2013/14: Red Zone Municipalities

Municipal Audit Outcomes Unpacked

A report by the Public Affairs Research Institute (University of the Witwatersrand) for the South African Local Government Association

PARI Public Affairs Research Institute

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ABBREVIATIONS / ACRONYMS

AFS	Annual Financial Statements
AG	Auditor General of South Africa
CFO	Chief Financial Officer
COGTA	Department of Cooperative Governance and Traditional Affairs
MM	Municipal Manager
MPAC	Municipal Public Accounts Committee
OAG	Office of the Accountant General
PARI	Public Affairs Research Institute
SALGA	South African Local Government Association
SCM	Supply Chain Management

EXECUTIVE SUMMARY

INTRODUCTION

The goal of the research was to investigate the underlying causes of poor audit outcomes in local government and to use the findings of this empirical research to produce targeted, evidence-based recommendations around remedial action for each of the 60 municipalities that attained poor outcomes in the 2013/14 audit.

The aim of the research was to obtain insights in the following areas:

- Institutional histories of poorly performing municipalities
- Institutional dynamics and complexities
- Basic administration and record keeping
- Oversight and compliance

Information was collected through the analysis of existing municipal governance and audit reports and research, and the collection of data directly from the municipalities. This municipal data collection process was largely qualitative in nature, using a combination of a questionnaire containing both structured and open-ended questions, together with workplace observation. The focus was on senior municipal staff (the MM and CFO), oversight structures (the Audit and MPAC Committees) and administration staff (in Accounting, Finance and/or Internal Audit). Where possible, it was planned that administration staff would be interviewed in their place of work, in order to obtain greater insights into the ways in which administrative processes are designed and implemented.

CONSOLIDATED FINDINGS

We have reported our main findings under the following headings:

- Leadership
- Governance and Oversight
- Basic Administration
- Capacity
- Inter-governmental Support and Interventions
- Audit-specific Issues

Leadership

Our findings indicated that most municipal leadership (i.e. Councilors) in our study sample (although by no means all of them) are not making the contribution to improved audit outcomes that they should be, for one or more of the following reasons:

- Lack of accountability for the audit outcomes;
- Poor prioritization of audit issues; and/or
- Low level of financial and management skills.

Governance and Oversight

In terms of oversight and compliance, the main problem areas that we identified are the following:

- Policy Implementation: Municipalities have policies, but are not implementing them.
- Municipal Public Accounts Committees (MPACs) are generally having no positive impact at all on governance and oversight.
- The Audit Committee is effective in some municipalities, but by no means in all. Shared service audit committees appear to be particularly problematic.
- Internal Audit has the ability to make a significant impact on the overall control environment within local government, but lack of capacity and the failure to prioritise internal audit means that it seldom makes this positive impact.

Basic administration

Basic administration and record keeping is a key issue in determining audit outcomes, as highlighted repeatedly in the AG's audit reports and management letters. Poor administration and record keeping also undermine the efforts of consultants employed by the municipalities to assist in preparation for the audit. Our research suggests that the main reasons for poor administration are the following:

- Lack of appreciation of the value of basic administration
- Corruption
- Archaic legacy approach towards administration and document management
- Insufficient guidelines and support on implementing new systems

Capacity

Capacity – in terms of financial and human resources – is a serious constraining factor in all the municipalities that were included in this study. The main issues that we identified in this respect are the following:

- Inability to afford the necessary skills
- Inability to attract the necessary skills
- Poor management of consultants

- High turnover/low skills of senior staff
- Lack of financial resources to purchase support infrastructure

Inter-governmental Support and Interventions

There are a number of public-sector entities that are involved in providing audit support to municipalities, including COGTA, National and Provincial Treasuries and SALGA. All of the municipalities included in this study require assistance – sometimes a great deal of assistance - but the way in which this support is currently being delivered is sometimes problematic. Our research identified the following issues in this regard:

- Poor coordination and replication of efforts
- Focus on “quick fixes” rather than addressing structural issues
- Support comes too late in the audit process
- Lack of support in certain key areas, such as basic administration.

Audit-Specific Issues

Our research highlighted a number of issues around the audit process itself. The issues that were found most often across all the municipalities in this study were the following:

- Valuation and recordal of assets
- The audit process, particularly the high percentage of junior and inexperienced staff.
- The cost of audits

RECOMMENDATIONS

We have divided our recommendations into three main categories: Guiding principles; non-SALGA interventions, and SALGA-specific interventions.

(i) Guiding Principles

Based on our research findings, we have proposed a number of guiding principles that could operate as a high-level framework for guiding the conceptualisation of interventions. We have developed five guiding principles:

- Leadership development is only valuable in the context of *effective and robust institutions*..
- Focus on addressing structural issues, not surface symptoms
- Shared services add value in operations, not in oversight functions.

- Regulation and reality must be better aligned.
- Effective compliance is based on separation of powers and independent reporting lines.

(ii) Non-SALGA interventions

Here we have described interventions that we believe will make a positive impact, but which cannot be delivered directly by SALGA. In these instances, the role of SALGA would be to lobby the relevant government entities for change. An important point to make here is that we believe many of these interventions will contribute to increased efficiency across all local municipalities, and not just those included on the red zone list.

The recommended non-SALGA interventions are as follows:

- Develop more shared services in operations
- Create a new independent structure for the management of internal audit functions
- Abolish the MPAC
- Increase the role and profile of the Audit Committee
- Embark on a long-term operational restructuring programme
- Review reporting from local government
- The office of the OAG to develop a closer direct working relationship with municipalities
- Conduct a review of audit costs and the municipal right of appeal
- Better coordination of interventions

(iii) SALGA-specific interventions

Clearly, the most important role for SALGA is to lobby for the interventions outlined above, and to monitor their progress, since it is through these interventions that real and sustainable change will be made. However, there are a number of other interventions that SALGA could consider, as set out below, which would support municipalities in building more effective operational structures. Once again, we believe that these interventions will benefit all municipalities, and so should not be confined just to those on the red zone list. The interventions listed below are proposed as **new** interventions – i.e. in addition to the services that SALGA already offers (such as training) which have not been repeated here.

- Develop a graduate work experience programme

- Institute shared learning programmes
- Implement a skills development programme with the private sector.

PART ONE
KEY FINDINGS

1.1. INTRODUCTION AND BACKGROUND

In 2009, Minister for Cooperative Government and Traditional Affairs Sicelo Shiceka announced Operation Clean Audit. Under this initiative, local government was to achieve a universal clean audit by 2014. However, on this date and in COGTA's terms, where the term 'clean audit' excluded all qualified findings, 50 per cent of municipalities and municipal entities had missed this target. Some improvement did occur between 2009 and 2014: unqualified opinions increased from 46 per cent to 50 per cent; unqualified opinions 'without findings' increased from 1 to 9 per cent; and opinions 'with findings' decreased from 45 to 41 per cent (AG, 2014). Late submissions (i.e. those that miss the AG's cut-off date for the completion of the audit) and adverse or disclaimer findings all declined appreciably during this period.

In government such progress is, however, widely seen as insufficient, and improving audit outcomes remains a key challenge. Outside government, the AG's annual release of municipal audit information provides fuel for public acrimony around problems of service delivery and corruption. In 2014, citizens widely decried findings reported in the 2012/13 Local Government Audit Outcomes around irregular expenditure of R11.6 billion, unauthorized expenditure of R9.2 billion, and fruitless and wasteful expenditure of R815 million. An important component of SALGA's mandate is to assist municipalities in improving their financial management and governance and thus their audit outcomes. From the perspective of SALGA, the AG's findings provide only limited value in helping to design interventions to assist or support poor performing municipalities. By the time they are released (more than halfway through the following financial year) many municipalities have already tried in their own way to address the findings in question (usually with limited success). In this regard, SALGA comes too late to the scene to provide meaningful assistance.

Additionally, in order to support cases of success effectively and address failures, it is important that SALGA's interventions (including any policy recommendations) are tailored to account for the underlying causes of failure. If these are not carefully identified, then the risk is that resources will continue to be expended on addressing the wrong issues - that symptoms will be addressed without tackling their underlying causes. In other words, there is a danger of focusing resources on solving the wrong problems.

The aim of this project is to improve the ability of SALGA to provide both timely, accurate and targeted assistance to local municipalities who have received adverse or disclaimed audit outcomes, or whose audits were not finalized by the legislated deadline, for the 2013/2014 financial year. The goal is to investigate the underlying causes of poor audit outcomes in local government and to use the findings of this empirical research to produce targeted, evidence-based recommendations around remedial action for each of the 60 municipalities that attained poor outcomes in the 2013/14 audit.

The Public Affairs Research Institute (PARI) is SALGA's research partner in this assignmnet. PARI is a research institute affiliated to the School of Social Sciences at the University of Witwatersrand. The Institute comprises a team of sociologists, economists, political scientists, anthropologists and historians trained in social science methodologies who bridge the gap between applied and academic research on the South African state and on state-citizen relations. A central aim of the Institute is to contribute to the development of effective and accountable public institutions in South Africa. The Institute has a particular track record in applied research on drivers of institutional performance in the public service and in local government with especial focus on public finance, supply chain management, planning, asset management, organisational development, process and systems design. The Institute also provides evidence-based solutions to the issue of performance improvement in public entities and in the development of public policy.

1.2. APPROACH AND METHOD

PARI's research agenda is informed by the understanding that organisational outputs (in this instance the quality of audit outcomes) are affected by a complex interaction of multiple factors – historical, institutional and technical. Obtaining insight into the underlying reasons for sub-optimal organisational outputs requires that all of these factors are considered and examined. This approach is significantly different from those most often currently applied to municipal performance, which tend to focus almost exclusively on technical issues and notions of "leadership" failure. By broadening the scope of the investigation, PARI aims to generate additional insights into the root causes of poor audit outcomes.

Although the Auditor-General reports on audit outcomes in local government provided one entry point for the research, PARI believes that there are a number of historical and organisational issues that are critical to operational outcomes, but which are under-researched in the area of audit outcomes. This research has investigated these issues alongside more "orthodox" technical factors, such as the quality of basic administration.

The aim of the research was to obtain insights in the following areas:

- Institutional histories of poorly performing municipalities
- Institutional dynamics and complexities
- Basic administration and record keeping
- Oversight and compliance

Information was collected through the analysis of existing municipal governance and audit reports and research, and the collection of data directly from the municipalities. This municipal data collection process was largely qualitative in nature, using a combination of a questionnaire containing both structured and open-ended questions, together with workplace observation. The focus was on senior municipal staff (the MM and CFO), oversight structures (the Audit and MPAC Committees) and administration staff (in Accounting, Finance and/or Internal Audit). Where possible, it was planned that administration staff would be interviewed in their place of work, in order to obtain greater insights into the ways in which administrative processes are designed and implemented.

The bulk of the data collection from municipalities took place between the 2nd of March and the 10th of April 2015. Most municipalities were attended by both a SALGA official and a PARI researcher. The interviews/observations were structured so that the formal interviews were conducted by the SALGA official. The PARI researchers fulfilled two main roles during the municipal interview process:

a. Supporting the SALGA officials: Although the interviews were conducted by the SALGA staff, the PARI researchers were present to provide support as is necessary. The PARI researchers could also request additional information from municipal officials as the interviews progressed; and
b. Participant observation and documentation: The PARI researchers compiled their own notes based on their observations of both the interview participants and the workplace environment. This included both photographic documentation and voice recording as this was possible (permission for voice recordings was obtained in advance from each participant, and the decision of whether or not to allow voice recordings was entirely voluntary.)

All respondents have been kept anonymous, and where possible, individuals in a municipality were interviewed separately, to encourage frank discussion.

1.2.1 Limitations of the Research

We had planned to interview at least the following officials at each municipality:

- Municipal Manager
- Chief Financial Officer
- Chair of the Audit Committee
- Chair of MPAC
- Accounting/Finance staff

During the course of the research, the actual persons interviewed differed from this list in several of the municipalities, for the following reasons:

1. Not all of the officials were actually available when we arrived at many of the municipalities, although our appointments had been confirmed in advance. Further, many of the Audit Committee Chairs were not available for meetings on those days that we had arranged meetings with municipal officials, since they are often located

at some distance from the municipality in question, and generally have very busy schedules. Given the short time frame available to us for the research, and the long travelling times to most of the municipalities, it was not practical to reschedule additional meetings and so in these instances we interviewed whoever was available on the day, and excluded those who were not available. As a result, we do not have identical interview samples for all the municipalities in the study.

2. We were not able to obtain interviews with all 60 of the municipalities included in the original project scope. The table below indicates the list of municipalities initially included in the scope of work (by Province) and those with whom interviews had been conducted, as at 20 May 2015. Of the 60 municipalities included in the original scope of work, only 43 had been interviewed by the 20th of May, despite an extension of the time made available for the fieldwork. Therefore, 18 of the red zone municipalities were not included in the study. The reason why municipalities were not included was because officials were not available on the days on which interviews were requested.

MUNICIPALITY	INTERVIEW		MUNICIPALITY	INTERVIEW	
	YES	NO		YES	NO
Eastern Cape			**Limpopo (cont)**		
Great Kei			Mopani DM		
Inkwanca			Thabazimbi		
Ikwezi			Tubatse		
Inxuba Yethemba			Vhembe DM		
Lukhanji			**Mpumalanga**		
Makana			Emakhazeni		
Mbizana			Emalahleni		
Mhlontlo			Mkhondo		
Ndlambe			Msukaligwa		
Ngqushwa			Thaba Chweu		
Ntabankulu			**North West**		
OR Tambo			Ditsobotla		
Sundays River Valley			Greater Taung		

Free State			Lekwa Teemane		
Lestemeng			Mamusa		
Mafube			Maquassi Hills		
Moqhaka			Ngaka Modiri Molema District		
Ngwathe			Dr Ruth Mompati		
Matjhabeng			Tswaing		
Nala			Ventersdorp		
Maluti-A-Phofung			**Northern Cape**		
Mantsopa			Dikgatlong		
Phumelela			Ga-Segonyana		
Gauteng			Kamiesberg		
Western Area			Karoo Hoogland		
KwaZulu Natal			!Kheis		
Amajubu District			Kgatelopele		
Hlabisa			Magareng		
Jozini			Nama Khoi		
Limpopo			Phokwane		
Aganang			Renosterberg		
Ba-Phalaborwa			Thembelihle		
Ephraim Mogale			Tsantsabane		
Fetagomo					

Despite these project limitations, we have a high degree of confidence in our research findings: Very early on in our fieldwork it became apparent that the most important issues impacting audit outcomes were remarkably similar across almost all the municipalities. We therefore believe that SALGA interventions based on these findings will be relevant for all municipalities that have poor audit outcomes, even if they were not included in our fieldwork.

We also made one addition to our scope of work: Very early on in the fieldwork it became apparent that there was considerable value in interviewing whoever in the municipality had responsibility for the internal audit function (where this was the case – not all municipalities have staffed internal audit functions). Therefore, where possible, this person was added to our list of interviewees, although our initial questionnaire had not included the internal audit function.

Finally, it is worth noting what this report is not about. This study does not seek to establish the relationship, causal or otherwise, between *audit outcomes and service delivery*. This is the topic of new research. Nonetheless, as will become clear in the course of the document, there are findings that bare on this question.

1.2.2. STRUCTURE OF THIS REPORT

This report is divided into two main parts: This Part One presents the background to the research and the consolidated research findings across all participating municipalities (section 1.3. below). Part Two of this report contains our recommendations for addressing the issues discussed in Parts One, including how SALGA could contribute to improving audit outcomes.

Individual reports will be issued for each participating municipality, based on the information collected at each location.

1.3. CONSOLIDATED FINDINGS

In this section of the report we have reported our main findings under the following headings:

- Leadership
- Governance and Oversight
- Basic Administration
- Capacity
- Inter-governmental Support and Interventions
- Audit-specific Issues

In Part Three of this report we have made recommendations as to how the issues that we have raised in this section could be addressed.

1.3.1. LEADERSHIP

Each year, the AG's local government audit reports highlight the role of municipal leadership (i.e. Council) in poor audit outcomes. Our research confirmed that this is often an issue, although the underlying factors are perhaps more complex than the AG's reports suggest. Our findings indicated that most municipal leadership (i.e. Councilors) in our study sample (although by no means all of them) are not making the contribution to improved audit outcomes that they should be, for one or more of the following reasons:

1. Lack of accountability;
2. Poor prioritization; and/or
3. Low level of financial and management skills.

In terms of the **lack of accountabilit**y, a common sentiment expressed by both officials and councilors was that the audit outcome (and thus changing this) is the responsibility of the finance function, together with the Audit Committee. In most instances there was no understanding or acceptance of the final responsibility of Council for the audit outcome. Many councilors seem genuinely to believe that the audit outcome of the municipality is not their responsibility. As a result, many councilors appear to take little or no interest in actively driving the process to improve the audit outcome. In many instances, it is the CFO who carries the brunt of the responsibility for a poor audit outcome, despite the fact that the MM is actually the responsible accounting officer. (This “misallocation” of responsibility to the CFO, and away from Council and the MM is, in our opinion, is one of the factors contributing to the high turnover of officials in this position).

One of the problems behind this is that councilors are not subject to the same kind of performance agreements that senior managers in municipalities are required to sign, since the regular elections are intended to provide this “performance management”. There are thus no real, pre-determined or clear implications for councilors if the municipality gets a poor audit and if voters do not respond. In addition, the audit outcome of the municipality appears to play little part in the assessment of councilor performance by local voters, for whom service delivery issues seem to be much more important. A commonly voiced sentiment in many of the municipalities that we visited was (1) that the level of service delivery was much more important than a particular audit outcome, and (2) that there was no real linkage between the audit outcome and the level of service delivery. In many municipalities it appears that interest in the audit outcome starts and ends with the CFO and the Audit Committee. In this environment it is very difficult to ensure that councilors in fact take the responsibility that they are required to take in the audit process.

(A similar situation seems to be in place with respect to the MM: In many of the municipalities the MM seems to be effectively avoiding his/her responsibility with respect to the audit outcome, by characterizing it as a “finance problem.” We cam across very few MMs who were taking active responsibility for the oversight of implementation of the audit action plan.)

The second issue **– poor prioritization of audit issues –** is related to the lack of accountability by councilors, but in this instance the actions of councilors and mayors are *actively undermining* the efforts of officials to improve the audit outcome of the municipality. Where the political leadership of the municipality has little interest in the audit outcome they will often require that officials allocate their time to other tasks or activities. As just one example, in one municipality that we visited during the course of this research the mayor had insisted that all the officials working on an important report back to the province on progress of the audit action plan (which report back was due in a few days’ time) leave their offices to spend the entire day at the launch of a relatively minor political campaign (dealing with litter). We came across many other similar examples where political leadership makes it difficult for officials to do their work, by forcing them to prioritise less important issues. Unfortunately it is these officials, and not the councilors in question, who then carry the responsibility for the implications of poor results.

The final issue – the generally **low level of financial and management skills** among councilors – was something that was obvious at all the municipalities that were included in this research. Many of the most serious audit issues – such as the valuation of assets or the calculation of revenue – are complex, and generally not well understood by the majority of councilors. The low level of financial management skills not only means that councilors are generally poorly equipped to understand why the municipality has a poor audit outcome in the first place, it also means that they struggle to exercise oversight over the audit action plan, or to have meaningful engagements with the Audit Committee. More seriously, this low level of skills means that councilors are often unable to exercise meaningful oversight over officials (even where they would like to do so). As several of our interviewees pointed out, a well-qualified CFO and/or MM could present incorrect or fictitious information about the state of the Municipality's finances or audit action plan and councilors would have little option but to believe him or her. "I could tell them anything as long as the report is pretty and they would believe me", one CFO told us. Councilors are generally well aware of their relative lack of financial literacy, which generally makes them feel that they have little to contribute to the audit outcome, and thus reluctant to take an active oversight role.

Unfortunately this situation represents current demographics: In most of the municipalities covered in this research tertiary education levels are extremely low – in many instances less than 2.5% of the population older than 18 have any form of post-Matric qualification, and those who do have suitable skills and/or experience have other opportunities than being a local councilor. A number of the people that we interviewed suggested that perhaps a minimum level of qualification needed to be introduced as a basic selection criterion for being a councilor. However, in communities where most people do not have such qualifications, this approach would, in our opinion, represent a poor tradeoff between technical competence of councilors and democratic representation.

1.3.2. Governance and Oversight

In almost every single municipality that we visited as part of this research we found serious or very serious problems with governance and oversight, across a wide range of functional areas and institutional structures. These identified issues provide a very good example of the gap between what is regulated and what is actually happening in local government, and the difficulties of bridging this gap. In most cases, the oversight structures are failing to provide the anticipated outcomes, and in certain instances are, in our opinion, even contributing to a deterioration in the quality of governance and oversight. In some instances this is because important components of the oversight structure are missing, but more often all the pieces are in place, but are failing to deliver what was expected, mostly because of the practical implications of how they are implemented.

Regulation with regard to oversight has tended to focus on the establishment of compulsory **institutions** (such as an Audit Committee), rather than the details of the processes by which particular outcomes are to be achieved. The regulatory – implementation gap (which in many cases is enormous) is, in our opinion, the result of a regulatory system that has made far too many assumptions about the ability of local government to effectively **implement** the legislation in a way that will achieve particular outcomes, no matter how comprehensive that legislation is. It was also clear to us that the "one size fits all" regulatory approach towards governance and oversight is failing: It is simply not possible for smaller and poorer municipalities to comply with the same regulations as larger, richer municipalities. The end result of attempting to enforce such a system is, in our opinion, most likely to be a further breakdown in oversight, as municipalities focus on "institutional compliance" (such as having a SCM policy or an Audit Committee) rather than "outcome compliance" (i.e. policies achieve the desired outcome). While it may certainly be possible for a large metro to design and implement an appropriate performance management system based on the regulatory requirement to have such a system, for example, this is definitely not the case in smaller, poorer municipalities, and many simply abandon trying to make the effort.

Our findings suggest that many of these oversight regulations either need to be re-visited and/or that Treasury, COGTA, the AG and SALGA need to take a more pro-active stance in managing how these regulations are actually implemented. They need to stop assuming that poorly capacitated and resourced municipalities will somehow automatically implement suitable and workable solutions.

In terms of oversight and compliance, the main problem areas that we identified are the following:

- Policy Implementation
- Municipal Public Accounts Committees (MPAC)
- The Audit Committee
- Internal Audit

1.3.2.1. Policy Implementation

In terms of prevailing legislation, even the smallest municipality is required to have an enormous number of policies in place, dealing with everything from municipal borrowing to the use of cellular telephones. These need to be reviewed and updated each year. These policies are intended to improve the control environment within municipalities, and thus contribute to improved oversight, accountability and the allocation of municipal resources. However, our research indicated that this is seldom the impact that is achieved, for at least the following reasons:

(i) Municipalities – especially smaller entities – allocate considerable resources and time to the annual review and update of policies. Limited capacity usually results in not enough time being allocated to each review (with a corresponding likely negative impact on the quality of the content), and in practice they are simply approved as presented to Council. There is thus very little benefit in terms of the "local customisation" of policies that this approach envisaged.

(ii) The focus is many municipalities is on ticking the compliance box in terms of ***having*** the policy, rather than effectively implementing it (or implementing it at all). Once again, this is often a resource issue: implementing a telephone usage policy, for example, requires skills in setting up a workable process and control system, and then monitoring actual activity against these controls. Most of the municipalities that we visited as part of this study do not have the capacity to accomplish this: in fact, many of them would not know where to start to do so.

This is an excellent example where compliance with legislation – in this case the requirement to have operational control and risk management policies – is not making much contribution to a better control environment, but diverting considerable resources in the process.

1.3.2.2. MPAC

The Municipal Public Accounts Committee (MPAC) is established in terms of Section 79 of the Municipal Systems Act, to give effect to the various oversight responsibilities of Councils, in terms of the MFMA, the Local Government Municipal Structures Act and related legislation. The overriding rationale for the establishment of MPACs was to improve oversight in local government; and it was envisaged that they would "undertake and manage similar functions and responsibilities for municipalities, as undertaken by the Standing Committee on Public Accounts in the national and provincial legislatures" (National Treasury, 2011).

According to Treasury, the primary functions of MPACs are as follows:

(i) To consider and evaluate the content of the annual report and to make recommendations to Council when adopting an oversight report on the annual report;

(ii) In order to assist with the conclusion of matters that may not be finalized, information relating to past recommendations made on the Annual Report is also reviewed. This relates to current in-year reports, including the quarterly, mid-year and annual reports;

(iii) To examine the financial statements and audit reports of the municipality and municipal entities, and in doing so, the committee must consider improvements from previous statements and reports and must evaluate the extent to which the Audit Committee's and the Auditor General's recommendations have been implemented;

(iv) To promote good governance, transparency and accountability on the use of municipal resources;

(v) To recommend or undertake any investigation in its area of responsibility, after reviewing any investigation report already undertaken by the municipality or the Audit Committee; and

(vi) To perform any other functions assigned to it through a resolution of council within its area of responsibility.

Our research indicated that, in almost every single municipality included in this study, the MPAC is failing dismally to make any contribution at all to an improved oversight function. In fact, an MPAC may even be contributing to a *deterioration* of the oversight environment by creating the false impression that having an MPAC is somehow a solution of sorts to a poor risk control environment, and thus giving Councils the idea that they are effectively managing oversight when they are in fact doing no such thing.

The main problems with the implementation and operation of MPACs that our research identified are the following:

(i) A very poor understanding of what it is that MPAC is supposed to be doing: Most of the people that we interviewed (whether municipal officials or members of MPAC) had little to no idea of exactly what it is that an MPAC is supposed to **do** on a day-to-day basis, beyond some vague idea about "oversight". As a result, MPACs seem to vary widely in what they actually do: In some municipalities MPAC is involved in a tangential way in the compilation of the municipality's annual report; in some they "review" reports by the Audit Committee; and in one instance the MPAC has as its current main activity the review of the efficacy of the municipality's physical access and security system. In general, members of the MPAC themselves appear to have very little idea of what they are supposed to be responsible for. Municipal officials are generally of the opinion that their MPAC is a completely ineffective structure, and in most cases make no effort to engage with the committee beyond some kind of presentation of the municipality's annual report. Those officials that did engage with (or attempt to engage with) their MPAC on what they (the officials) believed were important oversight issues found it to be a very frustrating experience.

A common perception among official is that if the municipality has a well-functioning Audit Committee, then what should the MPAC be doing? Conversely, if the municipality does not have a well-functioning Audit Committee, the MPAC is not able to fill that oversight gap. The Audit Committee members that we were able to interview seconded this view that the MPACs in general served no oversight function whatsoever (although none of them expressed the view that MPAC somehow was intended to "duplicate" the functions of the Audit Committee).

(ii) Generally low levels of requisite relevant skills and experience among MPAC members. As discussed above, in most of the municipalities included in this research – particularly the smaller ones – very few councilors have any financial analysis and/or financial management skills or experience. Many MPAC members are unable to critically assess the details of financial statements, or the municipality's management letter, or indeed the annual performance report (although non-financial reporting was not part of the brief of this research). Our interviews showed very clearly that most councilors did not really understand the technical reasons why their municipality received a poor audit outcome. In some cases, MPAC members indicated that they had been expecting a clean audit, when the actual outcome was a disclaimer. Such a wide gap between the expected and actual outcomes suggests to us that MPAC members have very little grasp of the actual state of financial management in their municipalities. As a result, they are not only very poorly equipped to be able to deliver what is required from an MPAC member, but may also be undermining the level of municipal oversight because they are unable to assess the veracity or accuracy of what is reported to them by officials. As more than one person put it to us: "if you have on one side of the table a person who doesn't even have a Matric, and on the other side of the table you have a person who has got a degree in accounting, who do you think is going to win that debate?"

The National Treasury Guidelines on the establishment and operation of MPACs state that "the Council must ensure that the MPAC is supported by officials to coordinate and undertake research activities as required by the committee work programme." In reality, most of the municipalities included in our study could not afford to provide the MPAC with this kind of comprehensive support. Sometimes a junior official has been made available on a part-time basis to assist with "research" for the MPAC, but this arrangement usually does not provide the MPAC with any meaningful support.

(iii) No accountability structure for MPACs: Although it is our belief that factors (i) and (ii) outlined above are the main reasons for the low level of MPAC functionality, we cannot ignore the contribution made by the lack of accountability of MPAC members for how the Committee functions. Unlike officials, or even members of the Audit Committee, there are no performance implications for members of MPAC, who are all councilors. That is, no matter how ineffective the performance of MPAC, there are no direct repercussions for the Councilors who are on the Committee. We believe that this is an important factor undermining oversight in local government: the lack of direct incentives to enforce the performance of a key component of the oversight structure. In one of the municipalities that we visited, the Chair of the MPAC (who had been in that position for just over three years) did not know what the 2013/2014 audit outcome of the municipality was. This omission does not, in our opinion, reflect a lack of skills or a lack of knowledge about MPAC's role, but rather a complete lack of interest in the financial state of the municipality.

1.3.2.3. The Audit Committee

A municipality's Audit Committee should play a central role in overseeing the design and implementation of the municipality's audit action plan, as well as preparation for the annual audit and the audit process itself. The Audit Committee also has an important role to play in the general oversight structure of a municiplaity, through its relationship with the internal audit function (see below for more details on the internal audit function.) However, our research indicated that, although all the interviewed municipalities **had** an Audit Committee of some sort, the actual **impact** of this varied to an enormous extent: In some municipalities the Audit Committee is playing an important and proactive role in improving not just the audit outcome, but the entire oversight and risk management environment. In others, the Audit Committee has so little impact it may as well not be present. Most of the municipalities fell somewhere in between, with a bias towards the "little impact" position. The AG's reports tend to focus on whether or not the municipality has a properly constituted Audit Committee and how often it meets, rather than on its impact, or the underlying factors that influence this.

The Audit Committee in most cases takes responsibility for overseeing the audit action plan – the municipality's response to its audit report – as well as audit preparation. There is little doubt in our opinion that the more involved the Audit Committee is in this process (such as active involvement in drafting the audit action plan and regular meetings with officials around progress) the more likely it is that the audit outcome will improve. The Audit Committee can (should) provide an additional layer of skills and experience in designing and implementing the audit action plan, and fulfill an important oversight role in this regard, as well as assisting the municipality in preparing for the audit. However, the level of involvement of the Audit Committee differs enormously across municipalities: in some cases the Audit Committee was very involved, both in developing the plan and in overseeing its implementation. In others this process was being driven largely by the CFO and/or the MM, with minimal input from the Audit Committee. We also found different levels of reported involvement of the Audit Committee in the preparation of the audit: Ito be taking the lead, and that responsibility was placed on the CFO. Which of these scenarios develops appears to be influenced both by the approach of the particular Audit Committee itself (particularly the commitment of the Chair) as well as the "rules of interaction" that govern how Audit Committees in general operate in municipalities.

In our assessment, the main reasons why an Audit Committee fails to deliver as required are one or more of the following:

- Not a dedicated, locally-based entity. In most cases, a shared service Audit Committee appeared to be associated with a limited involvement in and impact of the Audit Committee on the municipality's audit outcome (or wider risk management environment). Shared service Audit Committees tended to have fewer meetings (for each individual municipality), and spent relatively little "face time" with officials dealing with the audit action plan. Officials generally expressed dissatisfaction with shared service Audit Committees, feeling that they were not able to use the Audit Committee effectively as an oversight and advisory resource. There was only one notable exception to this: Westonaria, whose audit committee serves the District and all four of the underlying municipalities. In our opinion this shared structure works in large part because of the planned amalgamation of the four municipalities into one Metro, planned for 2016, which gives impetus to a programme to raise all the municipal audits to the same standard. Access to skills in Gauteng (see below) may also be an issue that works in favour of this Audit Committee, which has an extremely capable Chair.

  Our research also suggested that many (but by no means all) better performing Audit Committees tended to be composed primarily of either local people, or those with strong ties to the community in question. Audit Committee members from the local community tended to have a better understanding of the history and context within which the municipality operates; to take a stronger personal interest in the performance of the municipality; and to have a stronger and more accessible relationship with both local officials and councilors.

- Inappropriate/inadequate skills. In certain instances not all the members of the Audit Committee had the requisite **municipal financial management and control** skills and experience (as opposed to general accounting or auditing skills and experience). In many cases this is simply the result of the municipality's remote location together with their limited resources. It is usually (although not always) the smaller and more remote municipalities that are most dependent on support from an Audit Committee to supplement their internal shortcomings, but that are least able to acquire or retain these skills.

- Insufficient opportunity for the Audit Committee to have a real impact on the Audit Outcomes. The Audit Committees that we assessed in the course of our research generally tend to meet 4 -6 times a year – four is the mandated minimum number of meetings in a year. The audit outcome and report for the municipalities is, however, usually only available in January or the end of December – almost six months after the year-end in question, and only about 8 months before the start of the next audit. The Audit Committee would usually meet in January (after the holiday period) to discuss the audit report and develop an audit action plan. However, at this point the municipality is already more than halfway through the next financial year. If the Audit Committee then meets 2 - 3 months later (as is usually the case) – in March or April – this is the first time that they will formally discuss progress on the audit action plan. At this point it is usually too late in the financial year to make a real impact on the audit outcome. When combined with the manner in which the Audit Committee communicates with Council (see below) the result is that the Audit Committee has only a limited window of opportunity to influence the audit outcome.

There are some Audit Committees that meet monthly in the period from February to July, in an attempt to be more involved in the implementation of the audit action plan, and this is undoubtedly a useful strategy, but our research indicated that this was the exception rather than the norm. Even in these cases, the impact of the Audit Committee may be undermined by a lack of support from Council, exacerbated by the practical details of communication within the municipality, as outlined below.

- Poor "location" of the Audit Committee in the municipality. In this instance, what we mean by "location" is how the Audit Committee interacts with the various parts of the municipality, and most particularly, the way in which it is actually able to impact the audit outcome (and by implication, the wider control environment). This "location" is determined by a combination of how Audit Committees are regulated – which clearly specifies that they stand outside and independent of the Council and the day-to-day operations of the municipality - and how they operate in practice, which is determined by the Audit Committee itself and the senior officials and councilors.

  Audit Committee meetings are held separately from Council meetings: the Audit Committee may invite the Chair of MPAC to attend their meetings, on the understanding that he/she will then report back to Council. If, however, this person does not fully grasp all the technical issues discussed in the Audit Committee meetings and the implications thereof, that report back will be of limited usefulness to the Council. At the same time, and under "normal" circumstances, members of the Audit Committee do not automatically attend Council meetings (although they may be invited). The standard way in which the Audit Committee communicates with Council is through the minutes of its meetings, which are then included in the Council meeting packs (although this is not compulsory). In practice, this method of "communication" is seriously flawed: the minutes of each Audit Committee meeting are only approved at the next meeting (which may be three months later). Only then can they be submitted for inclusion into the pack for the next Council meeting. This Council meeting may be held only a month later, in which case there is an effective four month lag time between the Audit Committee discussing a potentially vital audit issue and the Council becoming aware of it. If the minutes of the Audit Committee meeting are not included in this pack, but held over for the next meeting (which does happen if the Council meeting agenda is judged to be full) then this period may be even longer. Clearly this does not facilitate a rapid response by Council to critical audit issues. This is a very important issue, since the Audit Committee itself has no means at its disposal to compel any municipal official to take any action in terms of the audit action plan. Only the Council can do this.

The underlying assumption seems to be that the MM and/or the CFO will take responsibility for reporting to Council on the progress/problems with the audit plan, based on their discussions with the Audit Committee. This, however, is not a good oversight outcome: these officials who are reporting on the audit plan are the same officials who are responsible for its implementation, and whose remuneration and/or job security often depends on perceptions of how well they have done this. Obviously this will impact on how they present progress on the action plan, and how they present (or even acknowledge) important problem areas. Without the impartial input and guidance of the Audit Committee it may be very difficult indeed for Council to determine what is actually going on with respect to the audit plan.

- Insufficient support to enforce Audit Committee recommendations by Council: Related to the issue of how the Council and the Audit Committee communicate with each other is that of how the Council responds to issues raised by the Audit Committee. As discussed above, the Audit Committee has no authority to discipline or to compel any official to take any action. This means that the Audit Committee may have helped to draft a very useful audit action plan and associated implementation plan, but it is then the (final) responsibility of the Council to ensure that this actually materializes. Our research indicated that most of the municipalities in the study drew up an annual audit action plan – this is mandated by regulation. But many of them don't progress much further than that. As one municipal official put it to us: “Every year there is an audit action plan, but then I don’t know what happens to it, maybe it gets filed somewhere.” If Council (or the MM) does not enforce implementation of the audit plan, and hold officials accountable against the progress reports of the Audit Committee, then even the best audit action plan is unlikely to have a meaningful impact on the next year’s audit outcome.

1.3.2.4. Internal Audit

The role of the Internal Audit unit is, in brief, to identify actual or potential areas of poor control in the municipality, and design and oversee the implementation of solutions. In theory, an effective Internal Audit function should play a central role not just in improving a municipality’s audit outcome, but also in developing “the organisation’s efficiency and effectiveness in risk management, internal control and corporate governance and performance management.” (National Treasury, 2009). That is, the Internal Audit unit should play a central role in improving the general efficiency and effectiveness of all municipal operations. Our research indicated clearly that many of the red zone municipalities have very poor internal control environments that would benefit enormously from a well-functioning internal audit function. As just one example, in some of the municipalities we found that even the most junior accounting staff have full access to all the financial statements, and are thus effectively able to make changes to these without any authorization.

Unfortunately, the reality of Internal Audit (compared to its envisioned role) in almost every municipality included in this study was very different. Although most of the Internal Audit staff that we interviewed were highly motivated, and generally had a fairly good understanding of the value that Internal Audit ***could*** add to their municipality, they were generally unable to make any kind of meaningful impact.

In our assessment, the main reasons for this state of affairs are the following, all of which are inter-linked:

- Poor understanding of the role of Internal Audit in the municipality
- Lack of capacity and skills within Internal Audit
- Lack of authority to implement recommendations
- Lack of external support

Almost every Internal Audit unit member that we interviewed indicated that they faced considerable resistance from the operational line departments. The latter often refuse to make documentation available to the Internal Audit unit, fail to cooperate in investigations and generally employ stalling tactics that make the job of Internal Audit very difficult. Most of the Internal Audit unit members (and many senior municipal officials such as the MM and/or CFO) believe that this is because of a **poor understanding of the role of Internal Audit**. Instead of seeing the Internal Audit unit as a value-adding entity, which can contribute to more effective and efficient operational performance and prevent problems related to a poor control environment, most municipal officials seem to be under the impression that the unit is some kind of "policeman", trying to "catch them out." This perception is probably exacerbated by the fact that much of Internal Audit's focus tends to be on issues around SCM – an area where municipal officials are particularly sensitive to any accusations of mismanagement and corruption. Of course we cannot ignore the possibility that certain senior managers may not be cooperating with the Internal Audit unit precisely because they are engaged in dubious and/or corrupt procurement activities. Whatever the underlying reasons, the result is that the Internal Audit units often get little or no cooperation from the line departments, and are thus greatly hampered in trying to do their work.

Most of the Internal Audit units that we encountered during the course of this study are both under-staffed and staffed by **relatively junior and/or inexperienced people**. It was not uncommon for us to find that the entire internal audit function comprised of one or two interns with very limited experience. This reflects a combination of a lack of municipal resources (they simply cannot afford to staff the unit with suitable people); a real lack of suitably skilled and qualified people in this area; and the fact that many senior municipal officials (outside of the finance function) are skeptical about the value of a well-staffed Internal Audit function.

The level of staff in the Internal Audit unit is important, since it appeared to us that the generally low job grades of the internal audit unit employees means that they are simply ignored by the senior line department managers, often for no reason other than that municipal "protocol" does not generally allow junior staff to demand performance from senior staff.

The **reporting lines** of the Internal Audit unit are, in our opinion, problematic from a practical efficiency point of view. Internal Audit reports to the Audit Committee – oversight of the Internal Audit function is a key responsibility of the Audit Committee.

In theory this seems the correct approach - to have a direct reporting line for the internal compliance function that bypasses senior management, in order to prevent interference by the latter. In the private sector, the corresponding reporting lines would be from the compliance function directly into the Board of Directors. However, in practice this is problematic, for several reasons. All of the issues (discussed above) that impact negatively on the efficacy of the Audit Committee then also impact on the efficacy of the internal audit function, since the latter reports to the former. Where the Audit Committee does not meet very often and does not have a close working relationship with municipal officials there will usually be a correspondingly remote and ineffective relationship with Internal Audit. This may cause (often substantial) delays in the ability of internal audit to bring potentially critical internal control issues to the attention of the Audit Committee. Further, once these issues have been brought to the attention of the Audit Committee it is likely that there will be a further delay in getting these to the attention of the Council, which has the authority to implement a remedial action (which authority the Audit Committee does not have.) Sometimes the MM takes responsibility for enforcing the implementation of the Internal Audit unit's recommendations, which may be a practical solution of sorts, by undermines the basic concept of the separation of functions and powers that supports an effective compliance system.

Our research indicated that there is little in the way of **external support** (i.e. from Treasury, COGTA, SALGA or other inter-governmental forums) for the Internal Audit function in local government. One of the Chief Directorates of the Office of the Accountant General (located in National Treasury) is the Internal Audit Support Unit. It would seem logical that this unit would be playing a key role in supporting the Internal Audit units across local government. However, none of the officials interviewed in this study who were specifically asked the question have ever had any interaction with any person from the Office of the Accountant General.

Some of the Internal Audit staff that we interviewed highlighted the fact that although there are dedicated monetary funds available for training of finance officials in local government, there are no similar dedicated funds available for that training of Internal Audit officials. In general, our research indicated that most Internal Audit staff feel very alone and unsupported, and are generally demoralized about their ability to make a meaningful impact in their municipality.

1.3.3. Basic Administration

Basic administration and record keeping is a key issue in determining audit outcomes, as highlighted repeatedly in the AG's audit reports and management letters. Poor administration and record keeping also undermine the efforts of consultants employed by the municipalities to assist in preparation for the audit: when the municipality's record keeping system is in chaos it is next to impossible for consultants to draft annual financial statements or compile accurate asset registers or complete any similar tasks as required. In these circumstances the municipality is effectively wasting the money spent on such consultants.

Poor administration and record keeping is not just an audit issue: it undermines the efficiency and effectiveness of almost every single municipal function and is a major obstacle to effective performance management and governance. As just one example, an effective Internal Audit function is supported to a considerable degree by an effective record keeping system, which can keep track of how controls are implemented.

In most of the municipalities that we visited some improvements to administration – particularly in the area of physical records security – had been introduced in the past twelve months, but the situation in most remains dire. When questioned as to the reasons for this, most officials focused on superficial issues, such as the fact that audit clerks remove documents and do not replace them correctly; the lack of a suitable strong room in which to store documents; and the inefficiency of municipal employees in regularly filing documents. Although these are all valid observations, they are not, in our opinion, the main reasons why this particular administrative environment (i.e. one in which these things are **able** to occur) is the norm. Our research suggests that the main reasons for poor administration are the following:

- Lack of appreciation of the value of basic administration
- Corruption
- Archaic legacy approach towards administration and document management
- Insufficient guidelines and support on implementing new systems

Although almost every audit report and management letter of every municipality included in this study highlighted basic administration and record keeping as a problem area, it does not seem to be an issue that is very high on the agenda of either Councilors or senior municipal officials, beyond the issue of the security of documents. Very few officials (or councilors) appear to make the link between organizational and operational efficiency and effective and appropriate **basic business processes**, which include the management of documentation. The issue of basic administration is often reduced to document filing, which is only one component thereof, albeit an important one.

We cannot ignore the role that corruption plays in contributing to problematic basic administration, particularly document management, and particularly with respect to supply chain management. One of the surest ways of making sure that questions are not asked about non-compliant procurement decisions is to have the file disappear. However, it is our assessment that the most usual causal link between poor administration and corruption runs from the former to the latter, and not the other way around. That is, it is most often the dismal state of basic administration that creates the ***opportunities*** for this kind of corruption, than that the poor state of administration is being driven by corruption. Improved administration will, in our opinion, reduce corruption, by reducing the opportunities to take advantage of chaotic systems.

Many municipalities have an old-fashioned and inefficient approach towards basic administration, which is not able to provide the efficient and effective operational platform that they require. For example, many municipalities base their document management systems on antiquated ideas of “archives management” (encouraged in very large part by the National Archives and Records Service of South Africa Act - 43 of 1996) instead of concepts of “information management”. Rigid work responsibilities and job descriptions are supporting this archaic approach: as one official described it to me – “You must remember that the job of the finance department is to do finance, it is not to do filing of documents. That is the job of the records officer.” In this picture of an organization, documentation of transactions is not an integral part of the finance process (as it should be), but something separate. It is this underlying conceptualization of operational process – as discrete organizational functions rather than as part of an inter-connected system - that we believe contributes to undermining operational efficiency (including audit outcomes) at local government.

Related to this lack of “systems thinking” is the separation of document management responsibilities across municipalities. Even where there is a records management official in place, different departments often maintain their own (usually completely unrelated in terms of indexing protocol) filing system. For example, in a fairly simple procurement process – as one example we used a broken window – multiple departments will be involved: the department requesting the new window, supply chain management who manages the procurement process; finance who receive the invoice and request and process payment; and stores, who receive the new window. Each of these departments is part of one process, but each will generate their own set of supporting documentation and very often each will file those documents according to their own indexing system – requisition number; invoice number; cheque number, etc. Each of these documents may also be filed in a different physical location – some find their way into the central record store, and some are kept by the relevant department. It is not hard to understand that attempting to put together a comprehensive paper trail for even the simplest transaction in this environment can be a labour-intensive and frustrating experience.

Another related problem area is the lack of digital records and back up storage. In one of the municipalities that we visited a fire had destroyed the document strong room and the main server. This represented all the municipality's records, as they had not digitised their documents, nor did they have an off-site data storage back up system.

Although the AG regularly highlights the issue of basic administration, municipalities receive very little in the way of **practical guidance** on how to improve things. There seems to be an assumption that municipalities will simply be able to address the issue on their own, and that their failure to do so is a failure of will, rather than of ability. Given the very real capacity constraints in most of the municipalities included in this study, and the usually dire state of basic administration, this seems an excessively optimistic assumption. Addressing the underlying cause of poor administration (rather than making cosmetic changes) requires a fundamental restructuring of the way in which municipalities operate, across all functions, not just finance. We do not believe that any of the municipalities that we interviewed in this study are in a position to undertake such an exercise unassisted. Additionally, many of them would not know where to start in commissioning outside expertise to assist them.

1.3.4. CAPACITY

Capacity – in terms of financial and human resources – is a serious constraining factor in all the municipalities that were included in this study. The main issues that we identified in this respect are the following:

- Inability to afford the necessary skills
- Inability to attract the necessary skills
- Poor management of consultants
- High turnover/low skills of senior staff
- Lack of financial resources to purchase support infrastructure

Over the past seven years the burden of financial management, performance reporting and regulatory compliance has increased significantly for local government (and this trend seems set to continue). This has, in turn increased the number of staff required to perform these tasks. Most of these activities require specialized skills, and particular experience. In addition, the Municipal Systems Amendment Act (2011) now stipulates the minimum qualification for a range of posts. Although the aim of this legislation is to raise the standard of municipal administration, in practice it is further contributing to competition for a limited pool of scarce skills that many smaller municipalities simply cannot afford.

The result of these pressures seems to be that **municipalities are allocating an ever-increasing share of their resources towards governance and administration**, which includes financial management and oversight. In many of the municipalities that we visited, staff in finance and related functions (including SCM) make up as much as 25% of all municipal employees, despite the fairly high level of vacancies in this area (i.e. calculated on the basis of filled posts, not budgeted posts). These findings reflect research undertaken by the Municipal Demarcation Board (MDB, 2012) which indicated that approximately 30% of employees in category B3 municipalities (the majority of the municipalities in our study) and about 40% of employees in category B4 municipalities (the second-largest group in our study) were employed in "Governance and Administration." In both categories this represented (by a considerable margin) the single largest category of employees in the municipality.

In terms of the percentage of municipal <u>expenditure</u> allocated to particular functions, the share of governance and administration is even greater: The MDB research suggested that expenditure on the entire governance and administration function makes up 36.3% of operating expenditure in B3 municipalities and a whopping 71.5% of operating expenditure in B4 Municipalities (MDB, 2012, p12). The difference between the share of staff and the share of operating expenditure is most likely related to the fact that many of the posts in governance and administration are the most highly paid in an average municipality, together with the increasing costs of administration systems (more on this below). As a result, the lion's share of municipal operating budgets are being directed towards administrative and oversight compliance, rather than the delivery of services.

Once again it is worth making the point that all municipalities carry much the same obligations in terms of financial administration and reporting (which includes both financial and non-financial information), no matter their level of resources. Over time this regulatory burden has increased, and is likely to increase further. In our assessment, many smaller municipalities, most of whom have an annual equitable share of less than R25 million and a very high percentage of indigent households (implying that their own revenue collection potential is severely limited) simply cannot afford to pay for the skills that they need to meet this regulatory burden.

Even where municipalities may be able to afford the requisite skills they may struggle to get people to take up positions, particularly where the municipal offices are located in a remote area. There is a general shortage of relevantly skilled and experienced financial management staff in local government, and thus little incentive for suitably qualified people to move to a small town in a remote location. A related – and currently contentious - issue is that of employing local people in local municipalities. In at least one of the municipalities included in this study, senior municipal officials indicated that they were unable to find local persons to fill skilled positions, such as senior financial management posts. However, the resulting employment of "outsiders" had contributed significantly to rising political tensions in the municipality, since the local community has a strong expectation that the municipality should employ local people, and thereby contribute to local employment. In situations of high local unemployment and low economic growth (the most common demographic position of the municipalities included in our study) the employment profile of the municipality (i.e. who works there) may be a critical factor undermining local political stability.

The result of low levels of skills and capacity in many municipalities is a high reliance on consultants. The use of consultants is not a negative issue *per se*, and in many smaller municipalities may actually make better financial sense than the permanent alternative in highly skilled functions where the cost of a full-time employee cannot be justified against the amount of work required. However, there appear to be a number of problems around the appointment and management of consultants (an issue also highlighted by the AG annual audit reports). In many instances consultants are appointed too late to make a meaningful impact on the audit outcome: the audit report (for the year ended 30 June) is usually only tabled in Council in January of the following year, and the process of procuring consultants to assist with the next audit usually only commences in February, or even later. The result is that consultants often only start working in April, less than 3 months before the next year-end, and less than six months before the commencement of the next audit. In municipalities with administration and record keeping in complete disarray (i.e. most of the red zone municipalities) this is not enough time for the consultants to be able to make a significant impact. (One positive trend that we observed in some municipalities with respect to the appointment and management of consultants is that there seems to be a general move towards placing consultants on longer (multi-year) contracts, which is likely, in our opinion, to contribute to better outcomes.)

Unfortunately, low levels of skills and human resource constraints within a municipality often imply that there is likely to be limited capacity to effectively manage consultants, from the initial setting of the terms of reference, to ongoing performance management. To make things even more cumbersome, many of the consultants are appointed by COGTA or by National Treasury or by the Province or by the District, but it is then not clear who is actually responsible for their daily performance management. In one of the municipalities that we visited, the District had appointed consultants to assist the municipality with the compilation of the annual financials. When the CFO of the municipality attempted to engage these consultants on the quality of their work, he was told that “we do not report to you, we report to the District.” In this instance the District took no action to rectify the situation.

When consultants have been used to fill oversight positions (such as internal audit) the situation becomes particularly problematic, since it is not clear how a paid consultant should be managed by the same officials that consultant has been appointed to exercise oversight over. In addition, how effective is the oversight exercised by someone who is dependent on the same official to approve his/her invoice at the end of the month?

Our research indicated a **high level of turnover of senior staff** central to the audit outcome, particularly at the CFO level. A significant number of the CFOs interviewed during the course of this research had been in their positions for less than two years, and a number of them were in an “acting” capacity. The high turnover of staff in senior positions is detrimental to organizational stability and continuity, and makes the design and implementation of long-term strategies to address the underlying causes of poor audit outcomes very difficult. High staff turnover may also contribute to an environment where poor organizational outcomes can always be blamed on a predecessor, which undermines accountability.

Related to this issue is the number of unsuitably qualified and/or acting persons in key senior positions, such as the MM or CFO roles. When these positions are occupied by junior, inexperienced staff it is much more likely that serious administration/financial management problems will be found. The number of staff working in senior positions in an acting capacity is cause for concern: The “acting” status – particularly where it has continued for six months or longer - contributes, in our opinion, to a high level of uncertainty within a finance department, and an undermining of the CFO position vis-à-vis other officials, due to the lower job status associated with “acting” versus “permanent” posts. In this situation it is often very difficult for an acting CFO to exercise the authority and leadership required to make real changes to the municipality’s audit outcome.

The final capacity issue relates to the **shortage of financial resources required to purchase support infrastructure**. As the financial management environment becomes more complex and as municipal reporting and oversight obligations increase, so municipalities need to invest in updated management systems, which in turn require investments in upgraded ITC infrastructure. Many of the smaller municipalities are finding it difficult to afford yet another claim on their limited resources.

1.3.5. Inter-Governmental Support and Interventions

There are a number of public-sector entities that are involved in providing audit support to municipalities, including COGTA, National and Provincial Treasuries and SALGA. All of the municipalities included in this study require assistance – sometimes a great deal of assistance - but the way in which this support is currently being delivered is sometimes problematic.

NOTE: Our primary intention in this research was to assess where SALGA could support municipalities, as opposed to the ways in which other parts of government could provide support. However, in these discussions, the way in which support in general is being experienced by municipalities was often raised by officials themselves as an important factor, and thus we have included the main points in this report.

Our research identified the following issues in this regard:

- Poor coordination and replication of efforts
- Focus on "quick fixes" rather than addressing structural issues
- Support comes too late
- Lack of support in certain key areas

Many officials bemoaned the fact that "**everyone is trying to do the same thing at the same time**". This not only creates confusion, but is often counter-productive, since poorly capacitated municipalities are seldom in a good position effectively to oversee or coordinate these efforts themselves. The problem is often compounded by the fact that assistance almost always tends to focus on a "**quick fix**" to one surface issue (such as the compilation of an asset register). This has (at least) two potentially negative implications: Firstly, this piecemeal approach may disrupt existing strategies to improve the audit outcome, since management is now required to allocate some of their focus to where the additional assistance has been provided, even though this may not be the immediate priority. This is particularly problematic where two separate entities are attempting to provide support in the same area. The second (and, in our opinion, potentially much more damaging in the longer term) impact is that these constant last-minute efforts to effect quick fixes never really get to the structural reasons why they have occurred in the first place. As one CFO put it, this kind of help isn't solving any of the underlying problems; in fact it just defers the municipality having to attend to them.

Related to this is the common situation where **support tends to come too late in the audit process to make a real difference** – typically after March in a particular year, which is only a few months before the year end and the commencement of the audit. This support seldom makes the desired impact, as is highlighted repeatedly in the AG's reports. This is a serious issue: it represents a significant expenditure of public funds for not much in the way of real benefit. Our assessment is that the lateness of support is often a reflection of how this support is conceived and structured: as a short-term response to the most pressing immediate issues highlighted in the latest audit report – things like the asset register, and the compilation of the annual financial statements.

Our final (and related) finding in this regard is the apparently paradoxical situation where there is duplication of efforts in certain areas (such as the compilation of the annual financial statements or the finalisation of asset registers), but little or no support in other critical areas such as basic administration. Our assessment is that external support is very skewed towards surface issues or the "symptoms" of underlying organizational issues and thus on "quick fixes" rather than long-term strategies to fundamentally restructure the way in which local municipalities operate. The problem, of course, is that if these underlying, structural issues are not addressed, then it is very difficult for these "drop in" initiatives to succeed. Once again, our assessment of why this situation has arisen is the (optimistic, but practically erroneous) assumption that municipalities themselves are able to structure and organize themselves in an optimum way, and that their failure to do so is a function of leadership, rather than real capacity challenges.

1.3.6. AUDIT-SPECIFIC ISSUES

Our research highlighted a number of issues around the audit process itself. Some of these (such as the verification of assets) impact directly on the audit outcomes. Others may not **directly** impact on a municipality's particular audit outcome (such as the audit process and the cost of the audit), but are considered important enough to the integrity or sustainability of the audit process that we believe that they need to be highlighted. The issues that were found most often across all the municipalities in this study were the following:

- Valuation and recordal of assets
- The audit process
- The cost of audits

The **valuation and recordal of assets** was either the most important or one of the most important reasons for a poor audit outcome in almost all of the municipalities included in this study. In summary, the key problem areas with respect to assets appear to be the following:

- Disputes over the ownership of assets: In many cases there are disputes over whether or not particular assets are actually "owned" by the municipality (and thus need to be included in the asset register), or not. This refers generally to land and/or buildings, sometimes in cases where another government department has built RDP houses on municipal land; sometimes in cases where land has been sold, but deed registries have not been updated; and sometimes in cases where the municipality is technically the owner of the land, but is no longer able to exercise effective control over it, such as where the land has been invaded. Current policies and regulations around the compilation of asset registers do not take account of these realities of local government.

- The verification of assets. This is another example where regulations do not always take account of the realities of local government. The rules governing the manner in which the location of assets must be verified are fairly rigid, and there appear to be many problems around the way in which this is done by municipalities (or in fact whether it can be done) and how this is then assessed by the auditors. This is a common cause of audit qualifications or disclaimers.

Related to the asset verification and recording issue is the importance of dynamic asset ***management systems,*** rather than static asset registers in building more efficient operational regimes in local government. This refers to how municipalities manage (and thus record) assets in a dynamic way, versus the AG's requirement for a static asset register, as at the 30th of June. For example, a truck may be recorded on the 30 June asset register, but by the time the AG comes to do the audit in October that truck has been in an accident and is at the panel beater, but there is no record of that. If the municipality does not have a well-managed and dynamic asset management system in place there will almost inevitably be inexplicable discrepancies between the year-end asset register and the actual situation when the audit is undertaken. Dynamic asset management systems would not only facilitate more accurate asset registers, but also contribute to improved asset maintenance, budgeting and planning. However, most of the municipalities that were included in this survey do not have the internal capacity or the financial resources effectively to implement such systems.

In both these instances the respective regulations around the treatment of assets in the AFS have been issued by the Office of the Accountant General, but in none of the municipalities included in this study have any of the senior financial management staff had any interaction with that Office around the practicalities of implementing these regulations. The danger, of course, is that if municipalities begin to believe that compliance with regulation is "impossible", they will simply begin to disregard that regulation.

In terms of the way in which **the audit process** itself unfolds, the most commonly cited problem area was that of the skills and experience of certain of the auditors. With respect to the audits undertaken by the AG's office (the most common situation), interviewees were agreed that the level of skills and experience of senior AG audit staff are generally very high. However, most respondents raised issues about the quality of junior audit staff. It appears that a significant percentage of the junior staff consists of students and/or interns. Reportedly, many of these have limited experience and often struggle in the difficult (often chaotic) environment of the red zone municipalities, where they are often attempting to "tick the regulatory box" to the audit. The experience of the auditors is not just important for the accuracy of the final audit outcome, but also because the analysis contained in the management letter is a central document guiding the municipality's audit action plan. Therefore, the quality and usefulness of the audit action plan is determined to a great extent by the quality of analysis of audit issues contained in the management letter.

A related issue reported by several municipalities is that junior auditors often take study leave in October and November, which is exactly when the work pressure in the audit process is the highest.

One of the municipalities interviewed had been assigned an “external” (i.e. private sector) auditor by the AG’s office, and in their assessment the audit services provided by this company had been woefully inadequate, in all respects. In the opinion of all the senior officials and the Chair of the Audit Committee, these auditors had very little understanding of the local government audit environment, and performed dismally. Most concerning, the municipality in question was not able effectively to object to their resulting audit outcome, or to ameliorate this situation.

The **cost of the audit** was an issue for many of the smaller municipalities. In certain cases, the cost of the audit could be as much as 7 – 8 per cent of the total annual equitable share of the municipality. This represents an enormous financial obligation for a municipality with limited resources and a high incidence of poverty and indigent households. There is a programme within Treasury that is designed to provide financial support to smaller municipalities in respect of their audit fees, through an effective subsidy of that portion of the fee that is in excess of one percent of the municipal budget. Some of our research suggests, however, that there are quite a lot of administrative obstacles to actually accessing this funding, and that Treasury does not go out of its way to ensure that qualifying municipalities are easily able to access this funding.

(Although we did not specifically investigate this issue, several of the persons interviewed raised the question of the cost of municipal audit against the costs of a similarly-sized audit in the private sector, with the implication that the latter would be significantly cheaper than the former.)

PART TWO
CONCLUSIONS AND RECOMMENDATIONS

2.1 INTRODUCTION

In this section we have presented our main conclusions and recommendations for how the issues raised in Part One of this report could be addressed. The original scope of work for this study emphasized the role of SALGA in directly assisting municipalities to improve their audit outcomes, and this has been our focus in the individual municipal reports contained in Part Two. But during the course of our fieldwork, and as is made clear in Part One, it became apparent that there are a number of factors that are critical both to audit outcomes (and thus to changing these outcomes) and the overall financial management/control environment that do not form a **direct** part of actions that SALGA is mandated to undertake in respect of local government. Just one example is our (generally poor) assessment of the incentive structure for local government councilors: directly taking action to change this incentive structure does not fall within SALGA's mandated activities in the same way as, for example, the training of MPAC members does.

However, we have not limited our recommendations section just to those areas where SALGA can play a direct role in designing and implementing a solution. The main rationale for this is our recognition of the important ***lobbying*** role that SALGA can play in bringing important issues to the attention of those entities who are mandated to deal directly with them.

2.2. KEY CONCLUSIONS

Based on the analysis presented in Part One above, we have summarized the main conclusions of our study as the following:

In terms of **leadership**:

- There appears to be a serious issue with (1) the level of financial and technical skills of councilors; (2) their prioritization of audit/financial risk issues; and (3) their acceptance of ultimate responsibility for both the audit outcome and overall control environment within the municipality.

In terms of **oversigh**t:

- Shared services oversight structures are generally undesirable.
- There needs to be a more robust interface between the Audit Committee and Council, and Audit Committees need operational “space” in which to impact financial controls and the audit outcome.
- Internal Audit needs dramatically better support, capacity building, a raised profile within local government and better structures to enable them to actually impact the control environment.
- MPACs are generally failing to deliver any kind of positive impact on audit outcomes (or oversight in general).
- Most municipalities are complying with the requirement to have policies, but few are effectively implementing them.

In terms of **basic administration**:

- Poor underlying business processes, controls and record keeping are a key reason for poor audit outcomes. These are also the main reasons for the rising share of administration costs in municipal budgets, to the detriment of other claims on expenditure (such as services, or unfunded mandates such as LED).
- We believe that poor administration (particularly document management) creates opportunities for corruption.
- Poor document management reflects a lack of “systems” thinking in municipalities.
- We believe that most of the municipalities that were included in this study are not in a position to undertake a forensic analysis and re-design of their business processes without significant external support.

In terms of **capacity**:

- Municipalities are struggling to meet the twin demands of rising regulatory compliance and service delivery demands in a tighter fiscal environment.
- Many smaller municipalities cannot (and probably never will) be able to afford to fully staff all their financial management/oversight/administrative posts with appropriately skilled staff.
- It is not always clear that regulatory authorities such as the Office of the Accountant General (OAG), Treasury and COGTA fully appreciate how difficult it is for municipalities to cope with the increasing regulatory burden and the simultaneous pressure to improve the quality of services.

Other important conclusions were as follows:

- Support and interventions by COGTA. Treasury, SALGA and other entities are generally poorly co-ordinated, implemented too late, and/or lack clarity in terms of reporting structures.
- Many municipalities are struggling to implement accounting/reporting/compliance standards that do not accurately reflect the reality of local government.
- Certain audit staff do not appear to have the requisite skills and experience of the local government financial environment.

2.3. RECOMMENDATIONS

2.3.1. INTRODUCTION

We have divided our recommendations into three main categories: Guiding principles; non-SALGA interventions, and SALGA-specific interventions.

(iv) Guiding Principles

In this section we have described what we have referred to as a series of "guiding principles": we have applied these to the development of our recommendations. However, we also believe that these may prove useful in guiding the development of public sector responses to the issue of sub-optimal performance in local government.

(v) Non-SALGA interventions

In this part of the report we have described interventions that we believe will make a positive impact, but which cannot be delivered directly by SALGA. In these instances, the role of SALGA would be to lobby the relevant government entities for change. An important point to make here is that we believe many of these interventions will contribute to increased efficiency across all local municipalities, and not just those included on the red zone list.

(vi) SALGA-specific interventions

In the final part of this section we have described interventions that fall directly under the mandate of SALGA.

2.3.2. Guiding Principles

Based on the findings of our research, we have proposed a number of guiding principles that could operate as a high-level framework for guiding the conceptualization of interventions to improve municipal performance and thus audit outcomes. We have adopted these guiding principles as the framework within which the detailed recommendations contained in sections 3.3.3. and 3.3.4. below were developed.

We have developed five guiding principles, as set out below:

A: Effective and robust institutions are more important than leadership

Each year, the AG's municipal audit reports emphasise the shortcomings of "leadership" (i.e. the political leadership together with senior officials) as a key factor contributing to poor audit outcomes. Although there is no doubt that skilled, experienced and committed persons can make a significant contribution to municipal performance, a focus on leadership as the most important factor in determining organizational performance is neither helpful nor accurate. Our assessment is that ***there is currently too great an emphasis on leadership to generate a particular operational outcome, rather than building institutions that are "leadership-proof"***, that is, which will survive intact even if there is a change in leadership in a particular municipality. Making leadership the key variable in effective municipal administration (which is the basis of New Public Management strategies) is, in our opinion, a high-risk strategy, and one that has certainly contributed to the current poor state of operational performance in local government.

Effective and robust institutions would also make it easier to identify the effect of poor leadership on municipal performance, and thus should make it easier to target remedial action. For example, an independent and strong internal audit function (as outlined below) will make it much more difficult for financial mismanagement to take place.

B: Focus on addressing structural issues, not surface symptoms

Our research indicated quite clearly that a substantial amount of resources and effort are being expended in short-term responses to addressing the symptoms of deeper structural issues, rather than addressing the latter. Until this approach is changed, government will continue to waste money, time and effort for very little return. ***It is important to emphasise our assessment that a focus on structural issues –***

particularly around basic processes – is required across all of local government, not just in the red zone municipalities. That is, we believe that there needs to be a concerted effort on improving the operational efficiency and effectiveness of all municipalities, rather than simply focusing on reducing the number of red zone municipalities: as outlined above, research by the MDB highlights the growing share of administration and governance in municipal expenditure. The only way in which additional resources can be made available for allocation to service delivery and other non-administrative line items is if the operational focus in all municipalities is more effective administration, and not just a better audit outcome (although, of course, more effective administration will support better audit outcomes). In our assessment, the latter is best considered a symptom, and the former a structural issue.

C: Shared Services add value in operations, not in oversight functions

We repeatedly found in our fieldwork that shared audit committees and internal audit functions under-performed dedicated units. The main reason for this was our assessment of the importance of both easy accessibility of the Audit Committee, and the value-add of a "local" membership. Although the main rationale for the shared service approach was a more effective use of resources, the poor outcomes imply that this is actually an ineffective use of resources. However, this finding does not imply that the shared services approach should be discarded as a solution for other identified challenges in local government, but rather that it should be used where it will add value. In our assessment that is through achieving economies of scale in operations, rather than undermining oversight by removing essential contact points. We believe that a shared service approach in certain targeted operational areas – as outlined below - could add considerable value to local government.

D: Regulation and reality must be better aligned

Our research documented many examples where regulations do not always take sufficient account of local realities, particularly in smaller and more remote municipalities. The inflexible insistence on the undifferentiated implementation of unworkable regulations will eventually undermine compliance and accountability by creating an environment where non-compliance becomes justifiable in the minds of many officials. We believe that policy makers need to take better account of (and responsibility for) the challenges of policy *implementation*, and work more closely with municipalities in developing practical ways of dealing with these.

E: Effective compliance is based on separation of powers and independent reporting lines

There is little doubt that the current oversight/compliance structure is failing in many critical respects, as documented in Part One above. In our assessment, one of the main reasons for this is the **overarching** oversight environment within which the various structures/entities operate. Most particularly, there are no really effective and independent reporting structures in place to timeously implement and monitor the recommendations of entities such as the internal audit unit. Without this additional layer of independent oversight the control environment will continue to be weak, and heavily dependent on the whims of the leadership of a municipality at a particular point in time.

2.3.3. NON-SALGA INTERVENTIONS

In this section we have outlined a number of interventions that we believe will contribute to improving the effectiveness and efficacy of municipal financial management (including audit outcomes), within the framework of our guiding principles. All of these interventions are beyond the scope of SALGA's direct mandate, and therefore their role would be to lobby for these interventions, rather than to implement them themselves.

Once again, it is important to emphasise that most of what we have recommended in this section will benefit the efficiency of all municipalities, not just those currently classified as "red zone". Many of these interventions are long-term in nature: we believe that this is a much more useful and resource-efficient approach than attempting to apply a costly (and usually ineffective) band aid during each annual audit period. Focusing on addressing the underlying structural issues will, by default, improve municipal audit outcomes, with significant additional benefits.

(i) Develop more shared services in operations

We do not believe that shared services in oversight (such as the Audit Committee or internal audit functions) add value, but we do believe that there are a number of areas (as outlined below) where a shared services approach can make a considerable difference to the efficiency and effectiveness of local government, by creating economies of scale. The areas where we believe this could be investigated include the following:

1. **Policy development**

   Many of the policies required in local government (such as motor vehicle usage, cell phone usage) could very easily be generic, including the annual updates. Municipal officials waste a lot of time on this function, which could be saved if they had the option of simply downloading a generic policy (and annual updates) from, say, COGTA. This would allow municipalities to focus on the implementation of policies, at which point policy modifications actually required would become apparent (rather than the rote "customization" that currently seems to be the norm.)

2. **Financial Management Software**

   Access to shared software (via a cloud or similar arrangement) necessary for operations – such as accounting, asset management, reporting, etc.- would save smaller municipalities a great deal of money, both in terms of the actual software cost, as well as associated hardware, such as servers and IT staff. In addition, standardization of software in this regard would facilitate easier consolidated reporting across local government.

(ii) Create a new independent structure for the management of internal audit functions

There is little doubt in our minds that a higher profile, higher capacitated internal audit function across local government would contribute to a greatly improved overall control environment, benefiting much more than just the audit outcomes. However, we would recommend that this be approached via the creation of a new structure for the management/oversight of internal audit functions, rather than just raising job grades or staff numbers in this function (a necessary but not sufficient remedy in our assessment).

In order for internal audit to have a real **impact** on municipal operations it must have real **authority**, both to investigate and to monitor implementation of recommendations. To do this it must have autonomy from the normal Council structures, and municipal leadership. As discussed above, we do not believe that this is achieved in the current arrangement, where internal audit reports to the Audit Committee, since the Audit Committee has very limited authority itself to ensure the implementation of internal audit recommendations.

We therefore recommend that a new oversight structure be implemented, similar to those arrangements in the private sector where a compliance officer reports directly to the Board of Directors:

- The national position of Chief Compliance Officer is established, located in national government.
- Provincial Compliance Officers are appointed for each province, and these report to the Chief Compliance Officer.
- Internal audit units in local government report to their respective Provincial Officers, with a right of escalation to the Chief Compliance Officer if they believe that the Provincial Officer has not addressed the issue at hand.
- Provincial Officers can issues compliance directives directly to municipalities, where the municipality has failed to comply with the request and/or recommendation of their internal audit unit.
- Compliance with directives from the Chief Compliance Officer is linked to some kind

of effective sanction for non-compliant municipalities.

(iii) Abolish the MPAC

In our assessment MPAC adds next to no value to the municipal oversight structure, and probably undermines oversight by giving the impression that something is being done. In most cases, MPAC represents a waste of Councilors' and officials' time. We do not believe that the skills gap between what is required of MPAC members and the actual situation can realistically be addressed. In our opinion, the restructuring of the internal audit function (as outline above) and the strengthening of the Audit Committee (as set out below) would be a much more effective way of improving municipal oversight.

An effective Audit Committee (see below) and internal audit function (see above) will make effectively make MPAC redundant.

(iv) Increase the role and profile of the Audit Committee

Audit Committees (if well constituted and dedicated to a particular municipality) can add considerable value to local government. However, their ability to do so depends to a large extent on their being able to make more timeous decisions and to having better access to Council. We would recommend the following with respect to the operation of Audit Committees:

- Audit Committees to meet a **minimum** of 8 (eight) times a year. Members who attend fewer than 7 meetings a year should be replaced.
- Compulsory attendance at the Audit Committee meetings for the MMC for Finance
- A member of the Audit Committee to attend each and every Council meeting. Preferably this should be the Chair of the Audit Committee.
- Oral report-back from the Audit Committee (in addition to a report in the Council pack) to be a compulsory at every regular Council meeting.
- Compliance with these to be included in the internal audit reports, as well as the annual external audit report.

(**v) Embark on a long-term operational restructuring programme**

A priority across government should be the fundamental restructuring of the operations of municipalities to increase efficiency and effectiveness. This would best be approached from the starting point of a detailed business process analysis and re-design initiative. One of the main purposes of engaging in a business process design exercise is to ensure that what every person does every day in the municipality is directly and appropriately linked to the municipality's strategic plan in an aligned manner, from desired strategic outcomes, through linked and relevant outputs, down to the details of activities and individual tasks. Thus, detailed process design forms an integral part of a more effective continuum between planning, implementation and project management.

What is currently considered as "process" in regulation is often at too high a level to function as effective **business process**. For example, SCM regulations require the establishment and function of adjudication and evaluation committees, but there is no detailed guidance on exactly how these should function, at a task level. This operational gap between regulation and work is what is filled by business process.

Good process design requires firstly that tasks within each process (such as, for example, the process – procurement of goods) are described in as much detail as possible, in discrete tasks that must be undertaken. In addition, the following needs to be included with each task:

- Responsible person: who is responsible for this task
- Back up person: Who is responsible when the responsible person is away/ill/resigns, etc.
- Time standard. This can be set in terms of start and completion times, or maximum duration of the activity.
- Measurement: This is what will be used to determine whether or not the task has been completed, such as a signed document, proof of payment, etc.
- Control: This is the control that determines whether or not the task has been completed, such as the senior manager signs the bank reconciliation, or reconciles the traffic fines books.

This is clearly a much more detailed output than the corresponding regulation, and thus a much better guide for day-to-day operations.

An integral part of a good process design is the incorporation of key performance indicators (accountability, timing and documentation) and compliance indicators (controls). Regular reporting on these will provide detailed information to management on how actual performance is developing compared to planned performance, and thus provide a very useful early warning system. Therefore, a comprehensive process re-engineering exercise will also provide the foundation for a more effective performance reporting structure in local government.

(vi) Review reporting from local government

A common compliant that we heard was that municipal officials spend a great deal of time compiling different reports (often containing very similar information) for different parts of government. This reporting burden appears to be increasing, and it diverts officials from other essential tasks. Of course, this reporting needs to remain in place, but we believe that it can be done in a much more efficient and cost-effective way, by requiring municipalities to submit standardized set of basic data (rather than lengthy narrative reports) to a central data repository, from which the various entities (such as COGTA, Treasury, Province, etc) could draw reports in their own required formats.

Achieving such a reporting solution would require a significant investment, but we believe that the long-term benefits for local government would be considerable.

(vii) The Office of the Accountant General (OAG) to develop a closer direct working relationship with municipalities

Although the Provincial Treasuries are intended to be the local representatives of the OAG, we believe that significant benefits would accrue from a more direct relationship between the OAG and local municipalities. Given the various responsibilities that the OAG has with respect to municipal accounts and internal audit it is difficult to understand why they have no **direct and regular** interaction with local government. We would recommend that there are regular meetings (at least twice each year) between the OAG and each municipality (represented by the CFO, a representative of the Audit Committee and a representative of the internal audit unit) at which they can discuss practical responses to difficulties experienced with the implementation of accounting standards, such as the verification of assets. The OAG should be required to report back on these issues, and to recommend remedial action as necessary,

(viii) Conduct a review of audit costs and the municipal right of appeal

Our research raised a number of questions around the costs of audits, the ability of municipalities to pay for audits, and the ability of municipalities to appeal audit outcomes that they believe are incorrect. Each of these issues warrants remedial action. As a start, we would recommend the following:

- An investigation into audit costs, relative to what private-sector companies pay for similar audits.

- The maximum cost of the audit for a particular municipality should not exceed 1% of their operational budget for that year, and this cap should be automatic. That is, the current process whereby municipalities have to apply to Treasury for an offset should be abolished. Instead, the AG should levy the 1% fee on the municipality based on the relevant financial statements, and then the AG should be required to apply to Treasury for the balance, possibly in one annual tranche.
- We recommend the establishment of an appeal panel for dissatisfied municipalities, comprising relevantly experienced, but independent auditors to assess the complaints. The current situation – where municipalities are essentially relying on the AG to assess its own audit outputs – is not desirable.

(ix) Better co-ordination of interventions

Many municipalities raised the issue of poor coordination of interventions to assist municipalities with the compilation of annual financial statements and/or addressing audit issues. One coordination (and reporting) point for these interventions needs to be established, preferably at a provincial level, which would ensure proximity to the various local municipalities. The lead coordinator could be determined on a functional set of criteria, as the circumstances require.

In addition, all support strategies for municipalities should be jointly developed, with clearly demarcated areas of responsibility and reporting. These strategies should take careful note of existing municipal activities, including the appointment of consultants.

2.3.4. SALGA-SPECIFIC INTERVENTIONS

NOTE: Individual reports have been generated for each municipality participating in this study. These contain targeted recommendations, focused specifically on addressing particular audit issues in that municipality. One of the key roles of SALGA will be to assist these municipalities in implementing these recommendations. However, these detailed recommendations have not been reproduced in this part of the report. Instead we have here dealt with recommended interventions that SALGA can make at a higher, more comprehensive level.

Clearly, the most important role for SALGA is to lobby for the interventions outlined in 2.3.3. above, and to monitor their progress, since it is through these interventions that real and sustainable change will be made. However, there are a number of other interventions that SALGA could consider, as set out below, which would support municipalities in building more effective operational structures. Once again, we believe that these interventions will benefit all municipalities, and so should not be confined just to those on the red zone list. The interventions listed below are proposed as **new** interventions – i.e. in addition to the services that SALGA already offers (such as training) which have not been repeated here.

(i) Develop a graduate work experience programme

Lack of relevant skills in (particularly) smaller and more remote municipalities is an important constraint. Lack of capacity also means that basic tasks such as document filing and verification of assets is either neglected or outsourced to consultants. At the same time, there is a pool of appropriately skilled graduates in South Africa (in accounting, economics, business management, etc) who struggle to find employment because of a lack of work experience. We believe that the establishment of a local government graduate work experience programme – managed by SALGA - could address both issues.

Such a programme would see graduates deployed to municipalities for period of between 3 and 12 months, to supplement capacity in particular and targeted areas (in order for such a programme to work, careful planning is required, to prevent a situation where graduates fail either to make a meaningful contribution to the municipality, or to gain valuable and relevant work experience). Areas where graduates could be utilized include:

- Asset management
- Process documentation

- Reporting/performance management

They would be compensated for living expenses plus paid a small salary. They would report directly to municipal officials and indirectly to SALGA, and be issued with a work experience certificate at the end of their work period.

(ii) Institute shared learning programmes

Local municipalities should be given more opportunities to learn from each other, and a formal programme in this regard would, in our opinion, add considerable value. Although there is some geographically-determined interaction between municipalities in the same District (or sometimes province) better shared learning could be facilitated by regular interaction between municipalities who are geographically remote, but similar in terms of size, structure or challenges. In addition, current interactions tend to focus on senior officials, and meetings in independent locations, rather than work experience visits by more junior officials.

An effective shared learning programme needs to facilitate experiential learning by a wider range of officials, not just MMs of CFOs. There is, for example, a great deal of benefit that could be derived by exchange visits of more junior staff in finance, SCM or internal audit to each other's place of work. This would allow more junior staff in poorly performing municipalities to experience first-hand how operations are managed in better performing municipalities, and to build up networks of colleagues who can act as an important problem-solving resource.

(iii) Implement a skills development programme with the private sector

We believe that many municipal employees would benefit from a capacity development programme that involves the private sector. Once again, this should best be focused on *operational* staff who can gain exposure to alternative ways of working. We would recommend that such a programme focus on practical work experience of between 3 and 5 days in a private-sector organisation, rather than just a presentation/quick visit. This will give municipal staff the opportunity to network with people in the organization, and gain first hand experience of effective administration and financial management environments. Such exchanges could, we believe, be particularly helpful for internal audit staff. In order for them to be effective, however, they need to be structured so that these staff members are actually responsible for work outputs, rather than just being “office tourists”.