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MEASURES TO MITIGATE AGAINST THE COST AND IMPACT OF FISCAL LEAKAGES ON THE ECONOMY AND THE DELIVERY OF SERVICES TO COMMUNITIES

KwaZulu-Natal has seen constant budget cuts implemented against the provincial budget over the past few years. The largest fiscal shock in this regard was in 2013/14 when the Census data was used to update the Provincial Equitable Share (PES) formula which saw a large amount of funding shifted away from the province. The second largest shock was through the fiscal consolidation budgets cuts implemented by National Treasury, with the 2021/22 MTEF showing some of the highest cuts the province had ever experienced

This has meant that the province has had to find innovative ways to ensure that each Rand goes an extra mile. In this regard, KwaZulu-Natal introduced cost-cutting measures in the province as early as 2009/10 – with National Treasury following in 2017/18, however, in some instances, the provincial cost-cutting measures were stricter than these, and the stricter measures were then kept intact. Provincial Treasury was mandated by the Provincial Executive Council to oversee the implementation of the cost-cutting measures. As a result, all events and international trips must first be submitted to Provincial Treasury who reviews all costs involved. This practice has resulted in event costs in the province being reduced significantly and any savings can then be redirected towards service delivery spending areas

KZN Provincial Government has established the Provincial Internal Audit Services (PIAS) as a shared services internal audit unit, for all provincial departments which plays a key role in identifying internal control weaknesses, providing control improvements to key business processes and also assisting with various risk assessments. The PIAS over the years conducted audits and/or consulting services in the following areas that are considered as a contributor to fiscal leakages:

- Staff Debt at the Department of Education (DOE)
- Leave management at DOE



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- Medico Legal claims at the Department of Health – this is from a risk management perspective, but has been covered in earlier slides
- Transfer Payments, including a performance audit, at the Department of Economic Development, Tourism and Environmental Affairs and Social Development
- Ethics/Ethical behavior/Ethics Risks – ethics, fraud and corruption risk assessments done at Departments in KZN

In line with government's drive for an ethical and capable state, Ethics, fraud and corruption risk assessments were conducted with the various key risks being identified and will be addressed through appropriate mitigating interventions

On 18 April 2022, following the severe weather events and the subsequent damage caused in various provinces, a national disaster was declared in terms section 27(1) of the Disaster Management Act, 2002 (Government Notice No. R2029 of 18 April 2022). To enhance the transparency of procurement and expenditure, Provincial Cabinet resolved on 18th April 2022 that Provincial Treasury must endeavour to provide effective support to organs of state to mitigate against procurement risks. In this regard all procurements of goods, services and infrastructure with a value in excess of **R1 million**, including all applicable taxes, shall be vetted by the Provincial Treasury prior to the award being made by the Departments/ Public Entities. The objective of the assessment is to detect non-compliance before the contract is concluded, thus preventing irregular expenditure; and provide guidance and assistance where necessary in order to enhance compliance with Supply Chain Management prescripts.

Irregular expenditure is a significant area of concern and whilst the condonement is undertaken by PT, our focus is to proactively address the underlying causes in terms of contract management, capacitating SCM units through various training programmes and providing resources as well as enforcing consequence management for employees who deliberately fail to conform with the required prescripts.

Provincial SCM team also monitors the upload of employee information onto the Central Suppliers Database by Municipalities and Public Entities in order to reducing irregular expenditure resulting from awards to employees of the state.

MEDICO-LEGAL COSTS are a major fiscal leakage for KZN (with a current balance of R26 billion rand Contingent liability) and in an attempt to reduce the budget pressure in this regard, the department has put together a comprehensive plan to synergise various units within the department to address these costs through the development of 7 Centres of Excellence - at the Queen Nandi Hospital supported by the



Ngwelezane Hospital, Greys Hospital supported by the PMB Assessment and Therapy Centre, King Edward VIII Hospital supported by the KZN Children's Hospital and the Phoenix Assessment and Therapy Centre. The intention is to use these Centres of Excellence to treat patients who have had medico-legal claims for the duration of their ailment/ lives so as to negate the necessity for the State to pay out large sums of money – the first test case is anticipated in October 2022 – if successful then precedent is set for future cases to be referred to the centres of excellence thus reducing lump sum payout cost. We are monitoring the impact of these interventions as it is still early days.

Turning now to municipalities...

The challenges facing the KwaZulu-Natal Municipalities are multifaceted and have been well articulated by the Minister of Finance. KwaZulu-Natal is largely a rural province with a large number of indigents resulting in many municipalities relying completely on the equitable share and conditional grants received by National Government. The political dynamics of the province further perpetuates the governance challenges highlighted in the Ministers address.

Provincial Treasury in line with its mandate, undertakes a detailed assessment of the financial management dynamics of each municipality in determining the appropriate support to be provided in each financial year. Given the capacity constraints, the Department has to focus its resources where the need is greatest, the impact is significant and the commitment of the municipal leadership is in place in order to ensure a sustainable intervention.

Budgeting

Effective financial management can help municipalities to transform their local areas into a better place to live and work by ensuring effective service delivery through the allocation of adequate resources. Proper budgeting is essential for effective financial management however; most municipalities still struggle in this area. One of the key elements of the budget process is ensuring that the budget is appropriately funded. Section 18 of the MFMA requires that the budget can only be funded by realistically anticipated revenue to be collected and cash-backed accumulated funds from previous years that are not committed for other purposes. Despite this, municipalities still table and approve unfunded budgets. Simply put, municipalities persist on budgeting for operating and capital expenditure in excess of realistically anticipated revenue to be collected and existing cash reserves that are not committed for other purposes.

It is for this reason that KZN Provincial Treasury provides extensive support to municipalities with regards to budgeting. KZN Provincial Treasury issues a number of circulars to assist municipalities with the preparation of their budgets to supplement the National Treasury budget circulars. These circulars are essential as they highlight areas of weaknesses and common errors noted by both the National and Provincial Treasuries in previous budget assessments with the intention for municipalities to address the



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weaknesses and errors, where applicable. The circulars also afford municipalities the opportunity to benchmark themselves against other municipalities in the province.

Extensive support is provided to all delegated municipalities during the budget process which includes onsite support and detailed evaluation of the Tabled Budgets. Bilateral engagements with municipalities are held during which detailed feedback is provided to municipalities on the Tabled Budgets. Municipalities with unfunded budgets are briefed on the causes of the unfunded budgets and actions that must be taken to improve the funding position of the municipalities' budgets. The findings on the Tabled Budgets are thereafter communicated to municipalities through formal feedback letters to all delegated municipalities which is required to be tabled in Council for consideration before the Final Budget is approved. In this way, the Council is made aware of Treasuries recommendations.

The extensive support provided by KZN Provincial Treasury has yielded positive results in the 2022/23 Budget process. Municipalities with funded Approved Budgets improved from 37 in the 2021/22 financial year to 46 in the 2022/23 financial year whilst municipalities with unfunded budgets have dropped from 16 in the 2021/22 financial year to only 8 in the 2022/23 financial year. The challenge is however ensuring that municipalities with funded budgets remain funded given the tough economic conditions impacting the country, the recent floods that caused much destruction in our province and the effect of both the lockdown restrictions as a result of the COVID-19 pandemic and the protest action and subsequent looting that municipalities and communities are still recovering from.

Reporting

The implementation of budgets by municipalities is thereafter monitored through the In-Year-Monitoring (IYM) process and the Mid-Year Budget and Performance Assessment process. In this regard, KZN Provincial Treasury undertakes a detailed assessment of the MFMA Section 71(1) submitted by municipalities. The IYM assessment aim to:

- Improve the quality and the credibility of the information provided by municipalities;
- To assist municipalities in identifying areas of under or over expenditure;
- To assist municipalities in identifying financial problems facing the municipalities, including any emerging or impending financial problems (early warning system); and
- To allow for appropriate and timeous action to be taken should there be indications of substantial over or under-spending against the budget or any other financial problems.

The Mid-Year Budget and Performance assessments are conducted by KZN Provincial Treasury on the six monthly budget performance (MFMA Section 72 Reports) of municipalities to:

- Provide vital feedback on the mid-year performance of the municipality to influence the adjustments that may be required to the annual budget due to under or over performance against the budget;
- Remind municipalities about the consequences of slow spending of conditional grants;



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- Hold bi-lateral engagements with municipalities with a detailed agenda on their mid-year budget performance, the meeting of their service delivery requirements and the mitigating and/or corrective actions that are required for the municipality to achieve the objectives of its annual budget; and
- Provide written feedback on the municipality's mid-year budget performance after the engagement to be shared with Council and municipal officials as it may be required and to serve as a basis for the Adjustments Budget to be produced.

Cost containment measures

The Minister of Finance promulgated the Municipal Cost Containment Regulations (MCCR), 2019 effective from 01 July 2019. The objective of these regulations is to ensure that the resources of a municipality are used effectively, efficiently and economically by implementing cost containment measures.

Cost containment must become an area of focus as it could result in significant savings by municipalities if adequately implemented. Thus KZN Provincial Treasury continues to encourage municipalities to use the principles of cost containment as an instrument for improving their financial sustainability and their budget funding positions. Both the National and Provincial Treasuries regularly highlight the importance of cost containment to all municipalities in budget circulars. Municipalities are also required to report on the implementation of cost containment measures on a quarterly basis.

Revenue and Debt management

The most significant fiscal leakage affecting local government is the poor recovery of consumer debt by municipalities. The "culture of non-payment", which had taken root in the struggle against apartheid, is entrenched in many communities within the province. Coupled with this is, is the lack of enforcement of strict credit control and debt collection by municipal officials and political leadership of municipalities.

In response to this, KZN Provincial Treasury has established a dedicated Municipal Revenue and Debt Management unit. The vacant positions in the newly created structure are currently in the process of being filled. The unit will be responsible to assist municipalities in the following areas:

- Provision of technical support to municipalities with regards to revenue management, including:
 - Tariff setting;
 - Accuracy and completeness of revenue from property rates and service charges; and
 - Guidance on the generation of other revenue and effective grant management.
- Provision of support to municipalities in terms of assessing policies, processes, systems and controls relating to revenue management, cash management, debt management as well as indigent management.



The unit will therefore assist municipalities to identify root causes resulting in fiscal leakages and put policies, processes and controls in place to assist in addressing the root causes.

In the interim, National Treasury has deployed a Revenue Management Technical Advisor to KZN Provincial Treasury through the Municipal Finance Improvement Programme. The Technical Advisor has assisted certain municipalities in the following areas:

- Designing of workable revenue management models for their specific environment;
- Providing guidance and assisting municipalities with the reconciliation process of the general valuation roll and billing system as required by MFMA Circular No. 98;
- Rolling out the tariff setting tool to municipalities;
- The review of revenue management related policies and procedures;
- Assisting municipalities to address common audit findings relating to “completeness of revenue”; and
- Assisting municipalities with customer relations management.

Furthermore, KZN Provincial Treasury has deployed specialists to pilot Revenue and Debt Management projects at selected municipalities. The main focus of the pilot project is to assist municipalities with the accuracy and completeness of billing, reconciliation of the valuation rolls to the billing systems and identifying weaknesses and providing recommendations for improvement in the municipalities’ revenue management environment.

During the implementation of the pilot project, it was found that there is a lack of co-ordination between the technical and finance departments. Consumption was not being measured effectively by municipalities which impacted negatively on the accuracy and completeness of billing. Furthermore, customer information is outdated and/or incomplete. Valuation rolls are not updated regularly, resulting in properties being charged incorrect tariffs as the actual use of the properties are not updated. Meters are not installed for all properties, or meters are by-passed and disconnections were undertaken timeously. In some instances, consumers disputed the accounts and therefore were not willing to pay the amounts due.

The implementation of the pilot project included recommendations to address some of these challenges which included the implementation of a temporary debt incentive scheme policy to encourage consumers to pay outstanding debt. Consumers are informed of the importance to pay on time and the benefit of participating in the temporary incentive scheme so as to benefit from the limited discounts for settlement of outstanding debts. Policies and procedures were developed with appropriate training for effective revenue management, debt collection, customer relations management as well as indigent management. Recommendations were also provided in terms of the required skills and number of resources to adequately implement the revenue and debt management function.



Communication campaigns were recommended to municipalities to create awareness of the need for consumers to pay. Assistance was provided to municipalities with regards to communication with farmers' associations, rate payers associations and the largest debtors in an attempt to collect outstanding debt.

The main challenge experienced during the pilot project was that the billing information was incorrect which resulted in a number of disputes. Municipalities are required to conduct a data cleansing exercise to ensure that the billing information is updated. This should include the physical verification of properties to confirm that all properties are included in the valuation roll, the actual use of the property is correctly recorded in the valuation roll and to determine if all properties are metered and that the meters are functional.

A further challenge is that there are no-go areas in KZN, similar to other provinces, where the community will not allow meter audits, readings and/or disconnections. It is therefore critical that the political leadership take the lead and take ownership to create awareness within the community for the need to pay for services.

Another major challenge is that the Senior Managers that manage the Trading services are generally not suitably qualified to assess the cost of the provision of services and therefore cannot attain cost reflective tariffs.

The political instability at one of the pilot municipalities prevented the approval and implementation of the recommended policies, procedures and controls to address the weaknesses identified. The political and administrative leadership of municipalities must ensure that the required governance framework is implemented for effective revenue and debt management. Accountability and consequence management is critical to ensure that the municipality takes the primary responsibility for resolution of financial problems as required by Section 135 of the MFMA. Sustainability of support provided by KZN Provincial Treasury is solely dependent on the municipalities' commitment to continue with the implementation of the recommended improvements once the support is complete.

Capacity of municipal officials

The main concern relating to municipal financial management is the competency of officials appointed. As per Section 62(1) of the MFMA, the Accounting Officer of a municipality is responsible for managing the financial administration of the municipality and must take reasonable steps to ensure that the resources of the municipality are used effectively, efficiently and economically. Furthermore, as per Section 81(1) of the MFMA, the Chief Financial Officer (CFO) is administratively in charge of the budget and treasury office and entails the performance of budgeting, accounting, analysis, financial reporting, cash management and debt management amongst other tasks. Therefore, it is crucial that municipalities appoint Accounting Officers and CFOs who are competent and are able to fulfil their responsibilities. It is crucial that they possess the requisite skills to ensure the effective and efficient running of the municipalities that they serve.



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Municipalities spend large amounts of their budgets on consultants to perform the very tasks that full time employees are employed to perform for example, the preparation of the annual financial statement, which is one of the key duties of a CFO. Given the current economic environment in the country, every cent counts therefore monies spent on consultants for the performance of tasks that could and should be performed by skilled municipal officials is tantamount to fruitless and wasteful expenditure.

It is for this reason that KZN Provincial Treasury focuses on capacity building initiatives. In this regard, KZN Provincial Treasury undertakes the following:

- Issuance of KZN Provincial Treasury circulars;
- Training of municipal officials through the CFO Forums and Training seminars; and
- Ongoing onsite/on-the-job training during the various budget and reporting processes as well as during the implementation of support initiatives.

The result thereof is a solid foundation on which municipalities can base their internal policies and procedures thereby ensuring sound financial management and sustainability. The support initiatives and capacity building provided by KZN Provincial Treasury has yielded positive results, which is evident from the increased number of municipalities that have approved funded budgets for the 2022/23 financial year. This is further evidenced by the overall improvement in the 2020/21 AGSA audit with 8 improvements and only 1 regression from the 2019/20 audit. The audit opinions for the 2020/21 financial year have improved as follows, with the anticipation that the 2021/22 audit will maintain a similar trend:

- The number of municipalities that received a financially unqualified with no findings (clean) audit opinion increased from 2 municipalities in the 2019/20 audit to 3 in 2020/21;
- 35 municipalities achieved an unqualified audit opinion with findings in the 2020/21 audit which is an increase from the 32 municipalities in the 2019/20 audit;
- The number of municipalities that received qualified audit opinions with findings decreased from the 15 in 2019/20 to 13 in the 2020/21 audit;
- There were no municipalities in the 2020/21 audit that received an adverse audit opinion, which is an improvement from the 2019/20 audit where 1 municipality received an adverse audit opinion;
- Municipalities that received disclaimer audit opinions with findings improved as the number of municipalities decreased from 4 municipalities in the 2019/20 audit to 3 in the 2020/21 audit.

However, the consequence of the support provided is that municipalities are overly reliant KZN Provincial Treasury officials despite having full time paid officials to undertake the required tasks which is another source of fiscal leakage.

Supply Chain Management (SCM)



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Other major areas of fiscal leakage are the inappropriate implementation of the SCM process, management of contracts, performance of service providers and lack of value obtained from public spending.

The SCM Unit within KZN Provincial Treasury provides support to all delegated municipalities in the province through routine and ad-hoc SCM assessments, direct and indirect support interventions, policy revision and formulation and SCM training and workshops.

The Municipal Bid Appeals Tribunal (MBAT) has improved decision making at the local government level and has significantly reduced the number of appeals and court challenges thus enhancing service delivery and good governance.

One of the targeted interventions by the SCM Unit is the Contract management project. Contract management was rolled out to all the municipalities in KZN excluding the eThekweni Metro which is supported directly by National Treasury. The Contract management project included two initial phases which were:

- The establishment of internal systems for Contract management including the creation of contract registers and the development of both manual and electronic filing systems to ensure effective document management; and
- The review of existing contracts to determine financial and legal risks that the municipalities are exposed to.

The final phase of the Contract management project was the development of a contract management framework and procedure manual. The SCM Unit assisted municipalities in developing their Contract Management policies in line with the Provincial contract management policy framework and ongoing monitoring and support was provided to all municipalities.

Risk Management

Risk management practices in local government operates in environments where factors such as politics, technology, change in regulations, climate change and changing service requirements create uncertainty over the future of local government. Provincial Internal Audit Services (PIAS) continues to assist identified municipalities with risk management support:

- Risk assessments (including fraud, ethics, information technology, strategic) to allow municipalities to develop plans that respond to challenges faced by municipalities;
- Risk management maturity exercise to ensure risk units are adequately capacitated and placed correctly to support municipalities in implementing effective risk management. This includes assisting municipalities with the development and review of risk management policies, plans, fraud prevention plans etc.

The challenges noted are as follows:



- Failure to set the right “Tone at the Top” for risk management by Councils;
- Risk management functions at municipalities are not adequately capacitated. Most municipalities only have one or two officials responsible for risk management who are often appointed at junior positions;
- In some municipalities, risk management functions are misplaced within the municipal organograms/structures e.g placed at CFO’s office instead of the office of the Accounting Officer (MM);
- Non establishment of risk management structures in most municipalities (risk committee, risk champions);
- Non-attendance of risk assessment workshops by critical role players of key functions resulting in compromised quality of risk registers;
- Lack of audit review of the risk management function as required by the Internal Audit Standards

Audit Committees and Internal Audit Functions

- Internal audit plays a key role in identifying internal control weaknesses and providing internal control improvements to key business processes to improve on efficiencies; with the audit committee providing a municipality with governance and oversight responsibilities in relation to financial reporting, internal control structure, risk management systems, legislative compliance, ethical accountability and the internal and external audit functions. Through the reviews and assessments conducted by PIAS, challenges and gaps faced by the internal audit unit and audit committees are identified, discussed with management and recommendations identified and agreed upon prior to implementation by municipalities. These actions assist municipalities to improve on these key governance processes. Unfortunately, the Internal audit support provided over the past few years was very limited due to capacity constraints.

Challenges/areas of concerns were noted during the review of IA functions and concerns raised by Audit Committees during meetings:

- Appointment of IA heads at junior positions resulting in limited access to management (not being invited to MANCO meetings);
- Lack of support/buy-in from management (lack of budget for the function resulting in inadequate capacity);
- Delays in approving annual audit plans (sometimes plans are only approved around April which is two months before end of the financial year);



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- Non-implementation of IA recommendations;
- Lack of skills and knowledge of the business;
- Outsourced functions – poor monitoring of the service provider’s performance;
- Co-sourced – some municipalities appoint junior officials to coordinate IA activities resulting in ineffective IA function as highlighted by AG.

Infrastructure – Crack Team

The Infrastructure Management Unit has deployed consultants to identified municipalities to assist with the physical verification of immovable assets, conditional assessments, revise remaining useful lives of assets where necessary and compilation of GRAP compliant immovable Fixed Asset Register. This support is aimed at assisting municipalities with improving the management of infrastructure so as to enable municipalities to plan more effectively for the repairs and maintenance of infrastructure and replacing of infrastructure that will assist in providing services to the community more effectively and with the potential of reducing fiscal leakage.

Municipal Public Private Partnerships (PPP)

KZN Provincial Treasury provides effective and efficient transversal PPP project advisory services to a number of municipalities in the province. KZN Provincial Treasury established the PPP Unit with the main objective of facilitating, managing and overseeing PPPs at a provincial level in accordance with legislative mandates. This is an area that needs further support, given the financial challenges and interest shown by the private sector to partner in investing in new and existing infrastructure as a catalyst for economic growth.

Conclusion

KZN Provincial Treasury will continue to provide the required support to municipalities as discussed above, with the main aim of improving financial management at municipalities and reducing fiscal leakage. Whilst significant strides have been made by KZN Provincial Treasury to support municipalities in an effort to mitigate against the cost and adverse impact of fiscal leakages, progress is hindered by the poor governance by municipalities and the capacity of municipal officials.

In conclusion, efforts must be made to improve the governance at municipalities and ensure that municipal officials have the requisite skills to carry out their duties in order to enhance financial management at



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municipalities thereby reducing the fiscal leakage, improve financial position and sustainability and therefore enhance the quality-of-service delivery for the communities.