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# **Nelson Mandela Bay Metropolitan Municipality**

## **Audit Report**

For the year ended 30 June 2015

# **Report of the auditor-general to the Eastern Cape provincial legislature and the council on Nelson Mandela Bay Metropolitan Municipality**

## **Report on the consolidated and separate financial statements**

### **Introduction**

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2015, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and 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 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, 2014 (Act No. 10 of 2014) (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 these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with 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 consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the consolidated and separate 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 municipality'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 consolidated and separate 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**

### **Creditors - Exchange Transactions**

6. The municipality did not have an adequate system in place to ensure that vacation leave activities of employees are properly administered. As a result sufficient appropriate audit evidence could not be obtained to confirm that the staff leave creditor of R176,3 million (2014: R144,7 million) and the related employee cost expenditure, was correctly accounted for in terms of GRAP 25: Employee Benefits. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the related account balances and classes of transactions.

## **Qualified opinion**

7. In my opinion, except for the effects of the matter described in the basis of qualification opinion paragraph, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2015 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**

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

### **Restatement of comparative figures**

9. As disclosed in note 40 to the consolidated and separate financial statements, the comparative figures for 30 June 2014 have been restated as a result of errors that were only corrected during the financial year ended 30 June 2015 but that existed in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2014

### **Irregular expenditure**

10. As disclosed in note 44.2 to the consolidated and separate financial statements, irregular expenditure amounting to R1.3 billion - (2014: R453 million) was incurred by the municipality during the year ended 30 June 2015. This is as a result of non-compliance with procurement requirements.
11. In addition, the municipality disclosed in note 44.2 that it was impracticable to determine whether expenditure incurred during the financial year ended 30 June 2015 amounting to R2.6 billion (2014: R2.7 billion; 2013 and prior: R7 billion)

was irregularly procured or not. This is as a result of missing tender files and related documentation.

#### **Unauthorised expenditure**

12. As disclosed in note 44.1 to the consolidated and separate financial statements, unauthorised expenditure amounting to R34 million was incurred due to overspending in respect of a vote within the approved municipal expenditure budget. This mainly relates to the impairment of traffic fines which was inadequately budgeted for.

#### **Fruitless and wasteful expenditure**

13. As disclosed in note 44.3 to the consolidated and separate financial statements, fruitless and wasteful expenditure amounting to R146 million (2014: R96 million) was incurred during the current financial year mainly due to operating costs incurred for the Integrated Public Transport System (IPTS), as operating costs were paid out and the buses are still not operating as intended as well as penalties and interest raised by the South African Revenue Services.

#### **Material losses and impairments**

14. As disclosed in note 15 to the consolidated and separate financial statements, the impairment of receivables amounted to R445 million (2014: R187 million) for the year.
15. As disclosed in note 35.10 to the consolidated and separate financial statements, water losses amounting to R148 million (2014: R113 million) were incurred during the financial year.
16. As disclosed in note 35.11 to the consolidated and separate financial statements, electricity losses amounting to R244 million (2014: R234,7 million) were incurred during the financial year.
17. As disclosed in note 35.12 to the consolidated and separate financial statements, revenue foregone amounting to R79 million has been disclosed due to a number of consumers not being billed for water and electricity

#### **Significant uncertainty**

18. The municipality is a defendant in a number of lawsuits to the amount of R82 million (2014: R90 million) as disclosed in note 45a to the consolidated and separate financial statements. The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

#### **Additional matters**

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

#### **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 consolidated and separate financial statements and accordingly I do not express an opinion thereon.

## Report on other legal and regulatory requirements

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development 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

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objective presented in the annual performance report of the municipality for the year ended 30 June 2015:
  - Development objective: 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 development 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)*.
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. I did not identify material findings on the usefulness and reliability of the reported performance information for the selected development objective.

### **Additional matters**

27. Although I identified no material findings on the usefulness and reliability of the reported performance information for the selected development objectives, I draw attention to the following matters:

#### **Achievement of planned targets**

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

## **Adjustment of material misstatements**

29. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information of Basic Service Delivery and Infrastructure Development. As management subsequently corrected the misstatements we did not identify any material findings on the usefulness and reliability of the reported performance information.

## **Compliance with legislation**

30. I performed procedures to obtain evidence that the auditee 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:

### **Annual financial statements**

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

### **Audit committees**

33. 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).

### **Procurement and contract management**

34. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
35. 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).
36. 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)
37. Bids were not always 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).
38. Sufficient appropriate audit evidence could not be obtained that contracts which 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.

39. 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).
40. 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).
41. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
42. Sufficient appropriate audit evidence could not be obtained that contracts and quotations 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).
43. 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.
44. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5
45. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
46. 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.
47. Awards were made to providers who are in the service of the municipality and/or whose directors are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the officials involved.
48. Awards were made to providers who 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).
49. 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) and the code of conduct for staff members issued in terms of MSA.
50. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

## **Budget**

51. 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.
52. The total unforeseen and unavoidable expenditure incurred exceeded R15 million, in contravention of Municipal Budget and Reporting Regulation 72.

## **Expenditure management**

53. 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.

## **Consequence management**

54. Irregular, Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
55. Unauthorised, irregular, fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
56. The accounting officer / council did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) and 32(7) of the MFMA.
57. Cases of financial misconduct which constitute a crime committed by officials were not always reported to the South African Police Service, as required by the Municipal regulations on financial misconduct procedures and criminal proceedings 10(1).
58. Allegations of theft / fraud / extortion / forgery / uttering a forged document which exceeded R100 000 were not reported to the South African Police Service, as required by section 34(1) of the Prevention and Combating of Corrupt Activities Act.

## **Internal control**

59. 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, and the findings on compliance with legislation included in this report.

## **Leadership**

60. Leadership did not set the appropriate tone at the top throughout the year to lead by example and this is evident from the numerous allegations against senior management officials and subsequent suspensions and resignations of top officials. The tone set by management tends to filter through the whole organisation resulting in actual and alleged irregularities occurring on all levels. Stability at leadership level was effected too late in the financial year to correct all the deficiencies that existed.
61. There was inadequate oversight by leadership over the commitment made to address the prior year qualification relating to the leave accrual payable.



Management was not committed to take the necessary steps as per the audit action plan and to put processes in place to ensure that all leave transactions are accurately captured.

62. Material adjustments were made to the fixed asset register submitted for audit purposes. This is due to a lack of succession planning since no official could immediately successfully take over the reconciling of the asset register in the absence of the senior assets official.
63. Oversight over compliance with laws and regulations was not effective resulting in numerous instances of transgressions of relevant laws and regulations. The lack of adequate consequence management also contributes to the culture of non-compliance.

## **Financial and performance management**

64. The municipality did not consistently implement and monitor the necessary daily and monthly financial disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial reporting framework. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end, and led to material adjustments being effected to the financial statements during the audit process.
65. The municipality further did not adequately monitor the reading of meters and subsequent billing of consumers for water and electricity consumption and this resulted in revenue foregone.
66. Management did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation.

## **Governance**

67. The recommendations made by internal audit and the audit committee were not adequately responded to, as improvements in the control environment did not resolve all control deficiencies identified. Consequently, recurring material non-compliance and misstatements in the financial statements have been reported. The position of Chief Risk Officer remained vacant during the financial year despite the commitment made by the former city manager to have the position filled by 31 January 2015.

## Other reports

### Investigations

68. National Treasury has conducted a forensic audit relating to the IPTS project. A preliminary report has been tabled. The investigation is not yet finalised at the date of this report.
69. An investigation relating to alleged serious misconduct by two senior officials was instituted. The report was tabled and recommendations made to council.

*Auditor-General*

East London

9 December 2015



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SOUTH AFRICA

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