

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE INGQUZA HILL LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ingquza Hill Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010, as amended) (DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

7. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Ingquza Hill Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

9. As disclosed in note 32 to the financial statements, the corresponding figures have been restated. The restatements resulted from errors identified during the financial year ended 30 June 2011 in the financial statements of the municipality at, and for the year ended, 30 June 2010.

Fruitless and wasteful expenditure

10. Fruitless and wasteful expenditure amounting to R301 509, relating to penalties and interest incurred, was disclosed in note 25.2 to the financial statements.

Irregular expenditure

11. As disclosed in note 25.1 to the financial statements, irregular expenditure of R33 981 886 was incurred by the municipality during the financial year in contravention of supply chain management (SCM) requirements.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

12. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

Presentation of information

13. The reported performance against predetermined objectives was deficient in respect of the following criterion:
 - Performance against predetermined objectives is reported in accordance with section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

14. The following audit finding relates to the above criterion:

Measures taken to improve performance not provided in the performance report

- Measures taken to improve performance were not explained in the report on predetermined objectives for targets not met in both of the programmes selected for testing. None of the variances identified (i.e. where targets were not met) had measures provided to improve performance.

Usefulness of information

15. The reported performance information was deficient in respect of the following criteria:

- Consistency: The reported objectives, indicators and targets are consistent with the approved integrated development plan.
- Measurability: Indicators are well defined and verifiable, and targets are specific, measurable and time bound.

16. The following audit findings relate to the above criteria:

Planned targets were inconsistent with those in the performance report

- Reported development priorities and targets were not consistent when compared to planned development priorities and targets. Due to the recurring inconsistencies, the reported targets could not be adequately compared to the planned targets.

Planned and reported targets not measurable (measurability)

- For both the selected programmes, 76% of the planned and reported targets were not measurable in that they did not identify the required level of performance.

Planned and reported targets not time bound (measurability)

- For both the selected programmes, 60% of the planned and reported targets were not time bound in specifying the time period or deadline for delivery.

Planned and reported indicators not well defined (measurability)

- For the selected programmes, 76% of the planned and reported indicators were not clear, as well-defined data definitions were not available to allow for data to be collected consistently.

Planned and reported indicators not verifiable (measurability)

- For the selected programmes, valid performance management processes and systems that produced actual performance against the planned indicators did not exist for 60% of the indicators.

Reliability of information

17. The reported performance information was deficient in respect of the following criteria:

- Validity: The reported performance did occur and pertains to the entity.

- Accuracy: The amounts, numbers and other data relating to reported actual performance have been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have been included in the reported performance information.

18. The following audit finding relates to the above criteria:

Reported performance against indicators not valid, accurate or complete when compared to source information (reliability)

- For the selected programmes, 60% of the reported indicators were not valid, accurate or complete based on the source information or evidence provided.

Compliance with laws and regulations

Strategic planning and performance management

19. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1)(a)(ii) of the MFMA.
20. The integrated development plan did not include the key performance indicators and performance targets determined in accordance with the performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and Municipal Planning and Performance Management Regulation 12.

Annual financial statements, performance report and annual report

21. The financial statements submitted for auditing did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit and these were corrected by management.
22. The mayor did not table the 2009-10 annual report of the municipality in the council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
23. The accounting officer did not make the 2009-10 annual report public immediately after the annual report was tabled in the council, as required by section 127(5) of the MFMA.
24. The municipal council did not adopt an oversight report containing the council's comments on the annual report within two months from the date on which the 2009-10 annual report was tabled in the council, as required by section 129(1) of the MFMA.
25. The accounting officer did not make public the council's oversight report on the 2009-10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
26. The performance report for the financial year under review was not prepared, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

Audit committee

27. The audit committee did not function as required by section 166 of the MFMA, in that:

- It did not advise the council, the political office-bearers, the accounting officer and the management staff of the municipality on matters relating to internal financial control and internal audits, risk management, performance management, effective governance, compliance with applicable legislation and performance evaluation.
 - It did not meet at least four times during the year.
28. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
29. The audit committee did not advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(a) of the MFMA.
30. The performance audit committee did not perform the following as required by Municipal Planning and Performance Management Regulation 14:
- Meet at least twice during the financial year.
 - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality.
 - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality.
 - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

Internal audit

31. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
- It did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
 - It did not report to the audit committee on the implementation of the internal audit plan.
 - It did not advise the accounting officer on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management as well as loss control.
32. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.
33. The internal audit processes and procedures did not include assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA, as required by Municipal Planning and Performance Management Regulation 14.
34. The internal audit processes and procedures did not include assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators, as required by Municipal Planning and Performance Management Regulation 14.
35. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal

manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

Procurement and contract management

36. Invitations for competitive bidding were not always advertised for the required minimum period as per the requirements of SCM Regulation 22(1) and 22(2).
37. The entries in the procurement register and the bid results were not published on the website of the municipality as per the requirements of SCM Regulation 23(c).
38. Awards were made to providers who were persons in the service of other state institutions or whose directors or principal shareholders were persons in the service of other state institutions, in contravention of the requirements of SCM Regulation 44. Furthermore, the providers failed to declare that they were in the service of the state as required by SCM Regulation 13(c).
39. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM Regulation 46(2)(e) and the code of conduct for councillors issued in terms of the MSA.

Expenditure management

40. The accounting officer did not take reasonable steps to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

41. Interest was not charged on all accounts in arrear, as required by section 64(2)(g) of the MFMA.

INTERNAL CONTROL

42. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the material audit adjustments, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

43. The accounting officer did not review the financial statements prior to their submission for auditing. The lack of daily, monthly and quarterly review and monitoring resulted in misstatements or errors in the transactions, balances and disclosure line items, which were identified by the auditors during the audit process. The accounting officer did not implement sufficient monitoring controls to ensure adherence to the internal policies and procedures at a programme or objective level, resulting in significant control deficiencies identified during the audit process relating to the reporting and presentation of predetermined objectives.
44. The accounting officer did not exercise oversight over adherence to the SCM Regulations, resulting in irregular expenditure that was incurred during the year.

Financial and performance management

45. The financial statements and report on predetermined objectives submitted to the auditors for audit proposes contained numerous misstatements and errors. This was mainly due to municipal staff not performing or implementing daily financial reporting controls throughout the financial year, including the daily processing of transactions, the monthly reconciliation of accounts, and continuous reviewing. The monitoring of controls was not adequate to ensure that all transactions were accounted for accurately and completely.
46. Policies and procedures that will ensure that all transactions are accounted for in terms of reporting framework (GRAP) requirements were not developed and communicated to staff members in the finance section. As a result, the auditors identified material misstatements or errors not accounted for in terms of GRAP.
47. Established internal control practices were not effective as they did not detect or prevent non-compliance with laws and regulations identified during the audit process.

Governance

48. The municipality did not have an audit committee and an internal audit function that promoted accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations. Furthermore, these bodies did not carry out their responsibilities in a manner consistent with the requirements of the MFMA. The interventions and mechanisms used were not appropriate as they did not prevent or detect significant control deficiencies in the municipality's internal control system, as evidenced by the numerous errors in the financial statements submitted to the auditors for audit proposes, weaknesses in the reporting of predetermined objectives, and non-compliance with SCM Regulations. The internal audit unit did also not enforce and monitor management's implementation of its recommendations on daily control weaknesses.
49. The internal audit unit did not assist management in maintaining effective and efficient controls over the information system environment, the reliability and integrity of financial and performance information, and compliance with laws and regulations.

Auditor-General

East London

29 November 2011



AUDITOR-GENERAL
SOUTH AFRICA

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