

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Tsolwana Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Tsolwana Local 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 the 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. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year, as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 40.3 to the financial statements was understated in respect of amounts incurred during the year that were identified during the audit process. Due to the lack of systems, it was impracticable to determine the full extent of the understatement or irregular expenditure disclosed at R9,6 million in note 40.3 to the financial statements. Consequently, I was unable to determine whether any further adjustments relating to irregular expenditure were necessary.

Aggregation of immaterial uncorrected misstatements

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

Making up and as disclosed in the statement of financial performance:

- Revenue from exchange transactions were understated by R515 014

Making up and as disclosed in the statement of financial position:

- Non-current provisions were understated by R906 993
- Receivables were understated by R366 932
- Payables from exchange transactions were overstated by R849 347
- Investment property was understated by R387 975
- Property, plant and equipment was understated by R290 836
- Accumulated surplus was overstated by R490 882

8. 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 if adjustments were required to the following:

- Inventory as per note 13 on the statement of financial position
- Payables from exchange transactions as per note 7 on the statement of financial position.

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 Tsolwana Local 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

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 33 to the financial statements, the corresponding figures for 30 June 2014 were restated as a result of errors discovered during the preparation of the 2014-15 financial statements.

Unauthorised expenditure

12. As disclosed in note 40.1 to the financial statements, unauthorised expenditure of R2,1 million was incurred by the municipality during the year. This was as a result of the overspending of the total amount appropriated for the budget and treasury office vote in the municipality's approved budget.

Material losses

13. As disclosed in note 40.4 to the financial statements, the municipality suffered significant electricity losses of 3,7 million kilowatts (39,09%) at a value of R3,4 million.

Additional matter

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

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. 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

16. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities 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

17. 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 2015:
 - Key performance area (KPA) 2: Basic services on pages x to x
 - Key performance area 4: Local economic development on pages x to x
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

19. 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 key performance areas. 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).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected key performance areas are as follows:

Key performance area 2: Basic services

Usefulness of reported performance information

22. Section 25(1) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the municipal council to adopt an integrated development plan (IDP) within the prescribed period after the start of the elected term. Section 46 of the MSA also requires an annual performance report (APR) to be prepared annually. In addition, section 53(1)(c) of the MFMA requires the mayor to approve the service delivery and budget implementation plan (SDBIP). The consistency of planned and reported objectives, indicators and targets could not be assessed as the annual performance report did not align to the SDBIP. Therefore, the municipality did not consider the SDBIP, as a planning document, during the execution of the predetermined objectives. The indicators reported in the APR were not planned by the municipality as the information reported on the APR was totally different to the information contained in the SDBIP and the IDP.
23. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance, must be measurable, and the period or deadline for delivery of targets must be specified. It also requires that 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. Performance indicators must also be verifiable.
24. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures or documented system descriptions.

Reliability of reported performance information

25. 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.
26. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with the development priorities selected for auditing. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures.

Key performance area 4: Local economic development

Usefulness of reported performance information

27. Section 25(1) of the MSA requires the municipal council to adopt an IDP within the prescribed period after the start of the elected term. Section 46 of the MSA also requires an annual performance report to be prepared annually. In addition, section 53(1)(c) of the MFMA requires the mayor to approve the SDBIP. The consistency of planned and reported objectives, indicators and targets could not be assessed as the APR did not align to the SDBIP. Therefore, the municipality did not consider the SDBIP, as a planning document, during the execution of the predetermined objectives. The indicators reported in the APR were not planned by the municipality as the information reported on the APR was totally different to the information contained in the SDBIP and the IDP.
28. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, and the period or deadline for delivery of targets must be specified. It also requires that 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. Performance indicators must also be verifiable.
29. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures or documented system descriptions.

Reliability of reported performance information

30. 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.
31. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with the development priorities selected for auditing. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures.

Additional matter

32. I draw attention to the following matter:

Achievement of planned targets

33. Refer to the annual performance report on pages x to x and 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 key performance areas reported in paragraphs 17 to 31 of this report.

Compliance with legislation

34. 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:

Strategic planning and performance management

35. The municipality did not give effect to its IDP and conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6 (MPPMR).
36. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and regulation 1 and 9(1)(a) of the MPPMR.
37. The 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 regulations 3 and 11 of the MPPMR.
38. 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 regulation 12(1) and 12(2)(e) of the MPPMR.
39. Revisions to the SDBIP were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
40. The annual performance report for the year under review did not include measures taken to improve performance as required by section 46(1)(c) of the MSA.

Revenue management

41. 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 MFMA.

Expenditure management

42. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
43. Sufficient appropriate audit evidence could not be obtained to determine that money owed by the municipality was paid within 30 days, as required by section 65(2)(e) of the MFMA.

Procurement and contract management

44. Invitations for competitive bidding were not always advertised for a required minimum period of seven or 14 days, as required by supply chain management (SCM) regulation 22(1) and 22(2).

45. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
46. Contracts and quotations were awarded to bidders who did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
47. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
48. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
49. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

Audit committee

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

Consequence management

53. Unauthorised, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
54. Unauthorised and fruitless and wasteful expenditure was written off as irrecoverable without being certified by the council as irrecoverable, in contravention of section 32(2)(a)(ii) of the MFMA.

Annual financial statements and annual report

55. 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 liabilities 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.
56. The 2013-14 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

57. A written explanation was not submitted to the council setting out the reasons for the delay in the tabling of the 2013-14 annual report in the council, as required by sections 127(3) and 133(1)(a) of the MFMA.

Asset management

58. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
59. Capital assets were sold and permanently disposed of that were needed to provide the minimum level of basic municipal service, in contravention of section 14(1) of the MFMA.
60. Capital assets were sold and permanently disposed without the approval of the council, as required by section 14(2)(a) of the MFMA.

Budgets

61. The 2015-16 annual budget was not approved by the council before the start of the financial year, as required by section 16(1) of the MFMA.
62. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the MFMA.

Internal control

63. 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 compliance with legislation included in this report.

Leadership

64. The leadership did not provide sufficient direction that is necessary to enable effective oversight that promotes efficiency and effectiveness in financial management, predetermined reporting and compliance with legislation.
65. The lack of political stability and stability in critical positions contributed to leadership not providing effective oversight over the implementation and monitoring of internal controls. This has further led to over-reliance on consultants during the year under review.
66. The lack of leadership led to problems in accountability at the municipality, resulting in the unfavourable outcomes in the financial statements, predetermined objectives and compliance with legislation.

Financial and performance management

67. The municipality did not prepare regular, accurate and complete financial and performance reports, and did not perform daily and monthly processing and reconciling

of transactions throughout the financial year. As a result, the municipality was unable to produce reliable financial statements and performance reports.

68. There was a lack of controls (such as checklists) in place to ensure compliance with legislation. As a result, management did not effectively monitor and address areas of non-compliance.

Governance

69. The municipality had recurring material findings on financial and performance management and compliance. This was as a result of leadership not responding adequately to recommendations made by the internal audit unit and the audit committee.

Other reports

Investigations

70. An investigation was conducted into a suspected fraudulent transaction regarding a stolen council cheque in the previous years. This was handed over to the South African Police Service (SAPS). At year-end, the investigation was considered a cold case by the SAPS and the municipality handed over the case to the Hawks (Directorate for Priority Crime Investigation) for further investigation.
71. At the time of this report, the municipality was investigating allegations of maladministration and irregularities at the SCM unit.

Auditor-General

East London

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence