

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE INTSIKA YETHU MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Intsika Yethu Municipality set out on pages xx to xx, 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 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 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, 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

Payables from exchange transactions

6. The municipality did not maintain an adequate record for payables from exchange transactions in that the supporting documentation provided for audit did not agree to what was disclosed in the financial statements. Consequently, payables from exchange transactions as disclosed in note 15 and expenditure as disclosed in note 22 to the financial statements are overstated by R1,6 million.
7. In addition, I was unable to obtain sufficient appropriate audit evidence to support the amounts of trade payables and sundry payables included in payables from exchange transactions. I was unable to confirm the amounts of trade payables and sundry payables by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade payables and sundry payables of R28,9 million (2013: R10,2 million) and R5,1 million (2013: R11,5million) respectively as disclosed in note 15 to the financial statements.

Commitments

8. The municipality did not accurately disclose the amount of contractual commitments for the acquisition of property, plant and equipment for the current and previous year as required by GRAP 17: *Property, plant and equipment*. The manual commitments schedules prepared in support of the amounts disclosed in the financial statements included incorrect contract and expenditure amounts. Consequently, commitments as disclosed in note 30 to the financial statements is understated by R7,2 million (2013: R17,7 million).

VAT receivable

9. Sufficient appropriate audit evidence was not provided in support of the amount disclosed as VAT receivable in the statement of financial position for the current and previous year. I was unable to confirm this amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to VAT receivable of R4,4 million as disclosed in the statement of financial position and note 9 to the financial statements.

General expenditure

10. The municipality did not apply the accrual basis of accounting for expenses as required by GRAP1: *Preparation of financial statements*. As a result expenditure relating to the 2012-2013 financial year was recorded in the incorrect accounting period. Consequently, general expenditure for the current year as disclosed in note 22 to the financial statements is overstated and accumulated surplus as disclosed in the statement of financial position is overstated by R6,8 million (2013: R2,1 million). This has also resulted in the previous year's general expenditure and payables from exchange transactions being understated by R6,8 million.

Material losses

11. The municipality did not disclose material losses for water and electricity in the financial statements as required by section 125(2) (d)(i) of the MFMA. I was unable to confirm the material losses by alternate means due to a lack of systems to identify and quantify material losses. Consequently, I was unable to determine whether any adjustments were necessary for material losses.

Corresponding figures

12. During 2012-13, I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements:
- Receivables from non-exchange transactions as disclosed in note 8 was understated by R1,3 million and the related revenue as disclosed in the statement of financial performance is understated by the same amount
 - Personal cost as disclosed in note 23 was overstated by R10,9 million and accumulated surplus as disclosed in the statement of financial position is understated by the same amount
 - General expenditure as disclosed in note 22 is understated by R5,3 million and the payables from exchange transactions as disclosed in the note 15 is understated by the same amount
13. In addition, during 2012-13, I was unable to obtain sufficient appropriate audit evidence regarding amounts disclosed for:
- General expenditure of R39,6 million as disclosed in note 22
 - Receivables from non-exchange transactions of R237 000 as disclosed in note 8 to the financial statements

Qualified opinion

14. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Intsika Yethu 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 matter

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Irregular expenditure

16. As disclosed in note 39 to the financial statements, the municipality incurred irregular expenditure of R14,2 million (2013: R24,3 million) during the year ended 30 June 2014. This is as a result of non-compliance with supply chain management regulations.

Unauthorised Expenditure

17. As disclosed in note 37 to the financial statements, unauthorised expenditure amounting to R 122.1million (2013:74.5 million) was incurred by the municipality during the year ended 30 June 2014. This is as a result of expenditure being incurred in excess of the limits of the amounts provided for in the votes of the approved budget

Restatement of corresponding figures

18. As disclosed in note 33 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during the 2013 audit for the year ended, 30 June 2013.

Additional matter

19. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

20. 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

21. 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 objectives presented in the annual performance report, 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

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Basic service delivery and Infrastructure development: on pages xx to xx
23. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
24. 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 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 (FMPP)*.
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. The material findings in respect of the selected objectives are as follows:

Basic service delivery and Infrastructure development:

Usefulness of reported performance information

Consistency of indicators and targets

27. Section 41(c) of the Municipal Systems Act requires the annual performance to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between the planning and reporting documents. Thirty-eight percent (38%) of the reported indicators and 39% of the report targets were not consistent with those in the approved annual performance report. This is due to management not aligning the planned indicators and targets of the approved service delivery and budget implementation plan (SDBIP) for their respective strategic objectives to the performance report before it is approved and submitted according to the statutory requirements.

Changes to indicators and targets not approved

28. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made according to the process prescribed in section 28 of the MFMA. Material changes were made to 89% of the indicators and all targets in the annual performance report, without adoption by the municipal council. This was due to there not being a proper review to ensure that all information from the integrated development plan (IDP) is consistent with the service delivery and budget implementation plan (SDBIP) and annual performance report.

Reliability of reported performance information

29. 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. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of standard operating procedures on the process to follow in the recording of actual achievements; monitoring of the completeness of source documentation provided and the frequency of review of the accuracy of reported achievements against source documentation.

Additional matter

30. I draw attention to the following matter

Achievement of planned targets

31. Refer to the annual performance report on pages xx to xx; for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on usefulness and reliability of the reported performance information in paragraphs 27 to 29 of this report.

Compliance with legislation

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

Budgets

33. 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.

Annual reports and annual financial statements

34. 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 expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

35. The performance management system and related controls were inadequate as they did not describe and represent the processes of performance reporting and how it is conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Consequence management

36. Unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Audit Committee

37. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by the Municipal planning and performance management regulation 14(4)(a)(i).
38. 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).

Human resource management and compensation

39. A manager directly accountable to the municipal manager was appointed without disclosure of financial interests, which contravenes regulation 4 of GNR 805.
40. The chief financial officer was appointed without having met the prescribed minimum competency levels as required by section 54A(2) of the Municipal Systems Act.
41. All senior managers did not meet any of the prescribed competency areas as required by regulations 6 and 7 of the Municipal regulations on minimum competency levels.
42. 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, regulation 13.
43. 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 Municipal regulations on minimum competency levels, regulation 14(2)(a).
44. The chief financial officer did not meet any of the prescribed competency areas as required by section 83 of the MFMA and regulations 4 and 5 of the Municipal regulations on minimum competency levels.
45. The head of supply chain management did not meet any of the prescribed competency areas as required by section 119 of the MFMA and regulations 10 and 11 of the Municipal regulations on minimum competency levels.

Expenditure management

46. An adequate management, accounting and information system which recognised expenditure when it was incurred was not in place, as required by section 65(2)(b) of the MFMA.

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

Conditional grants received

48. The Municipal Infrastructure Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of DoRA.
49. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, as required by section 12(5) of DoRA.

Procurement and contract management

50. Contracts were awarded to bidders based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.

Revenue Management

51. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of the MFMA.
52. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Liability management

53. 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.

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 compliance with legislation included in this report.

Leadership

55. Leadership did not take full ownership of the internal control environment and did not insist on daily disciplines to ensure efficiency and effectiveness in financial management, performance information and compliance with laws and regulations. Thus, it did not set the correct tone for the credibility of all reports of the administration. 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 that was not valid, accurate and complete.
56. Leadership did not implement an action plan to address previously reported internal control deficiencies in time to have a meaningful impact on the control environment. In addition, this was not monitored by the oversight bodies to ensure that it was adequately implemented and monitored and where necessary, appropriate action is taken. Further, there is insufficient attention to filling of critical vacancies which has negatively impacted the internal control environment.

57. Further, leadership failed to take disciplinary action against officials who incurred irregular expenditure and fruitless and wasteful expenditure, as well as against officials who failed to comply with the policies, processes and procedures of the municipality.

Financial and performance management

58. Adequate daily and monthly financial processing and reconciliations did not always take place during the year and prior to the preparation of the financial statements and performance information.
59. The municipality did not have processes in place to ensure compliance with all applicable laws and regulations, and therefore did not monitor and address non-compliance with all the requirements of the MFMA in a timely manner.

Governance

60. The municipality has an audit committee and internal audit unit. However, insufficient action was taken by the governance structures within the municipality during the year under review to ensure that the risks relating to the monitoring and reporting of financial and performance information and compliance with laws and regulations were adequately addressed.

Auditor-General

East London

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

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