

# Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Mquma Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Mquma Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 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 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. Irregular expenditure of R205 million (2013-14: R153,9 million) is disclosed in note 43. The municipality's processes for the recording and recognition of irregular expenditure were insufficient, as amounts either did not agree to supporting documentation or were not recorded. Consequently, irregular expenditure is overstated by R4.9 million (2013-14: R17,8 million understated). Due to the lack of systems, it was impracticable to determine the full extent of the misstatement of irregular expenditure.
7. Furthermore, sufficient appropriate audit evidence in support of the irregular expenditure balance of R205 million could not be obtained, as documentation in support of the amount disclosed either was not submitted for audit purposes or was found to be incomplete where it was submitted. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustment to irregular expenditure as disclosed in note 43 was necessary.

### **Corresponding figures**

8. During the audit of the 2013-14 financial year, I identified the following misstatement that is still included in the corresponding figures disclosed in the 2014-15 financial statements:
  - The corresponding figure for unspent conditional grants of R31,7 million as disclosed in the statement of financial position as well as in note 15 to the financial statements is overstated by R3,8 million and the corresponding figure for grants income is understated by the same amount.
9. In addition, I was unable to obtain sufficient appropriate audit evidence for the elements below included in the 2013-14 financial statements. During the current year, I was again not provided with the evidence required to substantiate these transactions and balances. I was thus unable to confirm by alternative means, or determine whether adjustments were required to, the following:
  - The corresponding figure for revenue from non-exchange transactions of R237 million as disclosed in the statement of financial position as well as in note 22 to the financial statements.
  - The corresponding figure for expenditure of R55 million as disclosed in the statement of financial performance and in note 30 to the financial statements.

### **Aggregation of immaterial uncorrected misstatements**

10. The financial statements are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items:

#### **Included in the statement of financial position**

- Inventory as disclosed in the statement of financial position and note 3 is overstated by R1,4 million.

- Accumulated surplus as disclosed in the statement of financial position is understated by R1,4 million (2013-14: R1,2 million).
- Employee benefits as disclosed in the statement of financial position is overstated by R0,187 million and employee related costs is overstated by the same amount.
- Property, Plant and Equipment as disclosed in the statement of financial position is overstated by R0,279 and depreciation is understated by the same amount.
- Vat receivables is overstated as disclosed in the statement of financial position is overstated by R0,057 and accumulated surplus is understated by the same amount.
- Payables from exchange transactions as disclosed in the statement of financial position is overstated by R0,010 (2014: R1,2) and expenditure is understated by the same amount
- The corresponding figure for receivables from non-exchange transactions disclosed at R7,6 million is overstated by R1,3 million and the corresponding figure for revenue from non-exchange transactions is understated by the same amount.

#### **Included in the statement of financial performance**

- The corresponding figure for expenditure disclosed at R55 million is overstated by R3,1 million and the corresponding figure for payables from exchange transactions is understated by the same amount.
- The corresponding figure for revenue from exchange transactions disclosed at R23,4 million is understated by R0,650 million and the corresponding figure for receivables from exchange transactions is overstated by the same amount.
- The corresponding figure for employee related cost disclosed at R104 million is overstated by R0,41 million and the corresponding figure for employee benefits is understated by the same amount.

11. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to, the following:

- An amount of R0,143 included in the payables from exchange transactions of R26,8 million disclosed in the statement of financial position and note 12.
- An amount of R2,6 million included in the corresponding figure for provisions of R24,7 million disclosed in the statement of financial position and note 16.
- An amount of R0,41 million included in the corresponding figure for employee related cost disclosed at R104 million in the statement of financial performance and note 24.

12. Consequently, I was unable to determine whether any further adjustment to these items was necessary.

## **Qualified opinion**

13. 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 Mquma 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**

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

## **Impairments**

15. As disclosed in notes 4 and 5 to the financial statements, impairments of R13,9 million and R51,8 million were incurred as a result of the impairment of receivables from exchange transactions and receivables from non-exchange transactions, respectively.

## **Restatement of corresponding figures**

16. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

## **Unauthorised expenditure**

17. As disclosed in note 41 to the financial statements, unauthorised expenditure amounting to R83,5 million was incurred by the municipality during the year ended 30 June 2015. This was as a result of expenditure not budgeted for and expenditure in excess of the budget.

## **Additional matters**

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

## **Unaudited supplementary schedules**

19. 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 these schedules and, accordingly, I do not express an opinion thereon.

## **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 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 objectives presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Development objective 2: service delivery and infrastructure development, on pages ... to ...
  - Development objective 3: local economic development, on pages ... to ...
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. The material findings in respect of the selected development objectives are as follows:

### **Service delivery and infrastructure development**

#### **Reliability of reported performance information**

27. 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 for the accurate recording of actual achievements as well as for the recording and monitoring of performance.

### **Local economic development**

#### **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. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of standard operating procedures or documented system descriptions for the accurate recording of actual achievements as well as for the monitoring of the completeness of source documentation in support of actual achievements.

### **Additional matter**

29. I draw attention to the following matter:

## **Achievement of planned targets**

30. Refer to the annual performance report on pages xxx to xxx 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 reliability of the reported performance information for the selected development objectives reported in paragraphs 27 to 28 of this report.

## **Compliance with legislation**

31. 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:

## **Annual report and annual financial statements**

32. 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 non-current assets, current assets and liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

## **Expenditure management**

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

## **Procurement and contract management**

34. Sufficient appropriate audit evidence could not be obtained that all contracts had been awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as all requested documentation could not be provided due to a poor document management system.
35. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
36. 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, contrary to SCM regulation 13(c).
37. Awards were made to providers who were in the service of the municipality or whose directors are in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, providers failed to declare that they were in the service of the municipality, as required by SCM regulation 13(c).
38. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the preferential procurement regulations.

## **Human resource management**

39. The competencies of financial and SCM officials were not assessed in a timely manner to identify and address gaps in competency levels, as required by municipal regulation on minimum competency levels 13.

## **Audit committee**

40. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

## **Internal audit**

41. 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.

## **Strategic planning and performance management**

42. 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 and improvement as well as how it is to be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

## **Internal control**

43. 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**

44. The leadership did not fulfil its oversight responsibilities with regard to the implementation and monitoring of internal controls and compliance with laws and regulations, and did not insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. The slow response by the accounting officer and management to the AGSA's messages of the previous audit contributed to the repeat material misstatements in the financial statements and non-compliance with laws and regulations.
45. Although attention was paid to filling critical vacancies to ensure sufficient capacity to address the ongoing control deficiencies, the municipality remained without a full-time chief financial officer and SCM manager until April and February, respectively, which compromised the SCM processes and internal control management.
46. The leadership did not set the correct tone with regard to performance reporting to build a high-performance environment that promotes accountability. This is evident in the type of findings reported.
47. The leadership failed to implement adequate controls to prevent and detect unauthorised, irregular as well as fruitless and wasteful expenditure incurred.

## Financial and performance management

48. Daily and monthly processes, procedures and controls were not adequately performed to ensure that all transactions had been accurately recorded, classified, reconciled, approved and reported on, in accordance with applicable legislation. Misstatements across all cycles and components signified a lack of review of transactions and balances at all managerial levels within the municipality, including the inadequacy of detection systems to alert management of control failures. Officials did not always fulfil their assigned duties and responsibilities, while the performance of staff was further compromised by outdated policies and procedures and by not holding staff responsible and accountable for their actions.
49. The annual performance report also included material misstatements due to a lack of oversight of the collection, collation and reporting of performance information. There was limited assurance and accountability regarding the performance management system.
50. There were significant instances of non-compliance with laws and regulations governing the municipality. This was because of inadequate controls within the municipality and a lack of adequate review and monitoring of compliance with laws and regulations.

## Governance

51. The internal audit function did not audit SCM in the current financial year. This resulted in material non-compliance with legislation and regulations in the procurement processes, which was identified and reported in the audit process.
52. The audit committee did not sit to review all the reports of the internal audit unit during the current financial year. This resulted in the unit not reporting on internal controls and compliance with legislation for all four quarters.

*Auditor General*

East London

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*