

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Sakhisizwe 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, the cash flow statement and the statement of comparison of budget information with actual information 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 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

Irregular expenditure

6. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose irregular expenditure that occurred during the financial year. Irregular expenditure of R 6,4 million (2013: R 6,5 million) as disclosed in note 37.3 to the financial statements was materially understated, as payments were made in contravention of the supply chain management (SCM) requirements. Due to the inadequate systems in place, it was impracticable for me to determine the full extent of the understatement of irregular expenditure. Consequently I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosed at R 34,9 million (2013: R28,6 million) in note 37.3 to the financial statements.

Water losses

7. The municipality is required by section 125(2)d of the MFMA to disclose in the financial statements the amount of material water losses for the year. The municipality did not have a system for the identification and quantification of water losses and consequently did not disclose any water losses. I was unable to confirm or verify by alternative means the water losses for the year, and, as a result I was unable to determine the water losses to be disclosed in the financial statements.

Aggregation of immaterial uncorrected misstatements in corresponding amounts

8. The corresponding amounts in financial statements as a whole are materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, performance and the notes to the financial statements:

- Property, plant and equipment reflected as R 101 million are overstated by R 1,3 million.
- Grant expenditure reflected as R 3 million is overstated by R 1 million.

Qualified opinion

9. 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 Sakhisizwe 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

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

Restatement of corresponding figures

11. As disclosed in note 30 to the financial statements, the corresponding figures have been restated as a result of errors corrected during the year ended 30 June 2014 that existed in the financial statements at, and for the year ended, 30 June 2013.

Unauthorised expenditure

12. As disclosed in note 37.1 of the financial statements, the municipality incurred unauthorised expenditure of R 29,8 million (2013: R 24 million) as a result of expenditure incurred which exceeded the total approved budget.

Irregular expenditure

13. As disclosed in note 37.3 of the financial statements, the municipality incurred irregular expenditure of R 6,4 million (2013: R 6,5 million) as a result of non-compliance with procurement requirements and requirements relating to performance bonuses of the MSA. Goods and services were received for the supply chain management related irregular expenditure disclosed in note 37.3.

Material impairments

14. Debt impairments of R 25,7 million (2013: R 6,8 million) as disclosed in note 23 to the financial statements were made against trade debts. These debts are long outstanding and are considered to be irrecoverable.

Additional Matter

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

Unaudited disclosure notes

16. 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

17. In accordance with the PAA and the *general notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives for the selected development priority 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

18. 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:

- Development priority x 273 indicators: Service Delivery on pages x to x

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

20. 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. 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).

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

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

Service Delivery

Usefulness of reported performance information

23. Section 41(c) of the Municipal Systems Act requires the annual performance, integrated development plan and service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. All of the reported objectives were not consistent with those in the approved integrated development plan. This was due to the lack of documented and approved internal policies and procedures to address strategic planning. Furthermore the municipality was not aware nor trained on acts and regulations regarding planning of the performance information.

24. Material measurability findings are as follows:

The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 24% of the targets and significantly important targets in relation to roads and storm water, electricity and water were not specific.

- Performance targets must be measurable. I could not measure the required performance for 53% of the targets and significantly important targets in relation to electricity, roads, water management and sewerage management.
- The period or deadline for delivery of targets must be specified. A total of 69% of the targets and significantly important targets in relation to roads, electricity, water management, sewerage management 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 service delivery were not well defined.
- Performance indicator must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 36% of the indicators and significantly important indicators in relation to electricity were not verifiable.

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. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records did not permit the application of alternative audit procedures.
26. The municipality did not have adequate standard operating procedures and key controls for collection, collation, verification and storage of information that support significant important indicators in relation to Service Delivery. Furthermore completeness of source documentation in support of actual achievements was not monitored by management.

Additional matter

27. I draw attention to the following matter:

Achievement of planned targets

28. Refer to the annual performance report on pages 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 priority reported in paragraphs 23 to 26 of this report.

Compliance with laws and regulations

29. 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 financial statements

30. 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 assets, liabilities, revenue, 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.

Budgets

31. 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.

Asset management

32. The right to use a capital asset was granted without the approval of the municipal council, in contravention of Municipal asset transfer regulation 34(1)(b).

Revenue management

33. 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.

Conditional grants received

34. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, the Municipal Systems Improvement Grant allocation and Finance Municipal Grant, as required by section 12(5) of DoRA.

Expenditure management

35. 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.

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

Procurement

37. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).

38. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

39. Contracts and quotations were awarded to bidders who did not submit 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).

40. 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.

41. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

42. 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.

43. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

44. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation

46(2)(e) or the code of conduct for staff members issued in terms of the Municipal Systems Act.

Consequence management

45. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2)(a)(ii) of the MFMA.

46. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Strategic planning and performance management

47. The annual performance report for the year under review did not include a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(b) & (c) of the MSA.

48. The municipality did not give effect to its integrated development plan and/or conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the Municipal Systems Act No 32 of 2000, section 21(2)(a) of the MFMA and MPPMR 6.

49. 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 section 41(1)(b) of the MSA and the MPPMR 12(1) and 12(2)(e).

50. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role-player, as required by section 38(a) of the MSA and Municipal planning and performance management regulation 7(2) (c) and (e).

51. The municipality did not establish mechanisms to monitor and review its performance management system as required by section 40 of the MSA.

52. The performance management system did not provide for steps of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.

53. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance (planning, monitoring, measurement, review, reporting and improvement) and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the MPPMR.

54. The integrated development plan (IDP) was not annually reviewed based on the assessment of its performance measurements and changing circumstances, as required by section 34 of the MSA and Municipal planning and performance management regulation 3 and 11.

Audit committee

55. The audit committee did not adequately advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA, as evidenced by the material adjustments made to the annual financial statements.

56. The audit committee did not review the municipality's performance management system and did not make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).

57. The audit committee did not review the quarterly internal audit reports on performance

measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).

58. 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).
59. The audit committee did not adequately advise the council and accounting officer on matters relating to performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
60. 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.
61. The audit committee was not constituted, in the manner required by section 166(4)(a) Municipal Finance Management Act as it did not have 3 members for the duration of the year.

Human Resource Management

62. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of MSA.
63. Bonuses were awarded to the municipal manager and senior managers directly accountable to the municipal manager without a performance evaluation being performed in contravention of section 57(4)(b) MSA.
64. 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 Regulations on Minimum Competency Levels reg14(2)(a).

Internal control

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

Leadership

66. Slow response to audit message and effective leadership remains a challenge as the roles and responsibilities for recording and filing of financial and performance information have been communicated to all relevant staff, but there is a lack of effective oversight by senior leadership to ensure accountability and adequate consequences for poor performance and transgressions, which has resulted in repeat financial, performance information and compliance findings raised during the audit.
67. The municipality did not develop documented and approved internal policies and procedures to address the collection, recording, processing, monitoring of, and reporting on predetermined objectives. Consequently, material misstatements were identified in the annual performance report.
68. This is due to action plans which were developed to address all internal control deficiencies within the municipality that were ineffective as there were inadequate monitoring from oversight committees, consequently similar findings were identified in the current year.

Financial and performance management

69. Management did not implement daily and monthly controls as designed for the entity's business processes and did not have a proper system of record management that provides for the maintenance of information to be reported in the annual performance report.
70. Compliance with the applicable legislation was not monitored on a regular basis and the municipality's information technology systems environment remained weak as numerous deficiencies identified in the prior year had still not been addressed.
71. This is mainly attributable to a lack of credible in year reporting by leadership and oversight committees in respect to financial, performance management and compliance matters resulting in numerous recurring findings.

Governance

72. The municipality did not conduct a risk assessment as required by the MFMA. Consequently, there was a failure to monitor compliance with the MFMA, MSA and SCM regulations, as well as the GRAP reporting framework requirements.
73. The internal audit unit and audit committee were not fully effective in strengthening the control environment within the municipality as numerous material misstatements were identified during the audit. Furthermore recurring findings on performance reporting and compliance matters were identified during the audit process.

Auditor-General

East London

30 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence