

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Nxuba Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as 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 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, 2013 (Act No. 2 of 2013) (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 these financial statements based on my audit. I conducted my 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. 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.
4. 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.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. The municipality did not account for its property, plant and equipment (PPE) in accordance with GRAP 17: *Property, plant and equipment* due to the following errors that were identified:
 - Not all the land and buildings recorded on the asset register could be verified;
 - The depreciation was incorrectly calculated; and
 - The assets were misallocated between land and buildings, community and infrastructure assets.
7. Consequently, land and buildings included in PPE as disclosed in the statement of financial position and note 8 to the financial statements are overstated by an amount of R852 200. Further, accumulated depreciation was understated by R1,2 million and land and buildings and community assets are overstated by R1,6 million. This resulted in the accumulated surplus being understated by R2,1 million and infrastructure assets being understated by an amount of R1,6 million.
8. Furthermore, not all land and buildings were included in the asset register and note 8 to the financial statements. Consequently, land and buildings included in property, plant and equipment as disclosed in the statement of financial position and note 8 to the annual financial statements is understated by an amount of R5,9 million and accumulated surplus as disclosed in the statement of financial position is understated by R5,9 million.
9. Sufficient appropriate audit evidence in support of the valuation for the land and buildings and community assets included in PPE as disclosed in the statement of financial position and in note 8 to the financial statements could not be obtained. I was unable to obtain the required evidence through alternative means. Consequently, I was also unable to determine if any adjustments were required to land and buildings of R52,5 million and community assets of R13,1 million as disclosed in note 8 to the financial statements.

Investment property

10. The municipality did not account for its investment property in accordance with GRAP 16: *Investment Property* as not all investment property was included in the asset register which supports the amounts disclosed in the financial statements. Consequently, investment property as disclosed in the statement of financial position and note 9 to the financial statements is understated by an amount of R5,7 million and the accumulated surplus is understated by R5,7 million.
11. Further, items of PPE to the amount of R7 million were incorrectly allocated to investment property. As a result investment property as disclosed in note 9 is overstated by R7 million and PPE as disclosed in note 8 to the financial statements is understated by R7 million

Qualified opinion

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements fairly present, in all material respects, the financial position of the Nxuba Local Municipality as at 30 June 2014 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

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

Unauthorised expenditure

14. As disclosed in note 46 to the financial statements, the municipality incurred unauthorised expenditure of R17,9 million (2013: R11,6 million) during the year ended 30 June 2014.

Fruitless and wasteful expenditure

15. As disclosed in note 47 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R2,6 million (2013: R600 000) during the year ended 30 June 2014.

Irregular expenditure

16. As disclosed in note 48 to the financial statements, the municipality incurred irregular expenditure of R10,8 million (2013: R234 730) during the year ended 30 June 2014.

Additional matters

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

Unaudited supplementary schedules

18. The supplementary information set out on pages ... to ... do not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Non-compliance with MFMA disclosure

19. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

20. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPAs) presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Development objective 2 : local economic development on pages x to x.
 - Development objective 4: service delivery and infrastructure development on pages x to x.
22. I evaluated the reported performance information against the overall criteria of the usefulness and reliability.

23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether 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 (FMPP)*.
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected development objectives are as follows:

Development objective 2: Local economic development

Usefulness of reported performance information

Consistency

Reported objectives not consistent with planned objectives

26. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 25% of the reported objectives included in the annual performance report were not consistent with the objectives in the approved IDP and the service delivery and budget implementation plan (SDBIP). This was due to a lack of review of the completeness of the annual performance report against the IDP and the SDBIP by management.

Changes to development objectives, performance indicators and targets are not approved

27. Section 25(2) of the MSA determines that an IDP adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an IDP is adopted by the next elected council. All changes made to the objectives and changes to 50% of the targets in the annual performance report were made without following the process as prescribed in section 34 of the MSA and without adoption by the municipal council. This was due to a lack of review of the adjustments to the objectives, indicators and targets in the annual performance report by management and the council.

Measurability

Performance indicators not well defined

28. The FMPP requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 73% of the indicators relevant to the selected development objective were not well defined, and unambiguous data definitions were not available to allow for data to be collected consistently. This was due to a lack of development and implementation of proper performance planning and management practices to facilitate the development of performance indicators for inclusion in the municipal IDP.

Performance indicators not verifiable

29. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 82% of the indicators relevant to the selected development objective were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to a lack of standard operating procedures and key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Performance targets not specific

30. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance. A total of 64% of the targets in relation to the selected development objective were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management did not correctly apply the principles contained in the FMPPI when setting their targets.

Performance targets not measurable

31. The FMPPI requires performance targets to be measurable. The required performance could not be measured for a total of 45% of the targets relevant to the selected development objective. This was due to the fact that management did not have sufficient appropriate audit evidence and monitoring activities to show how targets were measured.

Reliability of reported performance information

32. The FMPPI requires institutions to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. I was unable to obtain the information and explanations considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the information submitted with respect to the programme not being sufficient and appropriate to adequately support the reported performance. The institution's records did not permit the application of alternative audit procedures.

Development objective 4: Service delivery and infrastructure development

Usefulness of reported performance information

Measurability

Indicators not well defined

33. The FMPPI requires indicators to have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators relevant to the selected development objective were not well defined, and unambiguous data definitions were not available to allow for data to be collected consistently. This was due to a lack of development and implementation of proper performance planning and management practices to facilitate the development of performance indicators for inclusion in the municipal IDP.

Reliability of reported performance information

34. The FMPPI requires institutions to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important

targets were not reliable when compared to the source information or evidence provided. I was unable to obtain the information and explanations considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the information submitted with respect to the selected development objective not being sufficient and appropriate to adequately support the reported performance. The institution's records did not permit the application of alternative audit procedures.

Additional matter

35. I draw attention to the following matter:

Achievement of planned targets

36. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development objectives reported in paragraphs 26 to 34 of this report.

Compliance with legislation

37. 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 non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Budget

38. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15(b) of the MFMA.

Financial statements, annual report and annual performance report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Asset management

40. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

42. Payments were made from the municipality's bank account without the approval of the accounting officer, as required by section 11(1) of the MFMA.

43. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Consequence management

44. Irregular, Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the Municipal Finance Management Act.
45. Unauthorised and irregular expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
46. Failure to comply with the supply chain management system laid against officials / role players were not investigated by the accounting officer, as required by Municipal supply chain management regulation 38(1)(b).

Strategic planning and performance management

47. Measurable performance targets for the financial year with regard to each of the development priorities and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e). This is evidenced by the material findings on the measurability of performance indicators and targets.
48. The municipality's performance management system and its related controls were not adequate, as they did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how these should be conducted, organised and managed, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

HR Management

49. Senior managers did not meet any of the prescribed competency areas as required by regulation 6 and 7 of the Municipal Regulations on Minimum Competency Levels.
50. Finance officials at middle management did not meet any of the prescribed competency areas as required by regulation 8 and 9 of the Municipal Regulations on Minimum Competency Levels.

Procurement and contract management

51. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
52. Bid specifications for procurement of goods and services through competitive bids were drafted in a biased manner that did not allow all potential suppliers to offer their goods or services, in contravention of SCM regulation 27(2)(a).
53. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Internal control

54. 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 the qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

55. Leadership have not instituted all the disciplines necessary to enable oversight and monitoring that promotes efficiency and effectiveness in financial management, service delivery reporting and compliance with laws and regulations. This did not set the correct tone in building a high performance environment that promotes accountability.
56. Leadership failed to implement adequate controls to prevent and detect irregular expenditure and unauthorised expenditure incurred.
57. The municipality has vacancies in key management positions. These vacancies affect the leadership's ability to effectively manage the control environment by addressing identified internal control risks and deficiencies.

Financial and performance management

58. The municipality did not fully implement and monitor all required daily and monthly financial, performance and compliance disciplines to verify the credibility of in-year reporting. This resulted in key reconciliations and processing only being performed after the financial year-end. The municipality did not prepare reliable and accurate monthly and quarterly management accounts. This is due to the instability that existed in key positions in the finance department and management not understanding the requirements of the applicable reporting framework.
59. The municipality did not have a proper system of record management that provided for the maintenance of information that supported the reported performance contained in the annual performance report. This has contributed to material findings on the reliability of performance information. These deficiencies include a lack of information that relates to the collection, collation, verification, storing and reporting of actual performance information. This was due to the municipality not having standard operating procedures in place to ensure that all documentation is properly maintained for performance management.
60. There was a lack of processes in place to ensure compliance with all applicable laws and regulations. As a result management did not effectively monitor and address all areas of non-compliance

Governance

61. The municipality had an audit committee and internal audit unit. The recommendations of the audit committee and internal audit unit were not adequately addressed by management, and therefore did not have a positive impact on addressing control deficiencies identified in the municipality's control environment.

Auditor-General

East London

29 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence