

Nkonkobe Municipality

Audit Report

For the year ended 30 June 2016

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

Report on the financial statements

Introduction

I have audited the financial statements of the Nkonkobe Local Municipality set out on pages 1 to 124, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets and 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 financial statements

The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of Grap) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (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

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the 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.

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 entity'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 entity'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.

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

The municipality did not have adequate systems to identify and disclose all irregular expenditure during the year as required by section 125 of the MFMA. The irregular expenditure disclosed in note 45.3 was understated by R22,6 million (2015: R8,9 million) in respect of the amounts incurred during the year that were identified during the audit process. The lack of systems made it impracticable to determine the full extent of the understatement of irregular expenditure.

Qualified opinion

In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Nkonkobe Local Municipality as at 30 June 2016 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 the Dora.

Emphasis of matters

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

Restatement of corresponding figures

As disclosed in notes 41 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors only corrected during the year ended 30 June 2016 in the financial statements at, and for the year ended, 30 June 2015.

Irregular expenditure

As disclosed in note 45.3 to the financial statements, irregular expenditure of R15,5 million (2015: R14,1 million) was incurred in 2015-16 due to the supply chain management (SCM) processes not being followed.

Unauthorised expenditure

As disclosed in note 45.1 to the financial statements, unauthorised expenditure of R48,4 million (2015: R36 million) was incurred by the municipality during the year ended 30 June 2016. This was a result of expenditure that was not adequately budgeted for and expenditure in excess of the budget votes.

Fruitless and wasteful expenditure

As disclosed in note 45.2 to the financial statements, fruitless and wasteful expenditure of R1,2 million (2015: R2 million) was incurred by the municipality during the year ended 30 June 2016. This was a result of interest and penalties charged on late payments made by the municipality.

Consequence management

Unauthorised, irregular and fruitless and wasteful expenditure by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a) and (b) of the MFMA.

Allegations of financial misconduct made against officials were not investigated as required by section 171(4)(a) of the MFMA.

Internal control

I considered internal control relevant to my audit of the financial statements, the 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

Slow response to audit messages and ineffective leadership remain a challenge. The roles and responsibilities for recording and filing financial and performance information have been communicated to all relevant staff, but there is a lack of effective oversight by all leadership and oversight structures to ensure accountability and adequate consequences for poor performance and transgressions, which resulted in repeat financial, performance information and compliance findings being raised during the audit.

Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable legislation were not adequately performed. This resulted in the qualified audit opinion, non-compliance with applicable legislation and the information presented in the report on predetermined objectives not being useful and reliable.

The leadership did not implement adequate controls to ensure that the financial statements submitted for auditing did not contain material errors and non-compliance with applicable legislation. Although the municipality had developed an audit action plan, it was not adequately monitored by the leadership to ensure that management addressed internal control deficiencies.

Financial and performance management

The financial statements were subject to material adjustments that were not detected by management. In addition, there were material misstatements that were not corrected and form the basis of the qualified audit opinion. This is due to the lack of adequate daily and monthly financial processing and reconciliations prior to preparing the financial statements, and the audit process was used to correct the financial records.

The municipality did not have a proper system of record management that provided for the maintenance of information to be reported in the annual performance report. This includes information that relates to the collection, collation, verification, storing and reporting of actual performance information.

verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).

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

The material findings in respect of the selected development priorities are as follows:

Development priority: Basic services and infrastructure development

Usefulness of reported performance information

Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of reported objectives were not consistent with those in the approved integrated development plan.

Reliability of reported performance information

The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 36% of indicators were not reliable when compared to the evidence provided.

For 11% of indicators, the reported achievements against planned targets were not reliable because I was unable to obtain sufficient appropriate audit evidence for these targets.

Additional matter

I draw attention to the following matters:

Achievement of planned targets

Refer to annexure A of the annual performance report for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified conclusions expressed on the usefulness and reliability of the reported performance information in paragraphs 22 to 24 of this report.

Adjustment of material misstatements

I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the development priority: basic service and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are included in the basis for qualified opinion paragraph.

Compliance with legislation

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:

Financial statements

The financial statements submitted for audit were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were subsequently corrected; as a result, the municipality avoided an adverse opinion.

Procurement and contract management

Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).

Goods and services with 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).

Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of preferential procurement regulation 9.

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).

Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Contracts were extended and modified without tabling the reasons for the proposed amendment in the municipality's council, as required by section 116(3) of the MFMA.

Expenditure management

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

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

Liability management

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

Impairments

As disclosed in note 32 to the financial statements, impairments of R44,7 million were incurred as a result of writing off irrecoverable trade debtors.

Distribution losses

As disclosed in note 45.4 to the financial statements, material losses of R3,7 million (2015: R3,9 million) were incurred as a result of electricity distribution losses. Further to this, the 21,08% (2015: 16,27%) disclosed for electricity losses was above the acceptable range of 10%.

Events after reporting date

As disclosed in note 50 to the financial statements, the Raymond Mhlaba Local Municipality was subsequently established on 3 August 2016 by amalgamating the Nkonkobe and Nxuba local municipalities, this being the date of the local government election.

Additional matter

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

Unaudited disclosure notes

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 on it.

Report on other legal and regulatory requirements

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

I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:

- Development priority 1: Basic services and infrastructure development on pages x to x

I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined,

The municipality's compliance monitoring process was not effectively implemented and did not monitor controls to ensure that non-compliance with its legislation was prevented or detected. This contributed to repeat compliance findings and irregular expenditure in the current year.

Governance

The recommendations of the internal audit unit were not adequately addressed by management and therefore did not have a positive impact on addressing control deficiencies that existed in the municipality's control environment.

The audit committee was not effective in strengthening the control environment within the municipality, as numerous material misstatements were identified during the audit. Furthermore, findings recurred on financial reporting, performance reporting and compliance matters during the audit process.

Auditor-General

East London

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Nkonkobe Local Municipality set out on pages 1 to 98, which comprise the statement of financial position as at 06 August 2016, the statement of financial performance, statement of changes in net assets and 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 financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of Grap) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (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 the 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 entity'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 entity'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 to identify and update the irregular expenditure closing balance. The closing balance of irregular expenditure disclosed in note 42.3 is understated by R22,6 million (2015: R22,6 million) due to prior year amounts not been corrected.

Qualified opinion

7. In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Nkonkobe Local Municipality as at 06 August 2016 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 the Dora.

Emphasis of matters

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

Fruitless and wasteful expenditure

9. As disclosed in note 42.2 to the financial statements, fruitless and wasteful expenditure of R0,260 million (2016: R1,2 million) was incurred by the municipality during the year ended 6 August 2016. This was a result of interest and penalties charged on late payments made by the municipality.

Impairments

10. As disclosed in note 31 to the financial statements, impairments of R16,8 million were incurred as a result of writing off irrecoverable trade debtors.

Distribution losses

11. As disclosed in note 45.4 to the financial statements, material losses of R0,261 million (2016: R3,7 million) were incurred as a result of electricity distribution losses. Further to this, the 26,33% (2016: 21,087%) disclosed for electricity losses was above the acceptable range of 10%.

Events after reporting date

12. As disclosed in note 47 to the financial statements, the Raymond Mhlaba Local Municipality was subsequently established on 6 August 2016 by amalgamating the Nkonkobe and Nxubalocal municipalities, this being the date of the local government election.

Additional matter

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

Unaudited disclosure notes

14. 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 on it.

Report on other legal and regulatory requirements

15. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected development priorities 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

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priorities presented in the annual performance report of the municipality for the year ended 03 August 2016:
 - Development priority 1: Basic services and infrastructure development on pages x to x
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 development priorities. 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 development priorities are as follows:

Development priority: Basic services and infrastructure development

Usefulness of reported performance information

20. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of reported objectives were not consistent with those in the approved integrated development plan.

Reliability of reported performance information

21. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned

objectives, indicators and targets. The reported achievements against planned targets of 36% of indicators were not reliable when compared to the evidence provided.

22. For 11% of indicators, the reported achievements against planned targets were not reliable because I was unable to obtain sufficient appropriate audit evidence for these targets.

Additional matter

23. I draw attention to the following matters:

Achievement of planned targets

24. Refer to annexure A of the annual performance report for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified conclusions expressed on the usefulness and reliability of the reported performance information in paragraphs 22 to 24 of this report.

Adjustment of material misstatements

25. Identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the development priority: basic service and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are included in the basis for qualified opinion paragraph.

Compliance with legislation

26. 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:

Financial statements

27. The financial statements submitted for audit were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were subsequently corrected; as a result, the municipality avoided an adverse opinion.
28. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

Expenditure management

29. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
30. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

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

Internal control

32. I considered internal control relevant to my audit of the financial statements, the 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

33. Slow response to audit messages and ineffective leadership remain a challenge. The roles and responsibilities for recording and filing financial and performance information have been communicated to all relevant staff, but there is a lack of effective oversight by all leadership and oversight structures to ensure accountability and adequate consequences for poor performance and transgressions, which resulted in repeat financial, performance information and compliance findings being raised during the audit.
34. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable legislation were not adequately performed. This resulted in the qualified audit opinion, non-compliance with applicable legislation and the information presented in the report on predetermined objectives not being useful and reliable.
35. The leadership did not implement adequate controls to ensure that the financial statements submitted for auditing did not contain material errors and non-compliance with applicable legislation. Although the municipality had developed an audit action plan, it was not adequately monitored by the leadership to ensure that management addressed internal control deficiencies.

Financial and performance management

36. The financial statements were subject to material adjustments that were not detected by management. In addition, there were material misstatements that were not corrected and form the basis of the qualified audit opinion. This is due to the lack of adequate daily and monthly financial processing and reconciliations prior to preparing the financial statements, and the audit process was used to correct the financial records.
37. The municipality did not have a proper system of record management that provided for the maintenance of information to be reported in the annual performance report. This includes information that relates to the collection, collation, verification, storing and reporting of actual performance information.
38. The municipality's compliance monitoring process was not effectively implemented and did not monitor controls to ensure that non-compliance with its legislation was prevented or detected. This contributed to repeat compliance findings and irregular expenditure in the current year.

Governance

39. The recommendations of the internal audit unit were not adequately addressed by management and therefore did not have a positive impact on addressing control deficiencies that existed in the municipality's control environment.
40. The audit committee was not effective in strengthening the control environment within the municipality, as numerous material misstatements were identified during the audit. Furthermore, findings recurred on financial reporting, performance reporting and compliance matters during the audit process.

Auditor-General

East London

13 December 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

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

Report on the consolidated and separate financial statements

Introduction

1. I have audited the consolidated and separate financial statements of the Nkonkobe Local Municipality set out on pages 1 to 113, which comprise the consolidated and separate statement of financial position as at 30 June 2016, the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and consolidated and separate cash flow statement, and the consolidated and separate statement of comparison of budget and actual amounts for the year then ended, as well as the consolidated and separate 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 the South African Standards of Generally Recognised Accounting Practice (SA standards of Grap) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2014 (Act No. 1 of 2015) (Dora), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate 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 the 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 entity'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 entity'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

Irregular expenditure

6. The municipality did not have adequate systems to identify and disclose all irregular expenditure during the year as required by section 125 of the MFMA. The irregular expenditure disclosed in note 46.3 was understated by R22,6 million (2015: R8,9 million) in respect of the amounts incurred during the year that were identified during the audit process. The lack of systems made it impracticable to determine the full extent of the understatement of irregular expenditure.

Qualified opinion

7. In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Nkonkobe Local Municipality as at 30 June 2016 and its consolidated and separate financial performance and cash flows for the year then ended, in accordance with SA standards of Grap and the requirements of the MFMA and the DoRa.

Emphasis of matters

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

Restatement of corresponding figures

9. As disclosed in notes 42 to the consolidated and separate financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors only corrected during the year ended 30 June 2016 in the consolidated and separate financial statements at, and for the year ended, 30 June 2015.

Irregular expenditure

10. As disclosed in note 46.3 to the consolidated and separate financial statements, irregular expenditure of R15,5 million (2015: R14,1 million) was incurred in 2015-16 due to the supply chain management (SCM) processes not being followed.

Unauthorised expenditure

11. As disclosed in note 46.1 to the consolidated and separate financial statements, unauthorised expenditure of R48,4 million (2015: R36 million) was incurred by the municipality during the year ended 30 June 2016. This was a result of expenditure that was not adequately budgeted for and expenditure in excess of the budget votes.

Fruitless and wasteful expenditure

12. As disclosed in note 46.2 to the consolidated and separate financial statements, fruitless and wasteful expenditure of R1,2 million (2015: R2 million) was incurred by the municipality during the year ended 30 June 2016. This was a result of interest and penalties charged on late payments made by the municipality.

Impairments

13. As disclosed in note 33 to the consolidated and separate financial statements, impairments of R44,7 million were incurred as a result of writing off irrecoverable trade debtors.

Distribution losses

14. As disclosed in note 46.4 to the consolidated and separate financial statements, material losses of R3,7 million (2015: R3,9 million) were incurred as a result of electricity distribution losses. Further to this, the 21,08% (2015: 16,27%) disclosed for electricity losses was above the acceptable range of 10%.

Events after reporting date

15. As disclosed in note 51 to the consolidated and separate financial statements, the Raymond Mhlaba Local Municipality was subsequently established on 3 August 2016 by amalgamating the Nkonkobe and Nxuba local municipalities, this being the date of the local government election.

Additional matter

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

Unaudited disclosure notes

17. 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 consolidated and separate financial statements and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected development priorities 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

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
 - Development priority 1: Basic services and infrastructure development on pages x to x
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. 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).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected development priorities are as follows:

Development priority: Basic services and infrastructure development

Usefulness of reported performance information

23. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of reported objectives were not consistent with those in the approved integrated development plan.

Reliability of reported performance information

24. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 36% of indicators were not reliable when compared to the evidence provided.
25. For 11% of indicators, the reported achievements against planned targets were not reliable because I was unable to obtain sufficient appropriate audit evidence for these targets.

Additional matter

26. I draw attention to the following matters:

Achievement of planned targets

27. Refer to annexure A of the annual performance report for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified conclusions expressed on the usefulness and reliability of the reported performance information in paragraphs 22 to 24 of this report.

Adjustment of material misstatements

28. Identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the development priority: basic service and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are included in the basis for qualified opinion paragraphs.

Compliance with legislation

29. 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:

Financial statements

30. The consolidated and separate financial statements submitted for audit were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted consolidated and separate financial statements were subsequently corrected; as a result, the municipality avoided an adverse opinion.

Procurement and contract management

31. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
32. Goods and services with 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. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of preferential procurement regulation 9.
34. 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).
35. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
36. Contracts were extended and modified without tabling the reasons for the proposed amendment in the municipality's council, as required by section 116(3) of the MFMA.

Expenditure management

37. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
38. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

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

Consequence management

40. Unauthorised, irregular and fruitless and wasteful expenditure by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a) and (b) of the MFMA.
41. Allegations of financial misconduct made against officials were not investigated as required by section 171(4)(a) of the MFMA.

Internal control

42. I considered internal control relevant to my audit of the consolidated and separate financial statements, the 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

43. Slow response to audit messages and ineffective leadership remain a challenge. The roles and responsibilities for recording and filing financial and performance information have been communicated to all relevant staff, but there is a lack of effective oversight by all leadership and oversight structures to ensure accountability and adequate consequences for poor performance and transgressions, which resulted in repeat financial, performance information and compliance findings being raised during the audit.
44. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable legislation were not adequately performed. This resulted in the qualified audit opinion, non-compliance with applicable legislation and the information presented in the report on predetermined objectives not being useful and reliable.
45. The leadership did not implement adequate controls to ensure that the consolidated and separate financial statements submitted for auditing did not contain material errors and non-compliance with applicable legislation. Although the municipality had developed an audit action plan, it was not adequately monitored by the leadership to ensure that management addressed internal control deficiencies.

Financial and performance management

46. The consolidated and separate financial statements were subject to material adjustments that were not detected by management. In addition, there were material misstatements that were not corrected and form the basis of the qualified audit opinion. This is due to the lack of adequate daily and monthly financial processing and reconciliations prior to preparing the consolidated and separate financial statements, and the audit process was used to correct the financial records.
47. The municipality did not have a proper system of record management that provided for the maintenance of information to be reported in the annual performance report. This includes information that relates to the collection, collation, verification, storing and reporting of actual performance information.
48. The municipality's compliance monitoring process was not effectively implemented and did not monitor controls to ensure that non-compliance with its legislation was prevented or detected. This contributed to repeat compliance findings and irregular expenditure in the current year.

Governance

49. The recommendations of the internal audit unit were not adequately addressed by management and therefore did not have a positive impact on addressing control deficiencies that existed in the municipality's control environment.
50. The audit committee was not effective in strengthening the control environment within the municipality, as numerous material misstatements were identified during the audit. Furthermore, findings recurred on financial reporting, performance reporting and compliance matters during the audit process.

Auditor - General

East London

13 December 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence