

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

Report on the financial statements

Introduction

1. I was engaged in the audit of the financial statements of the Inkwanca 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 statement of comparison of budget and actual amounts 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 (ISAs). 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. Because of the matters described in the basis for disclaimer of opinion paragraph, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Limitations on the financial statements

4. I was unable to obtain sufficient appropriate audit evidence regarding the financial statements as a whole, as the financial statements were presented for audit purposes without accurate and complete underlying accounting records. I was unable to audit the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments relating to the financial statements as a whole were necessary.

Disclaimer of opinion

5. Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

Financial sustainability

6. As disclosed in accounting policy note 1.2 to the annual financial statements. The municipality is heavily dependent on government grants and subsidies because of its small revenue base which is unlikely to expand in future. The liquidity ratio shows that the municipality is faced with challenges in meeting its obligations. However, the Inkwanca Local Municipality will continue with its operations as a going concern in the foreseeable future as long as grants are still received from the upper spheres of government.

Additional matter

7. I draw attention to the matter below.

Withdrawal from the engagement

8. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislative requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of International Standards on Auditing.

Report on other legal and regulatory requirements

9. 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 key performance areas 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

10. I was unable to perform procedures to obtain evidence about the usefulness and reliability of the reported performance information, as the municipality did not submit its annual performance report for auditing, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

11. Although the annual performance report was not submitted for auditing, I evaluated the performance information in respect of the following selected material development priority as contained in the strategic planning and performance management documents:
 - Development priority 2: basic service delivery on pages x to x
12. I assessed the information to determine whether the performance 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).

Usefulness of planned indicators and targets

13. The period or deadline for delivery of targets should be specified as required by the FMPPI. Hundred percent of the targets were not time bound. This is due to a lack of developed and approved business processes, and the fact that there is no designated official responsible for performance information.
14. The FMPPI requires indicators and measures to relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives. The relevance of the indicators and measures could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation why the indicators and measures were considered important and relevant to the realisation of strategic goals and objectives.

Compliance with legislation

15. 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 and performance management

16. Sufficient appropriate audit evidence could not be obtained that the local community had been consulted by means of a municipal-wide structure for community participation in implementing the integrated development plan (IDP), as required by section 28 of the MSA and municipal planning and performance management regulation 15(1)(a)(i).
17. Sufficient appropriate audit evidence could not be obtained that the local community had been afforded the opportunity to comment on the final draft of the IDP before adoption, as required by section 42 of the MSA and municipal planning and performance management regulations 9, 13(1), 13(4)(c) and 15(3).
18. Sufficient appropriate audit evidence could not be obtained that the municipality had conducted its affairs in a manner 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.
19. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
20. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

21. 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 municipal planning and performance management regulations 1 and 9(1)(a).
22. The service delivery and budget implementation plan (SDBIP), used for implementing the municipality's delivery of municipal services and annual budget, did not indicate service delivery targets and performance indicators for each quarter, as required by section 1 of the MFMA.
23. 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.
24. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

Annual financial statements and annual report

25. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
26. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimer of audit opinion.
27. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126 of the MFMA.
28. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2014 -15 annual report had been tabled, as required by section 129(1) of the MFMA.
29. An annual performance report was not prepared for the financial period under review, as required by section 46 of the MSA.
30. The annual performance agreements for the municipal manager and all senior managers were not linked to the measurable performance objectives approved with the budget and to the SDBIP, as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

Budget

31. Sufficient appropriate audit evidence could not be obtained to confirm that the 2014-15 annual budget had been approved by the council before the start of the financial year, as required by sections 16(1) and 87(4) of the MFMA.

Revenue management

32. A credit-control and debt-collection policy was not adopted, maintained and implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
33. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

34. Sufficient appropriate audit evidence could not be obtained that accounts for municipal taxes, charges for municipal services and service charges had been prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.
35. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality had been calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
36. An adequate management, accounting and information system was not in place to account for revenue, debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.
37. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Expenditure management

38. Money owed by the municipality was not always paid within 30 days, as required by sections 65(2)(e) and 99(2)(b) of the MFMA.
39. Payments were made from the municipality's bank account without the approval of a properly authorised official, contrary to section 11(1) of the MFMA.
40. An effective system of expenditure control (including procedures for the payment of funds) was not in place, as required by sections 65(2)(a) and 99(2)(a) of the MFMA.
41. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred as well as to account for creditors and payments made, as required by sections 65(2)(b) and 99(2)(c) of the MFMA.
42. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by sections 62(1)(d) and 95(d) of the MFMA.

Conditional grants

43. Sufficient appropriate audit evidence could not be obtained to confirm that municipal infrastructure grant (MIG), municipal systems improvement grant (MSIG) and local government financial management grant (LGFMG) allocations had been spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.
44. Sufficient appropriate audit evidence could not be obtained to confirm that the municipality had evaluated its performance in respect of programmes or functions funded by MIG, MSIG and LGFMG allocations, as required by section 12(5) of DoRA.
45. Sufficient appropriate audit evidence could not be obtained to confirm that MIG, MSIG and LGFMG funds had only been retained or rolled over to the next financial year with the approval of the National Treasury, as required by section 22(1) of DoRA.

Liability management

44. An effective system of internal control for liabilities (including a liability register) was not in place, as required by sections 63(2)(c) and 96(2)(b) of the MFMA.

Asset management

45. An adequate management, accounting and information system was not in place to account for assets, as required by sections 63(2)(a) and 96(2)(a) of the MFMA.
46. An effective system of internal control for assets (including an asset register) was not in place, as required by sections 63(2)(c) and 96(2)(b) of the MFMA.

Consequence management

47. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by sections 32(2)(a)(ii) and 102(1) of the MFMA.

Audit committee

48. 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) of the MFMA.
49. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
50. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
51. 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).
52. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii).

Internal Audit

53. 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.
54. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not report to the audit committee on the implementation of the internal audit plan
 - it did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, risk and risk management as well as loss control.

Procurement management

55. 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 information that was requested for contract management was not submitted.
56. Sufficient appropriate audit evidence could not be obtained that quotations had only been accepted from prospective providers who are registered on the list of accredited

prospective providers and meet the listing requirements prescribed by the supply chain management (SCM) policy, in contravention of SCM regulations 16(b) and 17(b).

57. Sufficient appropriate audit evidence could not be obtained that contract and quotations had only been 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.
58. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value below R200 000 had been procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
59. Sufficient appropriate audit evidence could not be obtained that construction contracts had only been awarded to contractors registered with the Construction Industry Development Board (CIDB), in accordance with section 18(1) of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000).
60. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulation 16(b) and 17(b).

Human resource management

61. Sufficient audit evidence could not be obtained that the chief financial officer had the higher education qualification required by section 83 of the MFMA and municipal regulations on minimum competency levels 4 and 5.
62. Sufficient audit evidence could not be obtained that the chief financial officer met any of the prescribed competency areas required by section 83 of the MFMA and municipal regulations on minimum competency levels 4 and 5.
63. Sufficient audit evidence could not be obtained that the head of the SCM unit had the higher education qualification required by section 119 of the MFMA and municipal regulations on minimum competency levels 10 and 11.
64. The head of the SCM unit did not meet any of the prescribed competency areas required by section 119 of the MFMA and municipal regulation on minimum competency levels 10 and 11.

Internal control

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

Leadership

66. The municipality was placed under administration from October 2014 to March 2015, due to a breakdown in the leadership and internal control structures of the municipality that had a negative impact on the operations of the municipality. The intervention did not yield the desired result because all senior managers of the municipality absconded during this period.

67. The leadership did not provide adequate direction and oversight with regard to the control environment as it relates to financial management and compliance with laws and regulations. Adequate policies were not developed, reviewed and implemented to guide all significant processes within the municipality.
68. Furthermore, there was a lack of continuity in the top key management positions. The continued absence of permanent officials to lead and guide the municipality compromised the effectiveness of the control environment and undermined accountability. Furthermore, the leadership did not sufficiently address the challenges of skills and capacity in the municipality's finance section.

Financial and performance management

69. The municipality did not have a proper record management system to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting. These deficiencies included a lack of information relating to the collection, collation, verification, storing and reporting of actual performance information. This was due to the municipality not having standard operating procedures to ensure that all documentation was properly maintained for performance management.
70. Controls over daily and monthly processing and key reconciliations of transactions were not implemented. There were no processes to monitor compliance with all applicable laws and regulations within the municipality. This resulted in significant SCM non-compliance. This area should therefore be prioritised by the leadership and management to improve the current situation.
71. No information technology governance structures and policies were in place, which negatively affected user access management, program change management, security management and continuity. This is evidenced by information that was lost when the financial accounting system crashed and could not be recovered because data was not regularly backed up.

Governance

72. 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 operated, as risk assessment procedures were not adequately performed for the current year.
73. The internal audit unit did not adequately follow up the implementation of internal and external audit recommendations to improve the audit outcome. The unit did not meet all requirements in the audit plan and numerous items in the annual plan were not addressed. As a result, the internal audit unit did not provide any assurance to confirm the credibility of financial and performance reports presented to the council.

74. Although the audit committee was functional during the year, only three of the required four meetings were held, contrary to section 166(2) of the MFMA. The audit committee's ability to provide assurance was further limited, as the internal audit unit provided only one report for their review.

Auditor - General

East London
30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence