

# Report of the auditor-general to the Eastern Cape Provincial Legislature and the council of Intsika Yethu Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Intsika Yethu Local Municipality set out on pages XX to XX 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 audit opinion.

## **Opinion**

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Intsika Yethu 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**

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

### Impairments

8. As disclosed in note 5 to the financial statements material impairments to the amount of R5,6 million (2014: R3 million) were incurred as a result of a write-off of irrecoverable trade debtors.

### Unauthorised expenditure

9. Unauthorised expenditure of R19,6 million (2014; R47,6 million) as disclosed in note 38 to the financial statements was incurred due to overspending of the budget. No disciplinary action has been taken with regard to this expenditure.

### Irregular expenditure

10. Irregular expenditure of R45,6 million (2014; R14,2 million) as disclosed in note 40 to the financial statements has been incurred in the current year due to the supply chain management (SCM) processes not being followed. No disciplinary action has been taken with regard to this expenditure.

### Restatement of corresponding figures

11. As disclosed in note 34 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors only corrected during the year ended 30 June 2015 in the financial statements at, and for the year ended, 30 June 2014.

## **Additional matter**

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

### Unaudited disclosure notes

13. 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

14. 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 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**

15. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2015:

- KPA 2: Basic Service Delivery and Infrastructure development on pages x to x
- KPA 3: Local Economic Development on pages x to x

16. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

17. 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, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

18. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

19. The material findings in respect of the selected objectives are as follows:

### **KPA 2: Basic Service Delivery and Infrastructure development**

#### Reliability of reported performance information

20. 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 and evidence provided. This was due to a lack of standard operating procedures and documented system descriptions for the accurate recording of actual achievements and technical indicator descriptions for the accurate measurement, recording and monitoring of performance, monitoring of the completeness of source documentation in support of actual achievements and frequent review of the validity of reported achievements against source documentation.

## **KPA 3: Local Economic Development**

### **Usefulness of reported performance information**

#### Changes to objectives, indicators and targets not approved

21. Section 54(1) (c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Fifty percent of the changes made to the development objectives and 33% to the indicators in the annual performance report, were made without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to lack of adequate systems and processes to ensure that the municipality complies with the all regulation.

#### Performance indicators and targets not well defined

22. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 23% of the indicators and targets were not well defined.

#### Performance indicators and targets not verifiable

23. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 23% of the indicators and targets were not verifiable. This was due to management not adhering to the requirements of the FMPPI due to a lack of proper systems and processes.

#### Performance target not measurable

24. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 21% of the targets.

#### Targets not time bound

25. The period or deadline for delivery of targets should be specified as required by the FMPPI. A total of 21% of the targets were not time bound.

#### Targets not specific

26. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 21% of the targets were not specific. This resulted in the deficiencies within the municipality's performance management system.

### **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 and evidence provided. This was due to a lack of standard operating procedures and documented system descriptions for the accurate recording of actual achievements and technical



indicator descriptions for the accurate measurement, recording and monitoring of performance, monitoring of the completeness of source documentation in support of actual achievements and frequent review of the validity of reported achievements against source documentation.

## **Additional matters**

28. I draw attention to the following matters :

### **Achievement of planned targets**

29. Refer to the annual performance report on pages 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 objectives reported in paragraphs 20 to 27 of this report.

### **Adjustment of material misstatements**

30. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for Basic Service Delivery and Infrastructure Development and Local Economic Development. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

### **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:

#### **Procurement and contract management**

32. 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).

33. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).

#### **Audit Committee**

34. 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).

#### **Expenditure Management**

35. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.

36. 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.

## **Budgets**

37. 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.

## **Consequence Management**

38. Unauthorised, irregular and 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.

## **Annual reports and Annual Financial Statements**

39. 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 and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

## **Revenue management**

40. 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. (Ex 71)

## **Human resource management and compensation**

41. The competencies of the chief financial officer were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels 13 (MRMCL).
42. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant Provincial Treasury as required by the MRMCL 14(2)(a) .
43. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the MRMCL 14(2)(b).
44. Bonuses were awarded to the municipal manager and senior managers directly accountable to him before the annual report for the financial year under review was tabled and adopted by council, this is in contravention of section 57(4)(b) of the MSA.

## **Strategic and performance management**

45. 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 the MPPMR 12(1) and 12(2)(e).
46. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA. Measurable performance targets for the financial year with regard to each of the development priorities and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the municipal planning and performance management regulation 12(1) and 12(2)(e)."
47. 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, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the MPPMR

### **Internal control**

48. 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 findings on the annual performance report and the findings on compliance with legislation included in this report.

### **Leadership**

49. Leadership did not take disciplinary action against officials who incurred irregular and unauthorised expenditure, as well as against officials who did not comply with the policies, processes and procedures of the municipality.
50. The above challenge has resulted in leadership not setting the correct tone at the top to entrench the culture of clean administration. A leadership tone that drives accountability and clean administration is required to ensure progression towards improved audit outcomes.

### **Financial and performance management**

51. The municipality did not have processes in place to ensure compliance with all applicable laws and regulations, and therefore did not monitor and address non-compliance with all the requirements of the MFMA in a timely manner.
52. Material misstatements were identified in the financial statements due to staff members not correctly applying the requirements of the financial reporting framework and the municipality not preparing and reviewing monthly financial statements. The municipality appointed consultants to assist with the implementation of internal controls and preparation of financial statements due to the lack of in-house skills and competencies. However, the municipality must adopt a proper strategy to fill critical positions to ensure that the opportunity exists for the necessary skills transfer from the consultants to the responsible employees. This will ensure that the reliance on consultants is reduced over time.

Staff members do not always understand the applicable performance information reporting requirements for performance reporting. Information submitted for performance reporting was not sufficient to satisfy the reliability of the reported target in the annual performance report.

### **Governance**

53. Insufficient action was taken by the governance structures within the municipality against individuals who did not implement the audit committee findings during the year under review to ensure that the risks relating to the monitoring and reporting of financial and performance information and compliance with laws and regulations were adequately addressed

**Investigation**

54. An internal investigation has been instituted on a senior official in the traffic department over fraud allegations; the investigation is still in progress.

*Auditor General*

East London

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

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