

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I audited the financial statements of the Ngqushwa Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, changes in net assets, a statement of comparison of budget and actual amounts, statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

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 the 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 Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is 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. My responsibility is to express an opinion on the annual financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matter described in the basis for disclaimer of opinion paragraph, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

4. I was unable to obtain sufficient appropriate audit evidence regarding the financial statements as a whole, as the financial statements were presented for audit purposes without accurate and complete underlying accounting records. I was unable to audit the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments relating to the financial statements as a whole were necessary.

Disclaimer of opinion

5. Because of the significance of the matter described in the basis for disclaimer of opinion paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

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

Irregular expenditure

7. As disclosed in note 39 to the financial statements, the municipality incurred irregular expenditure amounting to R13 million (2013: R16 million) during the year ended 30 June 2014. This is as a result of non-compliance with supply chain management regulations.

Material impairments

8. As disclosed in note 26 to the financial statements, material losses of R25 million (2013: R9,8 million) were incurred as a result of significant impairment of debts due to poor collection practices.

Additional Matters

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

Unaudited disclosure notes

10. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Withdrawal from the audit engagement

11. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislative requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of ISAs.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

12. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

13. The annual performance report was not presented for auditing and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents for the following selected programmes:
 - Programme 1: Infrastructure development and service delivery on pages x to x
 - Programme 2: Local economic development (LED) on pages x to x
 - Programme 4: Municipal institutional transformation and development on pages x to x
14. I assessed the information to determine whether the performance indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
15. The material findings in respect of the selected programmes are as follows:

Usefulness of performance information

Programme 1: Infrastructure development and service delivery

Measurability

Performance targets not specific

16. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. All the targets were not specific in clearly identifying the nature and the required level of performance. This was due to lack of proper reviews when indicators and targets were decided on and formulated for inclusion in the service delivery and budget implementation plan (SDBIP).

Performance targets not measurable

17. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. Sixty-two per cent of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to a lack of proper reviews when indicators and targets were decided on and formulated for inclusion in the SDBIP.

Performance indicators not well defined

18. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. All of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow data to be collected consistently. Management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance indicators not verifiable

19. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. All of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Programme 2: Local economic development

Measurability

Performance targets not specific

20. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. All the targets were not specific in clearly identifying the nature and the required level of performance. This was due to lack of proper reviews when indicators and targets were decided upon and formulated for inclusion in the SDBIP.

Performance targets not measurable

21. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. Forty per cent (40%) of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to a lack of proper reviews when indicators and targets were decided on and formulated for inclusion in the SDBIP.

Performance indicators not well defined

22. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. All of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow data to be collected consistently. Management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance indicators not verifiable

23. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. All of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Programme 4: Municipal institutional transformation and development

Measurability

Performance targets not specific

24. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. All the targets were not specific in clearly identifying the nature and the required level of performance. This was due to lack of proper reviews when indicators and targets were decided upon and formulated for inclusion in the SDBIP.

Performance targets not measurable

25. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. Twenty per cent of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to a lack of proper reviews when indicators and targets were decided on and formulated for inclusion in the SDBIP.

Performance indicators not well defined

26. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. All of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow data to be collected consistently. Management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance indicators not verifiable

27. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. All of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Compliance with legislation

28. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

29. Sufficient appropriate audit evidence could not be obtained that the local community was consulted by means of a municipal wide structure for community participation or through a forum that enhances community participation in drafting and implementing the integrated development plan (IDP), as required by section 28 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and municipal planning and performance management regulation 15(1)(a)(i).
30. Sufficient appropriate audit evidence could not be obtained that the local community was afforded the opportunity to comment on the final draft of the (IDP) before adoption, as required by section 42 of the MSA and municipal planning and performance management regulation 15(3).
31. Measurable performance targets for the financial year with regard to each of the objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the Municipal Planning and Performance Management Regulations, 2001 (Government Gazette 22605 of 2001) (MPPMR).
32. The annual performance report for the financial year under review was not prepared and was not included in the annual report, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
33. Sufficient appropriate audit evidence could not be obtained that the annual performance agreements for the municipal manager and all senior managers exists and were linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan, as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
34. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal Planning and Performance Management Regulations.

Budgets

35. Sufficient appropriate audit evidence could not be obtained that the expenditure was incurred in accordance with the approved budget or was not incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

36. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA. The supporting records could not be provided, which resulted in the financial statements receiving a disclaimer of audit opinion.
37. The 2012-13 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
38. Sufficient appropriate audit evidence could not be obtained that a written explanation was submitted to council setting out the reasons for the delay in the tabling of the 2012/13 annual report in the council, as required by section 127(3) and 133(1)(a) of the MFMA.

39. Sufficient appropriate audit evidence could not be obtained that an oversight report, containing comments on the annual report, was adopted by the council within two months from the date on which the 2012-13 annual report was tabled, as required by section 129(1) of the MFMA.

Audit committee

40. The audit committee did not respond to council on the issues raised in the audit reports issued by the auditor-general, as required by section 166(2)(c) of the MFMA.
41. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
42. Sufficient appropriate audit evidence could not be obtained that the audit committee did make recommendations to the council on the performance management system (PMS), as required by Municipal planning and performance management regulation 14(4)(a)(ii).
43. Sufficient appropriate audit evidence could not be obtained that the audit committee did submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).

Internal audit unit

44. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the DORA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.
45. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
- it did not report to the audit committee on the implementation of the internal audit plan
 - it did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices and loss control.

Procurement and contract management

46. Sufficient appropriate audit evidence could not be obtained that some contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the municipality did not have a proper filing system that ensures that documents are easily retrievable.
47. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) & (c).
48. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

49. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
50. Invitations for competitive bidding were not always advertised for a required minimum period of 14 days, as required by SCM regulation 22(1) and 22(2).
51. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services, as required by SCM regulation 28(2).
52. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
53. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
54. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
55. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
56. Awards were made to providers who were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Human resource management and compensation

57. An acting chief financial officer and head of SCM were appointed for a period of more than six months, in contravention of section 56(1)(c) of the MSA.
58. The municipality did not develop and adopt appropriate systems and procedures to monitor, measure and evaluate performance of staff, in contravention of section 67(d) of the MSA.
59. Sufficient appropriate audit evidence could not be obtained that the municipal manager and senior managers directly accountable to the municipal manager did sign performance agreements, as required by section 57(2)(a) MSA.
60. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by regulation 14(2)(a) of the *Regulations on minimum competency levels*.

Expenditure management

61. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

62. An effective system of expenditure control, including procedures for the payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
63. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 65(2)(b) of the MFMA.
64. Reasonable steps were not taken to prevent unauthorised expenditure, fruitless and wasteful expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

65. Sufficient appropriate audit evidence could not be obtained that the municipal infrastructure grant (MIG), municipal systems improvement grant (MSIG) and local government financial management grant (LGFMG) allocation was spent in accordance with the applicable grant framework, in contravention of section 16(1) of DoRA.
66. Sufficient appropriate audit evidence could not be obtained that the municipality did evaluate its performance in respect of programmes or functions funded by the MIG, MSIG and LGFMG allocation, as required by section 12(5) of DoRA.

Revenue management

67. A credit control and debt-collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
68. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
69. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
70. Interest was not charged on some accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset and liability management

71. An adequate management, accounting and information system which accounts for assets and liabilities was not in place, as required by section 63(2)(a) of the MFMA.
72. An effective system of internal control for assets and liabilities was not in place, as required by section 63(2)(c) of the MFMA.
73. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2)(a) of the MFMA.

Consequence management

74. Sufficient appropriate audit evidence could not be obtained that unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

75. Sufficient appropriate audit evidence could not be obtained that unauthorised, irregular and fruitless and wasteful expenditure was always recovered from the liable person, as required by section 32(2) MFMA.

Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

77. There were prolonged vacancies in key senior management positions that resulted in leadership instability which undermined accountability. The absence of leadership resulted in there being inadequate direction within the municipality to direct and guide the strategies and operations.
78. The leadership was not able to implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored and where necessary consequence management is applied. This contributed to the material limitations identified in the financial statements as a whole and the findings on the predetermined objectives.
79. In addition, the municipality did not timeously prepare an adequate audit action plan to address internal and external audit findings and, as a result, numerous internal control deficiencies identified in the previous year have recurred in the current year.

Financial and performance management

80. The municipality did not prepare regular, accurate and complete financial reports, and did not perform daily and monthly processing and reconciling of transactions throughout the financial year. As a result, the municipality was unable to produce credible and reliable financial statements.
81. The municipality did not have a proper record management system in place to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. This resulted in the amounts disclosed in the financial statements not being supported by the relevant accounting records.
82. There are no processes in place to monitor compliance with all applicable laws and regulations within the municipality. As a result non-compliance with applicable laws and regulations is not effectively identified or prevented and municipal officials are not held accountable for any transgression in respect of this.

Governance

83. The municipality does not have adequate risk management processes in place. As a result there are no processes in place to identify all risks to which the municipality is exposed. In addition, mitigating controls were not set in place for risks that were identified. Consequently, a number of control deficiencies were identified during the audit that were similar to that of the prior year in respect of financial and performance management and compliance with laws and regulations.

84. Internal audit was not effective in their review of internal controls and compliance with laws and regulations. This is largely as a result of the instability within the municipality and the lack of co-operation from management.
85. As a result of the impaired functioning of the internal audit function, the audit committee could not effectively evaluate and monitor responses to risks and provide effective oversight in respect of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor - General

East London

27 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence