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ANALYSIS OF THE 2010/11 MUNICIPAL AUDIT OUTCOMES: LIMPOPO, EASTERN CAPE AND MPUMALANGA PROVINCES

1. Introduction and Background

In the 2010/11 audit report, the Auditor-General has identified the lack of leadership oversight, financial and performance management and lack of governance principles as the key reasons for the state of despair in most municipalities. The Department of Co-operative Governance and Traditional Affairs (CoGTA) has launched Operation Clean Audit 2014 campaign in 2009. The aim of this campaign is to address audit queries in a sustainable way, in order to improve service delivery and ensuring all municipalities and provincial departments have dealt with the causes of disclaimers and adverse opinions.

In accounting terms, a clean audit means a municipality's financial statements are in order, and it has followed all regulations. To achieve this, a municipality must meet three goals: its financial statements must be free of any mistakes; there must be no findings that are flagged by the Auditor-General in its annual report; and these documents must show the municipality has complied with all regulations.

According to the South African Institute of Chartered Accountants (SAICA),¹ the lack of financial competencies including accounting skills among officials in senior accounting positions will continue to negatively impact on municipal financial audits, unless municipalities embrace and implement the capacity building and skills development initiatives put in place to address the financial skills shortage. The accounting body has completed a capacity building and skills development pilot project to address the financial skills shortage in municipalities. However, SAICA cautions that drastic progress should not be expected from such initiatives as they are long-term projects with a long-term exponential impact.

For the purpose of dealing with the main challenges faced by local government in respect to audit outcomes, this analysis is limited to three provinces, i.e. Limpopo, Eastern Cape and

¹ SAICA support the Auditor-General's findings. Available at: <https://www.saica.co.za/News/NewsArticlesandPressmediareleases/tabid/695/itemid/3461/language/en-ZA/Default.aspx> [Accessed 28 August 2012].

Mpumalanga Provinces. A brief examination is provided below for each province's 2010/11 audit outcomes.

2. Limpopo Province Audit Outcomes

Local government in Limpopo comprises 5 district municipalities, 25 local municipalities and three municipal entities. Of the 30 municipalities in Limpopo, two municipalities managed to obtain clean audit reports but this achievement is overshadowed by the fact that the Province recorded an overall regression in audit outcomes. The two municipalities in Limpopo who managed to achieve clean audits in the 2010/11 financial year, are Waterberg District Municipality and Fetakgomo Local Municipality. While about 12% of the municipalities received unqualified audit opinions with findings, 82% received qualified, disclaimed or adverse opinions or did not submit financial statements for auditing.

A total of three (10%) auditees (Blouberg, Lepelle-Nkumpi and Greater Sekhukhune municipalities) were not able to meet the legislative requirement of timely submission. The audits of three municipalities had not been finalised as at 31 January 2012, the cut-off date set by the Auditor-General for inclusion of their audit outcomes. Lepelle-Nkumpi Municipality failed to submit their annual financial statements within the legislated date for two consecutive years. Although consultants have been assisting the Municipality for the past two years, no visible improvements were noted. Based on the Auditor-General's information, the cost to municipalities to employ consultants is estimated to have exceeded R23 million for the 2010-11 financial year. This equates to an average in excess of R1 million per municipality.

The Province's latest local government audit results also showed a number of regressions and an increase in unauthorised, irregular as well as fruitless and wasteful expenditure. The analysis of results shows that only 8% of the municipalities have implemented good internal controls that ultimately resulted in good outcomes. At 46% of the municipalities key controls are in the process of being implemented while 44% of the municipalities need serious intervention to implement basic accounting controls. All the areas of internal control (namely supply chain management, management of human resources, information technology controls, reporting against predetermined objectives as well as the quality of financial statements submitted for auditing) reflected a deterioration during the year.

This status of audit outcomes stems from the slow response to the audit recommendations and leadership not implementing the commitments made during the previous year at 87% of the auditees. The Province continues to be plagued by inappropriate skills, especially at chief financial

officer level, at 87% of the municipalities. The results are also driven by a lack of implementing consequences for poor performance or regressions at more than 90% of the municipalities.

Main Findings in Limpopo Province

The main findings in the Province are attributed to the following:

- Unauthorised expenditure was incurred as a result of overspending of a vote or conditional grants utilised for purposes other than intended for.
- Fruitless and wasteful expenditure was due to interest and penalties incurred as a result of late payments to suppliers. Poor budgetary controls and weaknesses over expenditure management contributed to the increase.
- The increase in qualifications on irregular expenditure was due to noncompliance with supply chain management prescripts and limitations due to documentation not provided for audit purposes. In some cases the non-compliance with supply chain management laws and regulations appeared to be deliberate and in some instances the process appeared to be manipulated to award a tender to a particular service provider.
- The main reason for the increase in qualifications for non-current assets relates to the expiry of GRAP 17 exemptions on the measurement of assets. There were no implementation plans to ensure that the municipalities would be ready to be fully GRAP compliant on the expiry of these exemptions.
- Due to the lack of adequate and regular reconciliations, there are a significant number of municipalities that had unexplained differences between the financial statements and accounting records resulting in qualifications.
- No appropriate systems in place for the identification and recognition of accruals and commitments disclosed in the financial statements.
- There was no system of control over property rates, rental and other billings, thereby resulting in consumers being charged incorrect amounts or even consumers not being billed for municipal services rendered.

3. Eastern Cape Province Audit Outcomes

Local government in the Eastern Cape Province comprises 2 metros, 6 district municipalities, 37 local municipalities and 10 municipal entities. The audit outcomes of the Eastern Cape local government revealed minimal improvement and general slow progress towards unqualified opinions (with findings or concerns), with the province showing an overall

improvement in four of the audit outcomes. Of the 45 municipalities and 10 municipal entities audited by the Auditor-General in the Eastern Cape, no municipality received the desired clean audit opinion (unqualified without findings). Nine auditees (14%), consisting of 6 municipalities and 3 municipal entities, were not able to submit their statements on or before the legislated date for auditing.

Thirteen municipalities (29%) received financially unqualified opinions with findings, 13 (29%) were qualified, while two (4%) received an adverse opinion and 17 (38%) disclaimers. This situation is reinforced by the status of internal controls that require urgent intervention at roughly half of the municipalities. The three most prominent reasons for the poor audit opinions in this province are a lack of political will at approximately 50% of the municipalities, where political leaders are not taking the Auditor-General's message towards ownership of key controls seriously; a lack of consequences for poor performance in the majority 98% of cases; and failure to appoint adequately qualified, skilled and competent individuals at 58% of municipalities.

Main Findings in the Eastern Cape Province

The root causes based on the analysis above that require the most focused attention are the following:

- The political instability in some municipalities diverted the attention of the council away from financial management and its oversight role.
- There was an ineffective leadership culture and leadership oversight at these auditees. The irregular expenditure due to supply chain management breaches and conflicts of interest, in particular, raises questions about the integrity and honesty of the leadership.
- Senior management did not always supervise and monitor basic accounting disciplines, such as daily record keeping and the preparation of monthly management accounts that are reconciled with the general ledger and are supported by appropriate schedules that have been reconciled with the underlying accounting records.
- Action plans to address prior year findings were either not prepared or not implemented and monitored on a regular basis.
- Poor IT governance and IT system controls had a direct impact on findings related to misstatements in the financial statements.
- The leadership did not support governance structures in order to strengthen control environments. In some cases these structures complied with the legislative

requirements; however, information was not always provided to internal audit units to enable them to conduct their audits.

4. Mpumalanga Province Audit Outcomes

Local government in Mpumalanga comprises 3 district municipalities and 18 local municipalities. The Mpumalanga Province received 4 clean audits in the 2010/11 local government audit results (the highest percentage of clean audits in the country for this period). This achievement is attributed to the improvement on strong internal controls and management's implementation of the previous year's action plans. Of Mpumalanga's 21 municipalities, four (19%) received clean audits, namely Ehlanzeni District Municipality, Gert Sibande District Municipality, Steve Tshwete Local Municipality and Victor Khanye Local Municipality. Seven (33%) municipalities were unqualified with findings, while 48% of the municipalities received qualified or disclaimed opinions or had outstanding audits.

The obstacles to attaining clean audits in the Province emanated from control weaknesses in supply chain management, service delivery reporting, human resource management, information technology controls as well as significant errors in financial reports due to a lack of skills in finance units. This situation is underpinned by the status of key internal controls that require urgent intervention at 28% of the municipalities.

Main Findings in Mpumalanga Province

The main findings in the Province are attributed to the following:

- Irregular expenditure due to non-compliance with supply chain management regulations.
- Non-disclosure in the notes to the financial statements.
- Management failed to implement action plans to address previous year findings, resulting in repeat findings.
- Inadequate controls to identify unauthorised, irregular as well as fruitless and wasteful expenditure.
- Key vacant positions were not filled timeously with competent persons, while HR management was ineffective and did not ensure that adequate and sufficiently skilled personnel were appointed and that their performance was regularly monitored.
- A risk assessment was not properly performed in order to understand the risks facing the municipalities. Hence, internal audit units could not adequately address the risks relating to financial reporting as well as compliance with laws and regulations relating to financial statement presentation and disclosure.

5. Issues for Consideration by the Committee

- The provincial departments should outline operational plans and support measures that will mitigate the key findings in the municipal audit outcomes, including timeframes in their respective provinces.
- There is a need for elevated cooperation between the provincial departments responsible for local government, and the provincial Public Accounts Committee in order improve oversight in dealing with the challenges faced by local government.
- It is critical that provincial departments responsible for local government engage the South African Local Government Association (SALGA) and the Local Government Sector Education Training Authority (SETA), with the aim to improve the effectiveness and efficiency of skills development system within the local government sector.

6. References

Consolidated General Report on the Audit Outcomes of Local Government, MFMA 2010/11.

Department of Cooperative Governance and Traditional Affairs, Operation Clean Audit Programme (2009 – 2014).

Mfuku, N. (2012) The 2010/11 Municipal Audit Outcomes – Discussion Document.