



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

Ngaka Modiri Molema District Municipality

Systemic breakdown in the discipline of financial controls

*Portfolio Committee on Co-operative Governance
and Traditional Affairs - 25 November 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.

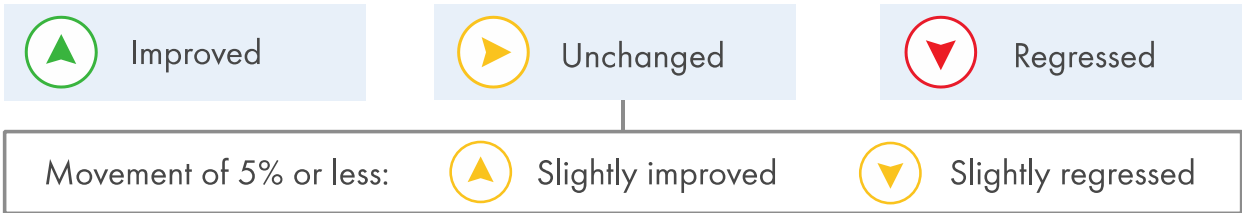


Important to note

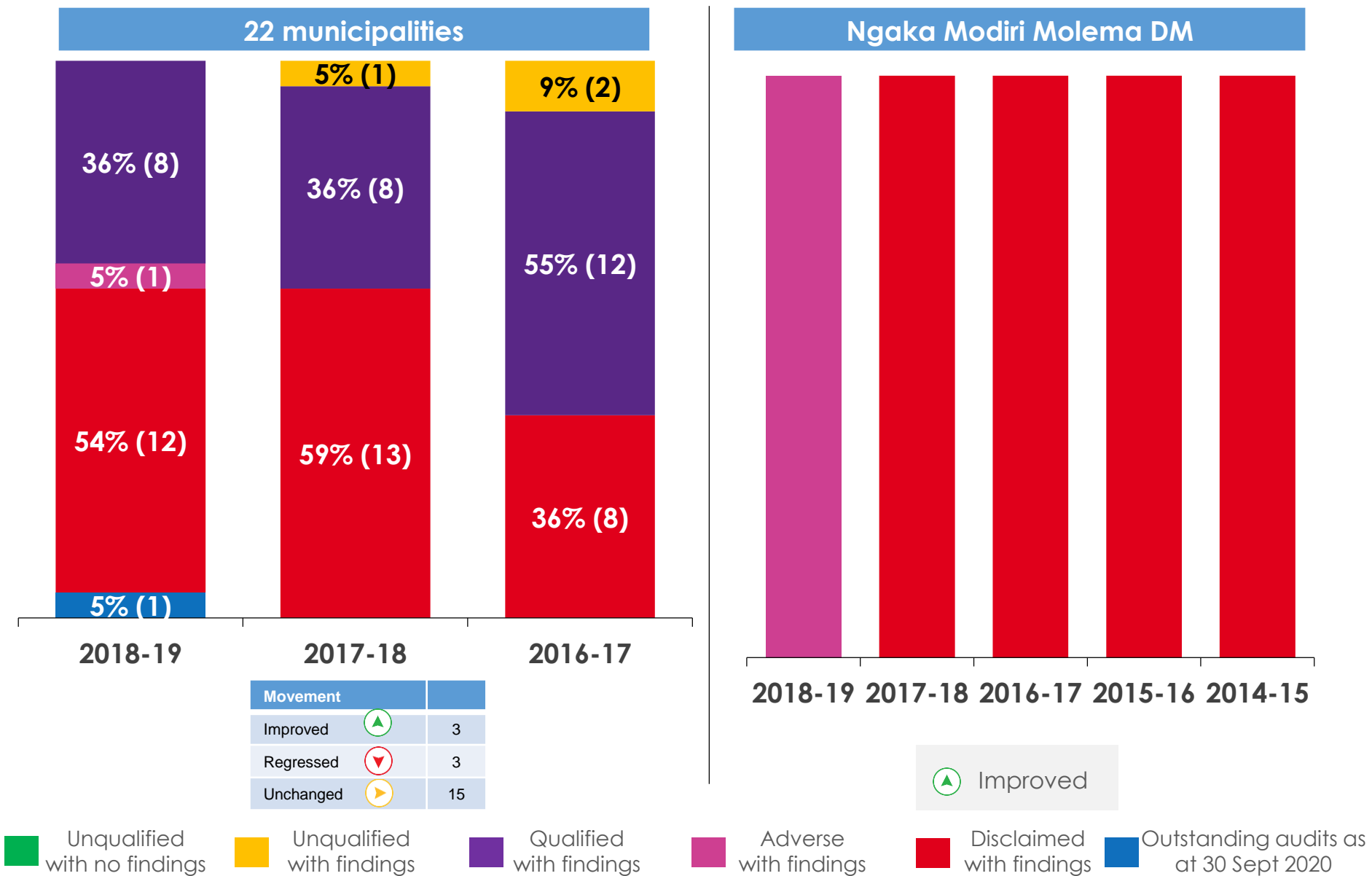
Audit outcomes are indicated as follows:

-  Unqualified with no findings
-  Unqualified with findings
-  Qualified with findings
-  Adverse with findings
-  Disclaimed with findings
-  Outstanding audits

Movement from the previous year is depicted as follows:



Stagnation in municipal audit outcomes



What does the financial statements say? The stark reality

53257
53257
28760
260835

Income statement



Revenue

- **Equitable share** of **R696,4 million** (2017-18: R616,3 million) and **conditional grants** of **R500,5 million** (2017-18: R262,6 million)
- **Revenue** of **R24,2 million** (2017-18: R13,5 million) was generated from billing



Expenditure

- **Salary and wages** (including councillors remuneration) of **R342,3 million** (2017-18: R320,7 million)
- **Average supplier payment period** of **430 days** (2017-18: 461 days)
- **Fruitless and wasteful expenditure** of **R7,9 million** (2017-18: R4,2 million)



Net result

- The municipality did not incur a deficit for the year

Balance sheet



- The district is solely dependent on grant funding. We note with concern that **49%** of the equitable share was spent on salaries.
- Additionally, the municipality has positions that were not budgeted for in the staff establishment and as a result paid **R510,9 million** over a period from 2012-13 to 2018-19, to officials in these positions. This is a clear example of a lack of processes and systems to ensure that all posts created are within the staff establishment of the municipality.
- Despite the municipality having **R300,3 million** of cash reserves on year-end, the outstanding amounts to suppliers have increased to **R266,1 million** (2017-18: R167,1 million)

Declining financial health and losses

53257
53257
28760
28760
260835
260835

What the numbers say



Creditor payment longer than 30 days

Yes

Deficit identified (expenses exceed revenue)

No

Municipalities in vulnerable financial position

Yes



The average payment period was **430 days** – affecting the sustainability of suppliers



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

- The **total water distribution losses** for the year amounted to **R14,6 million - 82%** (2017-18: R11 million - 78%). These losses were **in excess of the norm of 15% - 30%**.
- It should be noted that the district municipality is responsible for water and sanitation in the entire district, but in the urban areas the reticulation is done by the local municipalities, therefore not all water losses are disclosed by the district municipality.
- 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 **R58,4 million** (2017-18: R9,9 million) on maintenance which equates **to only 1.2%** (2017-18: 0.3%) of their infrastructure assets.

These losses are not affordable given the huge outstanding amounts for bulk services:

Municipality	Total amounts owed (as at June 2019)	Total amounts in arrears (i.e. 31 days and over)
Water (Sedibeng)	R65,4 million*	R42,6 million



*In addition, a contingent liability of R362 million is disclosed for an amount due to Sedibeng which the municipality is disputing





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

Annual irregular expenditure **increased** from R151,2 million to R1,56 billion*

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

Analyses of irregular expenditure: R1,56 billion (2017-18: R151,2 million)

Movement

2018-19

Payments or expenses in 2018-19



R409,2 million

26%

Represents non-compliance in 2018-19



R409,2 million

100%

Expenditure on ongoing multi-year contracts



R0 million

0%

Payments or expenses in previous years only
uncovered and disclosed in 2018-19



R1,15 billion

74%

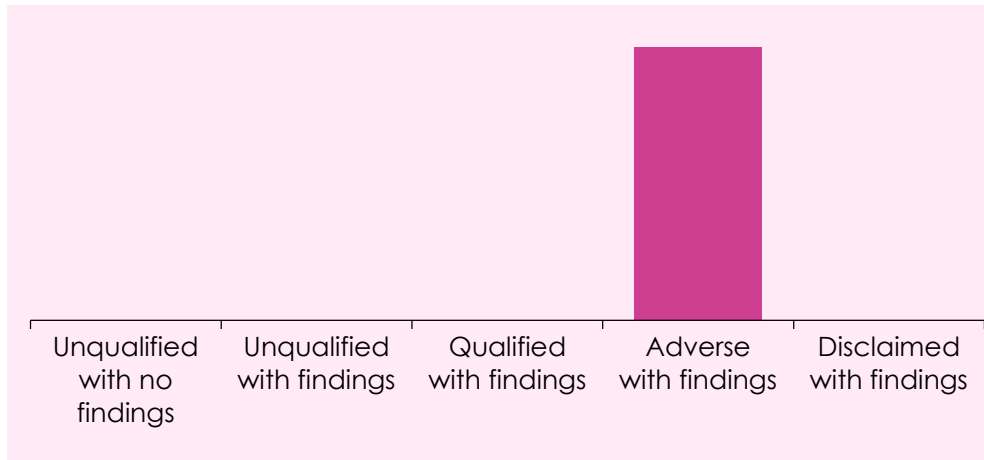
The balance
of
unresolved
irregular
expenditure
is **R2,7 billion**

Annual irregular expenditure	2018-19	2017-18	2016-17
Irregular expenditure	R1,56 billion	R151,2 million	R827,8 million

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



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



REASONS WHY CONSULTANTS WERE INEFFECTIVE:

- CONSULTANTS DID NOT DELIVER

- LACK OF RECORDS AND DOCUMENTATION

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

Ngaka Modiri Molema has the 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 unit
Ngaka Modiri Molema	R24,8 million	R0,9 million	R20,7 million	R46,4 million	30 positions

- The finance unit is not adequately capacitated with skilled staff and various vacancies had not been filled. A financial administrator was seconded to the municipality by CoGTA but due to **the systemic inability to maintain financial and performance records**, the impact was limited to an adverse audit outcome.
- The poor maintenance of financial records 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.

Instances of lack of accountability

Lack of support to local municipalities appointed as water service providers

- The equitable share allocation of the district municipality is meant for the provision of free basic water services to indigent communities. The local municipalities within the district **provide retail water services on behalf of the district municipality** as per the agreements with the district municipality.
- These services are billed by the local municipalities who as per agreement were appointed by the district as water services providers to the urban communities. However, the district – which ultimately remains responsible for these services – **only transferred R15 million** to the local municipalities from the **R484,1 million included in the equitable share for these services**. This was due to a **lack of monitoring and the fact that the local municipalities did not have proper systems** to record the **cost of the services they provided on behalf of the district**, which put a strain on the financial health of the local municipalities.

Consequence management

- **No action** was taken by the **leadership and management of the district municipality** despite this matter having been communicated through our **reports for a number of years**.

Impact on service delivery

- **Lack of funding to the local municipalities** by the district municipality towards the water services **puts a strain on the financial health of the local municipalities** which in turn impacts negatively on their ability for the provision of water and sanitation services.



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

ASSURANCE PROVIDED BY MANAGEMENT / LEADERSHIP

Senior management	100%	▶
Municipal manager	100%	▶
Mayor	100%	▶

- Management **non-responsive to audit messages** to address risks and improve internal control.

INTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT

Internal audit unit	100%	▶
Audit committee	100%	▶
Coordinating/ monitoring departments	100%	▶

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

EXTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT

Municipal councils	100%	▶
Municipal public accounts committees	100%	▶
Portfolio committee on local government	100%	▶

- 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.



Introduction of material irregularities (MI)

Material irregularity

.. means any **non-compliance** with, or **contravention** of, legislation, **fraud**, **theft** or a **breach of a fiduciary duty** identified during an audit performed under this act that **resulted in or is likely** to result in ... a **material financial loss**, the **misuse or loss of a material public resource** or **substantial harm to a public sector institution or the general public**.

If the accounting officer/authority does not appropriately deal with material irregularities, our expanded mandate allows us to ...



Refer material irregularities to relevant public bodies for further investigations



Take binding remedial action for failure to implement the AG's recommendations for material irregularities



Issue a certificate of debt for failure to implement the remedial action if financial loss was involved

MIs identified - Ngaka Modiri Molema District Municipality

Material irregularity

An existing contract for the extension of the municipal office building and the construction of a new gate house where the contractor was previously paid. A likely loss of R9,3 million due to avoidable costs resulting from the contract not being monitored.

Effective system of expenditure control was not in place to ensure that claims paid to the supplier providing water tankering services was for actual services received. Likely loss of R2,3 million if the overpayments are not recovered from the supplier.

The municipality wrote off assets valued at R2,4 million that could not be located during the asset verification process. This was due to lack of a system of internal control to safeguard assets.

Addressing the MI

Since the provincial treasury had already commissioned an investigation into the awarding of the initial contract, the AO will request the investigation report. The AO will assess if it addresses the MI. If not the AO plans to commission an independent investigation into the Irregularities by 15 June 2020.

The AO to commission an independent investigation in February 2020 to quantify the likely losses and the investigation report would be available by 31 May 2020. The AO will then take appropriate steps based on the outcome of the investigation.

The AO plans to do a full asset verification which will include an investigation of the missing assets by 31 March 2020. The AO will then take appropriate action by 30 April 2020 based on the outcome of the investigation.



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