

Corporate & White Collar Investigations

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IN THIS ISSUE

Addressing unauthorised, irregular, fruitless and wasteful expenditure (UIFW) in municipalities

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Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

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The Auditor-General of South Africa (AGSA) was established by Chapter 9 of the Constitution of the Republic of South Africa, Act 108 of 1996 (Constitution) and it is one of the institutions designed to strengthen and protect the constitutional democracy of South Africa. The functions of the AGSA are described in section 188 of the Constitution wherein it is stated that:

"188. (1) The Auditor-General must audit and report on the accounts, financial statements and financial management of:

- (a) all national and provincial state departments and administrations;*
- (b) all municipalities; and*
- (c) any other institution or accounting entity required by national or provincial legislation to be audited by the Auditor-General."*

The Public Audit Act 25 of 2004 (PAA) gives effect to sections 188 and 189 of the Constitution by establishing and empowering the AGSA to conduct audits according to its constitutional mandate. Section 4 of the PAA states that:

"4. (1) The Auditor-General must audit and report on the accounts, financial statements and financial management of:

- (a) all national and provincial state departments and administrations;*
- (b) all constitutional institutions;*
- (c) the administration of Parliament and of each provincial legislature;*
- (d) all municipalities;*
- (e) all municipal entities; ...*



Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

CONTINUED

(2) The Auditor-General must audit and report on the consolidated financial statements of:

- (a) the national government as required by section 8 of the Public Finance Management Act [1 of 1999 (PFMA)];*
- (b) all provincial governments as required by section 19 of the Public Finance Management Act; and*
- (c) a parent municipality and all municipal entities under its sole or effective control as required by section 122(2) of the Municipal Finance Management Act [56 of 2003 (MFMA)]."*

The AGSA produces annual audit reports on all government departments, public entities, municipalities and public institutions. In addition to the entity-specific reports, the audit outcomes are analysed in general reports which determine performance against the PFMA and MFMA cycles. The purpose of the reports is to demonstrate how the entities are performing against the allocated budgets and required deliverables.

Focus on local government audit outcomes for the 2021-22 Report

On 31 May 2023, the Auditor-General, Tsakani Maluleke, released the Consolidated General Report on Local Government Audit outcomes for the 2021-22 financial year (Report). This annual Report provides details of the financial state of local government institutions including municipalities and public entities. Only 38 out of the 257 municipalities in South Africa achieved clean audits. The Report highlighted a lack of requisite skills, accountability and consequence management, among other reasons, for the failure by municipalities to manage and use finances which are taxpayer funded for the intended purpose. The AGSA indicated that this was reflected clearly where councils did not deal effectively with unauthorised, irregular, and fruitless and wasteful expenditure (UIFW).

Unauthorised expenditure

Unauthorised expenditure is defined in section 1 of the MFMA as follows:

"Unauthorised expenditure', in relation to a municipality, means any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3), and includes:

- (a) overspending of the total amount appropriated in the municipality's approved budget;*
- (b) overspending of the total amount appropriated for a vote in the approved budget;*
- (c) expenditure from a vote unrelated to the department or functional area covered by the vote;*
- (d) expenditure of money appropriated for a specific purpose, otherwise than for that specific purpose;*
- (e) spending of an allocation referred to in paragraph (b), (c) or (d) of the definition of 'allocation' otherwise than in accordance with any conditions of the allocation; or*

Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

CONTINUED

(f) a grant by the municipality otherwise than in accordance with this act.”

The AGSA reported that at the 2021-22 financial year-end, the balance of unauthorised expenditure that had accumulated over many years and had not been dealt with totalled R107,38 billion. During the 2021-22 financial year, 68% of municipalities incurred a combined R25,47 billion in unauthorised expenditure. This is extremely disturbing when consideration is given to matters including infrastructure maintenance and community development that are underfunded.

Irregular expenditure

Irregular expenditure is defined in section 1 of the MFMA as follows:

“‘Irregular expenditure’, in relation to a municipality or municipal entity, means:

(a) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of this Act, and which has not been condoned in terms of section 170;

(b) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the Municipal Systems Act [32 of 2000], and which has not been condoned in terms of that Act;

(c) expenditure incurred by a municipality in contravention of, or that is not in accordance with, a requirement of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998); or

(d) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the supply chain management policy of the municipality or entity or any of the municipality’s by-laws giving effect to such policy, and which has not been condoned in terms of such policy or by-law, but excludes expenditure by a municipality which falls within the definition of ‘unauthorised expenditure’.”

According to the AGSA’s Report, at the 2021-22 financial year-end, the balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R136 billion. During the 2021-22 financial year, 24% of municipalities did not report all the irregular expenditure they should have in their financial statements. In some cases, the amount of the irregular expenditure reported was incorrect. Municipalities disclosed a total of R30,34 billion in irregular expenditure in 2021-22, significantly more than the R22,40 billion in the previous year. This indicates that there are serious financial management challenges in municipalities, which may be due to a lack of requisite skills or failure to plan adequately for projected expenditure.

Fruitless and wasteful expenditure

Fruitless and wasteful expenditure is defined in section 1 of the MFMA as *“expenditure that was made in vain and would have been avoided had reasonable care been exercised”*.

Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

CONTINUED

In terms of the AGSA's Report, at the 2021-22 financial year-end, the balance of fruitless and wasteful expenditure that had accumulated over many years and had not been dealt with totalled R14,65 billion. Fruitless and wasteful expenditure continued to increase in 2021-22, where it more than doubled from R2,15 billion to R4,74 billion.

Root causes of the financial problems in municipalities

The root causes of UIFW expenditure can be classified into three main areas: inadequate skills and capacity; governance failures; and lack of accountability and consequence management.

Inadequate skills and capacity

Municipalities are experiencing dire skills shortages in finance, IT, and technical departments which are in charge of infrastructure projects. Vacancies and instability in key positions such as those of municipal managers and chief financial officers are contributing to the limited improvement in audit outcomes and delays in dealing

with material irregularities and other transgressions. Municipalities have resorted to outsourcing key functions to consultants at a very high cost. Skills shortages result in poor financial management, projects taking longer than planned to be completed, ballooning project costs, and delayed and poor services to the rates and taxpayers, among other things.

Governance failures

A lack of established financial and performance management controls continues to leave municipalities inadequately prepared to operate optimally during times of change and instability. Uncertainty and disruption in councils, along with ineffectual municipal public accounts committees, limits the effectiveness of governance processes. Internal audit units and audit committees do not have the required impact, mostly because their recommendations are not implemented.

Lack of accountability and consequence management

Officials should be held accountable for their performance in order to create a culture that values excellence and supports continuous improvement. The AGSA's Report noted that limited to no action was taken against municipal officials and leadership for wrongdoing and poor performance. In particular, this can be seen where councils were unable to deal with unauthorised, irregular, and wasteful expenditure; and where municipal managers and senior management responded only minimally to the findings of the AGSA and to claims made by other parties of potential fraud, non-performance, and supply chain management system abuse.



Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

CONTINUED

Process to be followed when dealing with UIFW expenditure

UIFW investigations

The MFMA requires councils to objectively and diligently investigate UIFW expenditure. Neither councils (through their municipal public accounts committees) nor treasuries should write off or condone such expenditure without ensuring that no losses have been suffered or that any losses suffered cannot be recovered.

The AGSA's most common findings involved municipalities not investigating UIFW expenditure. This means that they did not take sufficient steps to recover, write off, approve, or condone such expenditure. In total, 53% of municipalities did not investigate the previous year's irregular expenditure, 47% failed to do so for fruitless and wasteful expenditure, and 47% did not do so for unauthorised expenditure.

As a result, the year-end balances of these types of unwanted expenditure continued to increase. At the 2021-22 year-end, the balance of irregular

expenditure that had accumulated over many years and had not been dealt with totalled R136 billion, while unauthorised expenditure stood at R107,38 billion, and fruitless and wasteful expenditure amounted to R14,65 billion.

According to the AGSA, municipal public accounts committees did not investigate identified instances of non-compliance as a matter of urgency to ensure that the irregular expenditure closing balance was dealt with in line with legislation, and that consequence management was swiftly implemented where appropriate. While councils have adopted resolutions to establish disciplinary boards to assist with investigations and disciplinary processes, these are not functioning as intended. The AG called on oversight structures to ensure that disciplinary boards are established and functional. In addition, municipal public accounts committees, with the assistance of internal audit units, must prioritise investigations into irregular expenditure.

Unauthorised expenditure

Section 32(2)(a)(ii) of the MFMA requires that unauthorised expenditure that resulted in a financial loss to the municipality or misuse of public resources be recovered from the liable official or political office-bearer unless the unauthorised expenditure has been certified as irrecoverable by the council after an investigation by a Council Committee. Councils must adhere to the stipulated process for all instances of unauthorised expenditure.

Irregular, fruitless, and wasteful expenditure

Section 32(2)(b) of the MFMA requires an investigation by a Council Committee before the Council can certify any irregular expenditure as irrecoverable. Writing-off is not a primary response, it is subordinate to the recovery processes, and may only take place if the irregular expenditure is certified by Council as irrecoverable.

Addressing unauthorised, irregular, fruitless and wasteful expenditure in municipalities

CONTINUED

How to address the identified problems

Professionalisation of the municipalities

Municipalities should be professionalised in line with the newly adopted National Framework towards the Professionalisation of the Public Sector. All vacant positions should be filled with competent and skilled people, continuous upskilling of municipal officials and council members, developing and implementing plans to reduce high reliance on consultants and to ensure skills transfer.

Governance

Municipalities should strengthen and institutionalise financial and performance management disciplines and information technology governance. It is also imperative that they continue to invest in preventative controls and focus on maintaining stable and well-functioning councils and municipal public accounts

committees. These bodies must provide effective oversight and monitoring. To derive full value from the expertise in internal audit units and audit committees, municipal managers should play a vital role in creating an environment where the roles of internal audit units and audit committees are effective, and their recommendations are implemented.

Accountability and consequences

Constant monitoring and evaluation enable early detection of financial and performance management failures and appropriate action can be taken immediately to remedy any failures. Municipalities should also improve the implementation of National Treasury's guidance on dealing with unauthorised, irregular, and fruitless and wasteful expenditure; and adopt National Treasury's Consequence Management and Accountability Framework. In addition to these measures, municipalities must also strengthen municipal public accounts committees, disciplinary boards, and investigation processes.

Conclusion

Municipality finance departments must employ competent and qualified people who have the skill to budget accurately and to implement effective financial controls to minimise UIFW expenditure. Oversight mechanisms must be deployed and monitored for effectiveness. Where there is failure to adhere to expenditure procedures, the relevant officials must be held accountable, and consequences must follow such actions. Municipalities should be encouraged to employ candidates who are affiliated to professional bodies as these provide for a code of conduct which guides members on how they should conduct themselves professionally and in the execution of their duties. Continuous professional development must be a requirement for all officials who are charged with managing public funding.

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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