

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Maletswai Local 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 and cash flow statement 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, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on 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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Maletswai Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

8. As disclosed in notes 38 and 39 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2014 that existed in the financial statements at, and for the year ended, 30 June 2013.

Financial sustainability

9. Note 55 to the financial statements indicates that the municipality's current liabilities exceeded its current assets. This situation, along with other matters as set forth in the note, indicates that the municipality may encounter difficulty realising its assets and discharging its liabilities in the normal course of business.

Debt impairment

10. As disclosed in note 30 to the financial statements, debt impairment of R4,1 million was recognised in the statement of financial position.

Fruitless and wasteful expenditure

11. As disclosed in note 45.2 to the financial statements, fruitless and wasteful expenditure amounting to R3 million was incurred due to interest for late payment of suppliers.

Unauthorised expenditure

12. As disclosed in note 45.1 to the financial statements, unauthorised expenditure amounting to R17,9 million was incurred due to overspending on votes.

Additional matter

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

Unaudited disclosure notes

14. 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

15. 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 presented in the annual performance report, compliance with legislation and 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

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
 - Key priority area (KPA) 3: Service delivery, on pages xx to xx
17. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
18. 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 and time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected objectives are as follows:
 - KPA 3: Service delivery, on pages xx to xx

Usefulness of reported performance information

21. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 46% of the targets in relation to the selected KPAs 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 targets.
22. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 43% of the targets relevant to the selected KPAs. This was due to the fact that management did not have sufficient appropriate audit evidence for showing how targets were measured.
23. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 40% of the indicators relevant to the selected KPAs were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the lack of development and implementation of proper performance planning and management practices to facilitate the development of performance indicators for inclusion into the integrated development plan (IDP).
24. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 40% of the indicators relevant to the selected KPAs were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of standard operating procedures and key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

25. The FMPPI requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 37% of indicators did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the IDP. This was due to management not appropriately defining its indicators to report on the achievement of the service provided.

Reliability of reported performance information

26. The FMPPI requires that institutions should 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.
27. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to KPA 3: Service delivery.
28. This was due to limitations placed on the scope of my work due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the programme. The institution's records did not permit the application of alternative audit procedures.

Additional matter

29. I draw attention to the following matter:

Achievement of planned targets

30. 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 the usefulness and reliability of the reported performance information for the selected development priority in paragraphs 21 - 27 of this report.

Compliance with legislation

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

Strategic planning and performance management

32. The performance management system and related controls were not appropriately maintained as it did not sufficiently 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 section 38 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and regulation 7 of the Municipal planning and performance management regulations (GNR 796 of 24 August 2001) (MPPMR).

33. 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 regulations 12(1) and 12(2)(e) of the MPPMR.

Budgets

34. 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.

Human resource management

35. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by regulation 14(2)(a) of the Municipal regulations on minimum competency levels) (MRMCL).
36. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by regulation 14(2)(b)/14(3) of the MRMCL.
37. Sufficient appropriate audit evidence could not be obtained to confirm that financial officials at middle management met all the prescribed competency areas, as required by regulations 8 and 9 of the MRMCL.

Audit committee

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 regulation 14(4)(a)(iii) of the MPPMR.
39. The audit committee did not adequately review the municipality's performance management system and make recommendations to the council, as required by regulation 14(4)(a)(ii) of the MPPMR.
40. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by regulations 14(4)(a)(i) and 14(4)(b) of the MPPMR.

Internal audit

41. The internal audit unit did not function, as required by section 165(2) of the MFMA in:
- reporting to the audit committee on the implementation of the internal audit plan.
 - advising the accounting officer and reporting to the audit committee on matters relating to risk and risk management.
42. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.
43. The internal audit unit did not adequately and continuously assess the functionality of the performance management system, as required by the regulation 14(1)(b)(i) of the MPPMR.

Expenditure management

44. Money owed by the municipality to creditors was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
45. Reasonable steps were not taken to prevent unauthorised expenditure/ irregular expenditure / fruitless and wasteful expenditure, as required by section 62(1)(d) / 95(d) of the MFMA.

Procurement and contract management

46. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) and (c).
47. Sufficient appropriate audit evidence could not be obtained that deviations for goods and services of a transaction value above R200 000 were approved by the accounting officer only if it was impractical to invite competitive bids, as required by SCM regulation 36(1).
48. Bid adjudication was not always performed by committees which were composed in accordance with SCM regulation 29(2).
49. 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 section 112(j) of the MFMA and SCM regulation 44.
50. Sufficient appropriate audit evidence could not be obtained that quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Internal control

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

Leadership

52. There was increased intervention by leadership and senior management, resulting in an improved audit outcome on financial reporting for the current year. However, there is still a lack of oversight and accountability to ensure consistent implementation and monitoring of daily, weekly and monthly controls over performance information and compliance with laws and regulations.
53. The deficiencies in the control environment of the municipality that were reported in previous years have not been adequately addressed for predetermined objectives and compliance with laws and regulations. This was mainly due to staff members not fully understanding the performance reporting and compliance requirements.

54. The municipality did not properly plan and provide training on planning, managing and reporting on performance information to meet the requirements of the FMPPI.
55. The shortage of in-house skills and competencies resulted in the municipality having to appoint consultants every year to prepare the financial statements. The municipality has made slow progress in ensuring adequate skills transfer from consultants; however, the municipality has been able to reduce the extent to which they use the consultants year to year. The municipality should implement a system to ensure that there is sufficient transfer of skills to permanent finance staff members to reduce the reliance on consultants over time.

Financial and performance management

56. The record management of the municipality was satisfactorily implemented in terms of its policies and procedures. Improvements in record management have been noted in the current financial year as evidenced by their improved audit outcome for financial reporting. However, 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 usefulness and 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.
57. Although the municipality does have systems in place to monitor compliance with all applicable legislation, material findings related to compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored.

Governance

58. There was insufficient focus on, and pre-emptive measures taken to address the emerging risks relating to changes in the environment in which the municipality operates as risk assessment procedures were not performed for the current year.
59. Internal audit does not adequately follow up the implementation of internal and external audit recommendations to address audit outcomes. They did not meet all requirements in the audit plan, and numerous items on the annual plan were not addressed. The reporting provided is not timeous and not relevant and the assurance ultimately provided is low. Furthermore, their effectiveness is not being reviewed by the audit committee.
60. The internal audit unit did not assess the functionality of the performance management system and whether the performance management system complied with the requirements of the MSA and did not audit the performance measurements on a continuous basis. This is due to the internal audit not performing all the activities specifically relating to performance information as outlined in their internal audit plan.
61. The audit committee was operational during the year. The financial statements were reviewed prior to being submitted to the external auditors and no material findings were noted.

62. The audit committee did not adequately review the municipality's performance management system and make recommendations to the council, resulting in significant deficiencies identified in performance information. The effectiveness of the audit committee can only be maintained by holding internal audit accountable for preparing and submitting the required reports, assessments and plans regularly during the year and by holding management accountable for implementing the recommendations made by the audit committee, internal and external audit.

Auditor-General

East London

28 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

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