

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL OF INXUBA YETHEMBA MUNICIPALITY**

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the consolidated and separate financial statements of the Inxuba Yethemba Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2014, the consolidated and separate statement of financial performance, statement of changes in net assets, statement of cash flows and the 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 consolidated and separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with Generally Recognised Accounting Practice and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate 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 consolidated and separate 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 the 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 45 to the financial statements, irregular expenditure of R6,2 million was incurred in the current year due to non-adherence to the Supply chain management (SCM) regulations and procedures.

Material impairments and losses

8. As disclosed in note 4 to the consolidated and separate financial statements an amount of R26,7 million (2013: R26,7 million) in respect of receivables from non-exchange transactions has been impaired as a result of non-payment by consumer debtors.
9. As disclosed in note 5 to the consolidated and separate financial statements and amount of R215 million (2013: R178,3 million) in respect of receivables from exchange transactions has been impaired as a result of non-payment by consumer debtors.
10. As disclosed in note 32 to the consolidated and separate financial statements, the municipality incurred material losses relating to electricity of R8,8 million (2013: R9.8 million) due to technical and non-technical issues.

Material underspending of conditional grants

11. As disclosed in note 23 to the consolidated and separate financial statements, the municipality has underspent its Municipal Infrastructure Grant (MIG) by R4,9 million (2013: R4,9 million).

Additional matters

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

Withdrawal from the audit engagement

13. 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 legislated requirement to perform the audit of municipality, I would have withdrawn from the engagement in terms of the ISAs.

Unaudited supplementary information

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

Unaudited disclosure notes

15. 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

16. 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 development priorities 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

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Local economic development on pages ... to ...
- Community services department on pages ... to ...
- Technical services department on pages ... to ...

18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

19. 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 development priorities or objectives. 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* (FMPPI).

20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

21. The material findings in respect of the selected development priorities are as follows:

Local Economic Development

Usefulness of reported performance information

Basis 1: Consistency of objectives, indicators and targets

Reported indicators and targets not consistent with planned indicators and targets

22. Section 41(c) of the Municipal Systems Act (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Significantly important indicators and targets that relate to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not consistent with those in the approved service delivery budget implementation plan. This was due to management amending the wording used in the annual performance report as well as including additional key performance indicators and targets in the annual performance report that were not included in the approved service delivery budget implementation plan.

Basis 2: Measurability of indicators and targets

Performance targets not specific, measurable, time bound and indicators not well defined

23. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. Significantly important targets in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not specific.
- Performance targets must be measurable. Significantly important targets in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not measurable.
- The period or deadline for delivery of targets must be specified. Significantly important targets in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not time bound.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Significantly important indicators in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not well defined.

24. This was due to the fact that management was aware of the requirements of the FMPPI but did not have the appropriate systems and processes implemented and did not exercise due care to enable application of the principles.

Reliability of reported performance information

Basis 1: Reliability of reported performance information

25. The FMPPI requires auditees 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. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Community services department

Usefulness of reported performance information

Basis 1: Measurability of indicators and targets

Performance targets not specific and measurable and indicators not well defined

26. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. Significantly important targets that relate to the primary function or purpose of the municipality; are in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not specific.

- Performance targets must be measurable. Significantly important targets that are primary function or purpose of the municipality; are in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not measurable.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Significantly important targets that are primary function or purpose of the municipality; are in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not well defined.

27. This was due to the fact that management was aware of the requirements of the FMPPI but did not have the appropriate systems and processes implemented and did not exercise due care to enable application of the principles.

Reliability of reported performance information

Basis 1: Reliability of reported performance information

28. The FMPPI requires auditees 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. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Technical services department

Usefulness of reported performance information

Basis 1: Consistency of objectives, indicators and targets

Reported indicators and targets not consistent with planned indicators and targets

29. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Significantly important indicators and targets that relate to the primary function or purpose of the municipality; are in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not consistent with those in the approved service delivery budget implementation plan. This was due to management reporting on an additional key performance objective and target in the annual performance report that was not included in the municipality's service delivery budget implementation plan.

Basis 2: Measurability of indicators and targets

Performance targets not measurable

30. The FMPPI requires the following:

- Performance targets must be measurable. Significantly important targets that are primary function or purpose of the municipality; are in relation to community interest or interest to the public, including the media and those which impact on public health, safety, social, economic or environmental wellbeing were not measurable.

31. This was due to the fact that management was aware of the requirements of the FMPPI but did not have the appropriate systems and processes implemented and did not exercise due care to enable application of the principles.

Reliability of reported performance information

Basis 1: Reliability of reported performance information

32. The FMPPI requires auditees 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. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Additional matter

33. I draw attention to the following matter.

Achievement of planned targets

34. Refer to the annual performance report on pages ... to ... for information on the achievement of the planned targets for the year.

Compliance with legislation

35. 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:

Annual Report and Annual Financial Statements

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. Material misstatements identified by the auditors in the submitted financial statements were not corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
37. Consolidated financial statements were not submitted for auditing, within three months after the end of the financial year, as required by section 126(1)(b) of the MFMA.

Asset management

38. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
39. 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.

Budget

40. 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 of the MFMA.

Consequence management

41. Unauthorised, irregular and 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 MFMA.
42. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

Expenditure management

43. Sufficient appropriate audit evidence could not be obtained that money owed by the municipality had always been paid within 30 days as required by section 65(2)(e) of the MFMA.
44. Sufficient appropriate audit evidence could not be obtained that payments from the municipality's bank account were approved by the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
45. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal, payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
46. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.
47. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

48. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
49. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Revenue management

50. An adequate management, accounting and information system which accounts for receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
51. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.
52. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
53. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Audit committee

54. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
55. The audit committee did not 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).

56. The audit committee was not constituted, in the manner required by section 166(4)(a) MFMA as sufficient appropriate audit evidence of council approval could not be provided for appointment of members.

Conditional grants and transfers

57. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Systems Improvement Grant Local Government Financial Management Grant allocations, as required by section 12(5) of the Division of Revenue Act (Act No. 2 of 2013) (DoRA).
58. The Municipal Infrastructure Grant and Local Government Financial Management Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of the DORA.

Procurement and contract management

59. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the documentation could not be provided due to poor document management system.
60. 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 Municipal Supply Chain Management Regulations (SCM), regulation 17(a) and (c).
61. 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 regulation 16(b) and 17(b).
62. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
63. 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).
64. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
65. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
66. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations (2011) (PPR).
67. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
68. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).

69. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act (Act No.5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
70. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
71. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of PPPFA.
72. Sufficient appropriate audit evidence could not be obtained that contracts were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
73. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
74. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act and CIDB regulation 18.
75. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers and officials involved.
76. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

Human resources management

77. Sufficient appropriate audit evidence could not be obtained that the senior managers dismissed for financial misconduct in a previous position and re-appointed before the expiry of 10 years in contravention of section 57A of the MFMA.
78. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels of 2007 (MRMCL) regulation 13.
79. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the MRMCL regulation 14(2)(a).
80. The financial officials at middle management and SCM officials did not meet any of the prescribed competency areas as required by sec 83 and 107 of the MFMA and regulation 2 to 11 of the MRMCL.
81. Finance officials at middle management and supply chain managers did not have the higher education qualification as required by regulation 8 and 9 of the MRMCL.
82. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of MSA sec 67(d).

Strategic planning and performance management

83. Adequate and reliable corroborating evidence could not be provided to assess the municipality's compliance with applicable laws and regulations. This was due to limitations placed on the scope of my work by the absence of information systems.
84. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
85. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by National Treasury's FMPPI chapter 3 paragraph 3.3 and chapter 4 step 4.
86. The performance management system and related controls were inadequate 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, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Internal control

87. 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 non-compliance with legislation included in this report.

Leadership

88. Although there was no change in leadership, the municipality has not improved from the prior year. Notwithstanding the consistency in leadership, there was a lack of oversight and accountability, together with management's failure to respond to prior year internal and external audit findings adequately, which has resulted in a number of repeat audit findings.
89. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatements in the annual financial statements that were submitted for audit, non-compliance with applicable laws and regulations as well as information presented in the report on predetermined objectives not being valid, accurate and complete.

Financial and performance management

90. The municipality remains reliant on the use of consultants to perform financial administration and reporting functions that should be performed by the staff employed by the municipality. A poor control environment over financial reporting exists as extensive unsuccessful manual reconciliation of accounting records and supporting schedules was required at year end as these controls were not performed on a regular ongoing basis during the year. As a result, material misstatements were identified based on the auditor's high level review that could not be substantially corrected by management at that stage. Further, there was a lack of segregation of duties as reliance is placed on a few key personnel to perform crucial functions. This has the impact of limiting supervision and monitoring. Should adequate monitoring, supervision and controls be implemented, these misstatements should be able to be identified and

corrected by management on a timeous basis.

91. The financial statements and supporting accounting file submitted for audit purposes contained numerous limitations and deficiencies as assessed during our high level. This was due to weaknesses identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation and underlying supporting schedules required for audit purposes. The lack of adequate review of the financial statements and supporting documentation prior to submission of the annual financial statements further contributed to the deficiencies noted.
92. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality has not formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

Governance

93. Insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed. Management failed to implement the recommendations of the internal audit unit which resulted in external audit findings within the current year. This has contributed to repeat audit findings in a number of areas.
94. The municipality has an audit committee and internal audit unit in place, and the audit committee held regular meetings as required by the MFMA. However, the audit committees' ability to provide assurance was limited due to the inadequacy of the financial reports provided for their review.

Auditor - General

East London

28 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence