

# Report of the auditor-general to the Eastern Cape provincial legislature and the council on OR Tambo District Municipality

## Report on the consolidated and separate financial statements

### Introduction

1. I have audited the consolidated and separate financial statements of the OR Tambo District 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 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 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 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**

### Property, plant and equipment

6. The municipality did not account for its property, plant and equipment (PPE) in accordance with GRAP 17 -Property, plant and equipment in the following circumstances:
  - The municipality recorded incorrect invoice amounts in the fixed asset register.
  - The municipality calculated depreciation incorrectly.
7. Consequently, property, plant and equipment are overstated by R16 million, depreciation is understated by R2,4 million and expenditure is understated by R13,6 million.
8. In addition, the corresponding figures for property plant and equipment are understated by R3,1 million, the corresponding amount for payables from exchange transactions is understated by R3,4 million and the corresponding amount for revenue from exchange transactions is overstated by R418 369 as a result of errors identified in the prior year that were not corrected in the current year.
9. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment as supporting documentation for land and buildings was not submitted for audit purposes, negative values were recorded for infrastructure assets and unique identifiers for infrastructure assets were not recorded in the asset register. Supporting documentation for the disposal of assets was also not provided. I was unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any further adjustments to property plant and equipment of R4,3 billion (2014: R4,1 billion) as disclosed in the statement of financial position and note 8 were necessary.

### Consolidation of material subsidiary

10. The requirements of GRAP 6 – Consolidated and separate financial statements, have not been considered and applied by the entity for Kei Fresh Produce Market and, due to inadequate information, the impact on the consolidated financial statements and respective notes to the consolidated financial statements for this subsidiary could not be determined for the current and prior year. Although adjustments to the financial statements were necessary, I was unable to determine the full extent of these adjustments as sufficient appropriate audit evidence was not provided.

## Irregular expenditure

11. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure during the year, as required by section 125(2)(d) of the MFMA. The irregular expenditure disclosed in note 49.3 to the financial statements is understated by R158,6 million in respect of amounts incurred in the year that were identified during the audit process. Due to the lack of systems and the non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed as R93,9 million (2014: R161,1 million) in note 49.3 to the financial statements.

## Fruitless and wasteful expenditure

12. The municipality did not have adequate systems in place to recognise and disclose fruitless and wasteful expenditure incurred during the year, as required by section 125(2)(d) of the MFMA. Additional fruitless and wasteful expenditure amounting to R4,3 million was identified during the audit that was not disclosed in note 49.2 to the financial statements. Due to the lack of appropriate systems it was not practical for me to determine the full extent of the understatement of fruitless and wasteful expenditure as disclosed in the financial statements.

## Material losses

13. The municipality did not disclose the accounting policy on the determination of material losses and how these are recorded in the accounting records and the financial statements. As a result, it was not possible to recalculate the material losses disclosed in note 40.2 of the financial statements. Consequently, I was unable to determine whether any adjustment to material losses of R42,7 million (2014: R29,5 million) as disclosed in note 40.2 was necessary.

## Financial instruments

14. GRAP 104, Financial instruments, requires the following disclosure in terms of paragraph 130, 115(b):
  - Maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
  - A maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of cash flows.
  - A description of how it manages the liquidity risk inherent in the above.
  - A breakdown of the interest earned from the call deposits.
15. The municipality did not include these required disclosures.

## Corresponding figure: Payables from exchange transactions

16. The municipality did not account for its corresponding figure of payables from exchange transactions correctly due to errors made in the previous year that were not corrected during the year under review.
17. Consequently, the corresponding figure for payables from exchange transactions is overstated by R4,9 million, the corresponding figure of employee related costs is understated by R2,9 million and the corresponding figure for expenditure is overstated by R7,7 million.
18. During the previous audit, I was unable to obtain sufficient appropriate audit evidence for the corresponding figure for payables from exchange transactions. The required supporting documentation was also not provided to me during the current audit. I was unable to confirm the corresponding figure for payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to the corresponding figure for payables from exchange transactions of R381,1 million was necessary.

## Aggregation of immaterial uncorrected misstatements

19. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position, the statement of financial performance and the notes to the financial statements:
  - Receivables from non-exchange transaction reflected as R45,4 million are overstated by R30 million.
  - Cash and cash equivalents reflected as R327,9 million are understated by R21,4 million.
  - Revenue from non-exchange transactions reflected as R1 190,1 million is overstated by R32,3 million.
  - Employee-related costs reflected as R361,5 million are understated by R6,5 million.
20. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:
  - Employee costs of R21,6 million (2014: R8,1 million) as included in the disclosed balance of R361,5 million (2014: R317,2 million)
  - Revenue from exchange transactions of R28,3 million (2014: R6,8 million) as included in the disclosed balance of R188,6 million (2014: R150 million)
  - Depreciation and amortisation of R16,4 million (2014: R22,3 million) as included in the disclosed balance of R161.2 million (2014: R226,6 million)
  - Receivables from non-exchange transactions of R13,1 million (2014: R42,3 million) as included in the disclosed balance of R45,4 million (2014: R94,7 million)

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

## **Qualified opinion**

22. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs the consolidated and separate financial statements present fairly, in all material respects, the financial position of the OR Tambo District Municipality and its municipal entities as at 30 June 2015 and their 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**

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

## **Corresponding figures**

24. As disclosed in note 44 to the financial statements, the corresponding figures for 2013-14 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.

## **Additional matter**

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

## **Unaudited supplementary schedules**

26. The supplementary information set out on pages XX to XX 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**

27. 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**

28. 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**

29. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2015:
  - Basic Service Delivery and Infrastructure Development on pages x to x
30. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
31. 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).
32. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
33. The material findings in respect of the selected objectives are as follows:

## **Basic service delivery and infrastructure development**

### Usefulness of reported performance information

34. Performance targets should be specific in clearly identifying the nature and the required level of performance as required by the FMPPI. A total of 23% of the targets were not specific.
35. The processes and systems that produced the indicator/measure should be verifiable, as required by the FMPPI. A total of 52% of the indicators/measures were not verifiable.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

### Reliability of reported performance information

36. 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to inadequate maintenance of records to prove actual performance

## **Additional matter**

37. I draw attention to the following matter:

### **Achievement of planned targets**

38. 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 objectives reported in paragraphs 34 to 36 of this report.

## **Compliance with legislation**

39. 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 management**

40. The municipality did not establish and implement a performance management system, as required by section 38(a) of the MSA.
41. A framework for integrated development planning in the district was not adopted after the start of its elected term / was not consulted with the local municipalities within its area, as required by section 27(1) of the MSA
42. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
43. The performance management system and related controls were not in place 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 Municipal planning and performance management regulations.

## **Expenditure management**

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
45. 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.

## **Annual financial statements**

46. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.

47. Material misstatements of 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.
48. The consolidated annual financial statements (AFS) did not incorporate the AFS of Kei Fresh Produce Market, as required by section 122(2) of the MFMA.

## **Asset management**

49. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
50. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Consequence management**

51. Unauthorised, irregular, and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
52. Allegations of financial misconduct laid against officials of the municipality were not investigated in accordance with the requirements of section 171(4)(a) of the MFMA and Municipal regulations on financial misconduct procedures and criminal proceedings 5(1).

## **Revenue management**

53. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Human resources management**

54. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of MSA.
55. Sufficient appropriate audit evidence could not be obtained that the municipality developed and adopted appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff as required by section 67(d) of the MSA.
56. The municipal manager and or senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.
57. 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 Municipal Regulations on Minimum Competency Levels 14(2)(a).



## Procurement

58. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
59. Sufficient appropriate audit evidence could not be obtained that all contracts and / or quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive.
60. Sufficient appropriate audit evidence could not be obtained that bid specifications for the 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).
61. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees that 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).
62. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
63. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees that were composed in accordance with SCM regulation 29(2).
64. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
65. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
66. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act.
67. 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).
68. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act (PPPFA) and SCM regulation 28(1)(a).
69. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

70. 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.
71. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
72. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 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).
73. Contracts and quotations 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.
74. 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.
75. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
76. 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).
77. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids and that deviations were approved by the accounting officer only if it was impractical to invite competitive bids, as required by SCM regulation 19(a) and 36(1).
78. Bid specifications were not always drafted by bid specification committees that were composed of one or more officials of the municipality as required by SCM regulation 27(3).
79. 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).
80. 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).

## **Internal audit**

81. 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.

## **Internal control**

82. 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**

83. Officials under the leadership's guidance and supervision continued to disregard laws and regulations governing procurement and supply chain management. A significant portion of irregular expenditure was detected during the audit process. The leadership has not followed up or investigated these supply chain transgressions by officials. The lack of consequence management to ensure that appropriate action is taken against officials has a material impact on the effectiveness and the stability of the control environment. The leadership's inability to address and prioritise this critical area has a direct bearing on the number of compliance findings reported. As a result of instability in leadership due to municipal manager and other senior manager vacancies, leadership could not effectively deliver on its responsibilities.
84. The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting within the annual financial statements and annual performance report as well as over compliance with laws and regulations. Furthermore, disciplinary action was not always taken against officials who failed to adhere to the policies and procedures of the municipality or in instances where non-compliance with legislation was identified.
85. The institution did not have adequate action plans in place to address shortcomings in the compliance and performance management process that were identified during the internal and external audit processes. As a result of this, the number of compliance findings has increased in the current year.

## **Financial and performance management**

86. Weekly and monthly reconciliations were not prepared for all financial items during the year, including payroll, debtors, creditors and fixed assets. This is due to a lack of skills to execute basic accounting functions. This resulted in a high volume of manual reconciliation at year-end as part of the financial statement preparation process. Internal controls are not in place as a limited number of key officials within the finance unit are responsible for performing multiple incompatible functions (e.g. bank and cash, supply chain management and assets).
87. Certain reconciliations are prepared by senior finance officials and thus, does not allow for a higher level of review. Errors noted in these reconciliations were identified by the external auditors indicating that there were no proper systems in place, no segregation of duties and there were no skilled officials to performing proper reviews on these items.
88. Systems and processes were not in place to monitor compliance with applicable laws and regulations. This is a repeat finding from the prior year. Resources available at

the municipality were focused on addressing deficiencies in the annual financial statements; however, this focus did not extend to the compliance deficiencies.

## **Governance**

89. The municipality conducted a risk assessment as required by the MFMA. However, it was noted that specific repeat items were not taken into account in the risk assessment e.g. monitoring suppliers and contractors is not considered nor does it consider risks resulting from excessive reliance on contractors or other related parties to perform critical entity operations identified.

90. Although a risk assessment framework is in place, management does not adequately monitor and report on progress of controls implemented, or respond to new risks that may arise. Therefore the risk management process of the municipality is not considered to be adequate or effective.

## **Other reports**

## **Investigations**

91. The Directorate for Priority Crimes Investigations (Hawks) are currently investigating the matters listed below:

- The irregular payment of fraudulently appointed casual workers
- Various matters of alleged financial misconduct

AUDITOR-GENERAL

East London

11 December 2015



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SOUTH AFRICA

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