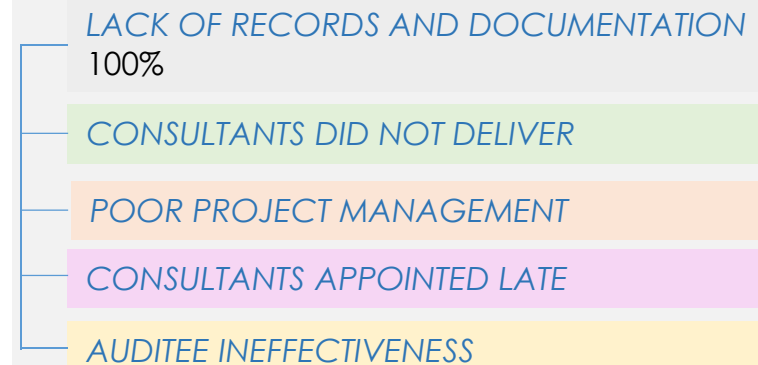
Municipality	Total amounts owed (as at June 2019)	Total amounts in arrears (i.e. 31 days and over)
Electricity (ESKOM and City of Tshwane)	R97,6 million	R56,7 million
Water (Rand Water and City of Tshwane)	R72,3 million	R28,4 million



The usage of consultants for financial reporting did not result in improved quality of financial statements



REASONS WHY CONSULTANTS WERE INEFFECTIVE



Madibeng's financial statements submitted for audit included material misstatements in the area in which consultants did work.

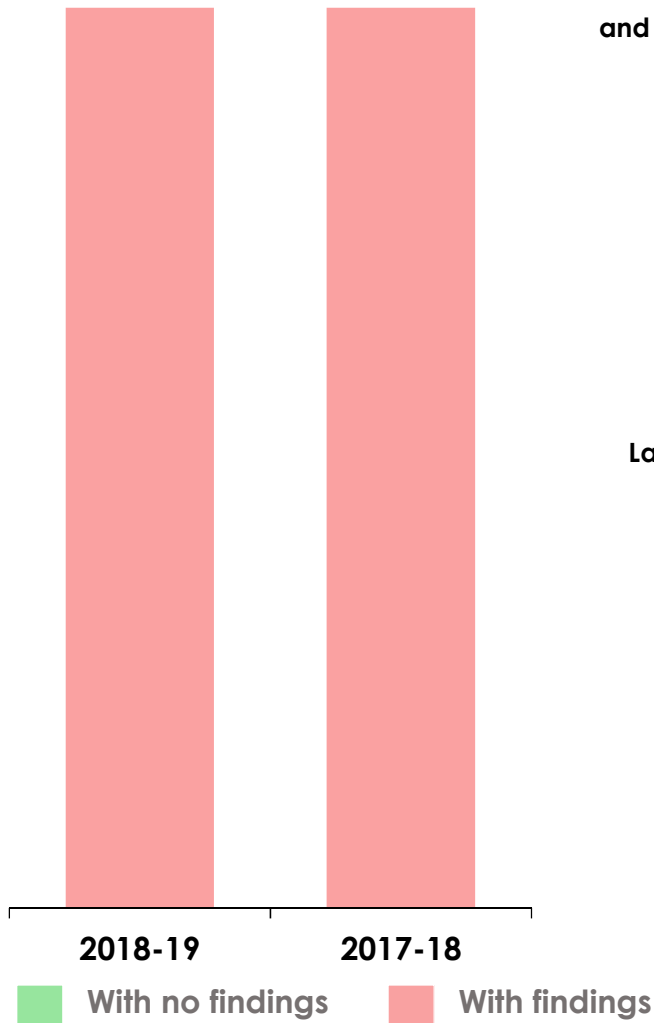
Municipalities with highest consultant costs for financial reporting:

Municipality	Financial reporting cost paid by municipality	Financial reporting cost paid by others	Cost of finance unit salaries	Total cost of financial reporting	Staff complement of Finance units
Madibeng	R34,6 million	R0,8 million	R33,6 million	R69,0 million	105 positions
JB Marks	R14,3 million	R1,0 million	R36,9 million	R52,2 million	56 positions
Mahikeng	R20,2 million	R0,8 million	R24,2 million	R45,2 million	53 positions
Dr Ruth S Mompoti	R14,7 million	R0,9 million	R9,3 million	R24,9 million	25 positions

- There was **also instability at both municipal manager and chief financial officer level** during the financial year and the provincial treasury seconded staff to the municipality to assist in these roles after year-end. However, even the provincial treasury's seconded staff could not assist the municipality due to **an inability to maintain proper records to support the information presented in the financial statements**.
- This made it **difficult for the consultants to rectify or prepare a credible set of financial statements**, as they were **provided with incomplete ledgers and trial balances**. Public funds are a scarce resource and should be used only to create value for the community; therefore the leadership of the municipality should ensure that funds are not misused to this extent.

The disregard of compliance with legislation continues

Findings on compliance with key legislation



Most common non-compliance areas





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

Annual irregular expenditure increased from R61,1 million to ***R443,8 million**

** This amount is not a true reflection of the full extent of the irregular expenditure at Madibeng, due to the municipality being qualified for incomplete disclosure of all irregular expenditure incurred.*

Analyses of irregular expenditure: R443,8 million (2017-18: R61,1 million)

Movement

2018-19

Payments or expenses in 2018-19	▼	R280,3 million	63%
Represents non-compliance in 2018-19	▲	R0 million	0%
Expenditure on ongoing multi-year contracts	▼	R280,3 million	100%
Payments or expenses in previous years only uncovered and disclosed in 2018-19	▼	R163,5 million	37%

Annual irregular expenditure	2018-19	2017-18	2016-17
Irregular expenditure	R443,8 million	R61,1 million	R562,0 million

The root causes for the irregular expenditure incurred, related to bid adjudication committees that were not properly constituted, unfair procurement processes, inadequate contract management and a tolerance for deviations from competitive processes without sound reasons.



Instances of lack of accountability

Financial losses due to investment in VBS Mutual Bank

- The municipality's financial situation worsened in the previous year after it invested **R31,5 million in VBS Mutual Bank, which was written off as a financial loss**. The municipal manager and chief financial officer resigned in December 2018 following an investigation into the matter.

Financial losses due to unauthorised debit orders

- During the 2017-18 audit, **we identified unauthorised debit orders against the municipality's bank account indicative of an environment that was vulnerable to misappropriation, wastage and the abuse of funds**. The sum total of these debit orders could not be quantified due to a lack of records and documentation at the municipality. **These were used to pay accounts of private individuals for items such as clothing, DSTV and AMC cookware – and are definite indicators of fraud**. These matters have been reported to the municipal manager and executive mayor to empower them to act in preventing further losses by putting in place and strengthening access controls to accounts.

Consequence management

- No further action has been taken on the **VBS matter pending the finalisation of the investigation**.
- Despite reporting the **unauthorised debit orders to the municipal public accounts committee** as well, **no investigation or action has been taken to stop these transactions or to recover the money from the individuals** and safeguard the municipality from continuing to incur financial losses.

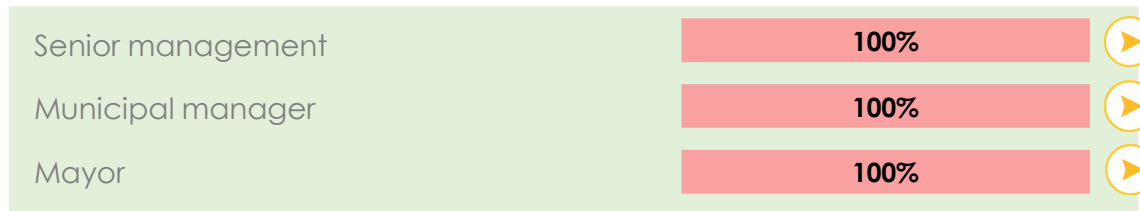
Impact on service delivery

- **Public funds should be used to provide services to the community** and these instances are clear examples where the **leadership of the municipality has failed to implement the discipline of financial controls over public funds**, which further **hindered the municipality from delivering services to the community**. We remain concerned by this lack of action and the continued disregard of our recommendations.



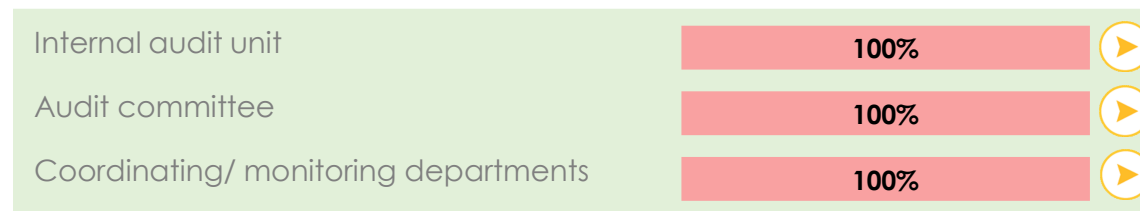
Preventative controls cannot work effectively if all assurance providers are not playing their role

ASSURANCE PROVIDED BY MANAGEMENT / LEADERSHIP



- Management **non-responsive to audit messages** to address risks and improve internal control.
- **Vacancies and instability** in the MM and CFO role.

INTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT



- Limited **availability of skills** for the internal audit function.
- Management **non-responsive** to their recommendations.

EXTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT

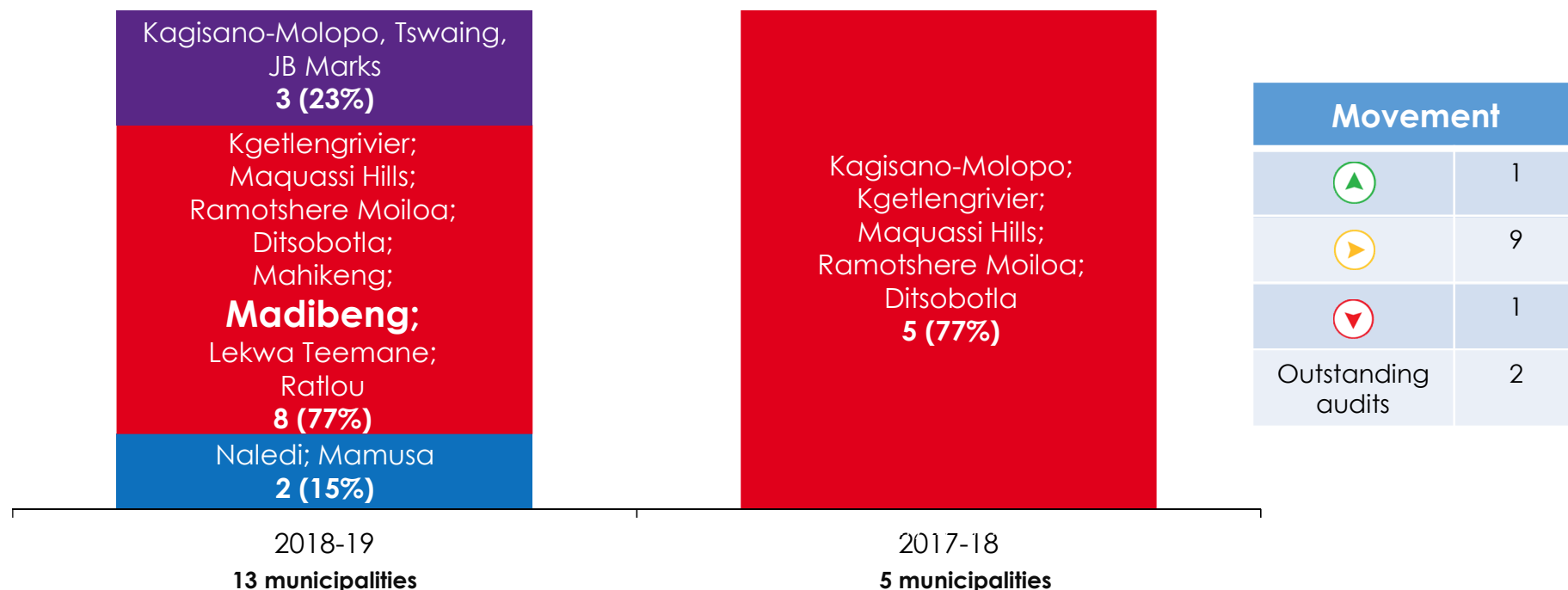


- Lack of **research staff** to support MPACs
- Limited **progress in investigations of irregular expenditure.**
- Lack of **political will** to effect **consequences** for historical **UIFW.**

Overall the key role players of the combined assurance model especially senior management and municipal managers **are not at the desired level** in responding to recommendations. To reverse the negative trajectory of audit outcomes, **preventative controls needs to be developed, implemented and monitored** in all aspects of financial and performance management.



Madibeng LM placed under administration in terms of section 139(1)(b) of the Constitution



The interventions did not have the desired impact due to the **lack of clarity of the roles and responsibilities of the appointed administrators**, which resulted from inconsistencies between their appointment letters, the terms of reference concluded with CoGTA and their misalignment to the requirements of legislation. This resulted in the **interventions not receiving the support of councils**.

The nature of these interventions and their success are dependent on a **strong tone of political leadership**, which is currently lacking. TROIKA should therefore **collaborate efforts to monitor** and ensure that the **interventions are effectively implemented** for the benefit of the citizens.



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