

Nxuba 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 Nxuba Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Nxuba Local Municipality set out on pages ... to ..., 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

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 of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (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 adverse audit opinion.

Basis for adverse opinion

Property, plant and equipment

6. In terms of GRAP 17, *Property plant and equipment*, the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the entity, and the cost or fair value of the item can be measured reliably. The general ledger and fixed asset register could not be reconciled back to the financial statements and capital assets were capitalised in the incorrect financial period.
7. Further to this, work in progress was not accounted for in accordance with GRAP 17: *Property, plant and equipment* as the municipality inaccurately recorded depreciation on work in progress.
8. As a result, property, plant and equipment, disclosed in note 10 to the financial statements was understated by R5,2 million and accumulated depreciation and impairments was overstated by the same amount.

Investment property

9. In terms of GRAP 16: *Investment property*, investment property is property held to earn rentals or for capital appreciation or both. Investment property shall be recognised as an asset when, it is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and the cost or fair value of the investment property can be measured reliably. The municipality did not include all items classified as investment property to which it has title in the investment property register. Further to this, not all the items of investment property could be located for physical verification.
10. As a result, investment property, disclosed in note 9 to the financial statements was understated by R14,2 million and accumulated surplus was understated by the same amount.

Payables

11. Sufficient appropriate audit evidence was not available to support payables relating to unallocated deposit, accrued leave pay and accrued bonuses presented in the statement of financial position and disclosed in note 13 to the financial statements. This was due to weak internal controls over the reconciliation of accounts and poor record management for payables. Further to this, the municipality did not have adequate systems in place to identify and record all payables as required by section 63(2)(b) of the MFMA.
12. I was unable to confirm the payables balance by alternative means. Consequently, I could not determine whether any adjustments were necessary to the Payables of R81,1 million disclosed in note 13 to the financial statements.

Bulk purchases

13. In terms of GRAP 1: *Presentation of Financial Statements*, an entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting. The municipality incorrectly recorded bulk purchases in relation to the previous financial year in the current financial period. The current year invoices were accounted for at the incorrect value. As a result, bulk purchases is understated by R10,9 million, payables is understated by R9,2 million and vat receivables is overstated by R1,7 million.
14. Sufficient appropriate audit evidence was not available to support journals relating to bulk purchases as the municipality did not maintain adequate records relating to bulk purchases. This was due to weak internal controls and poor record management of bulk purchases.
15. I was unable to confirm the bulk purchases balance by alternative means. Consequently, I could not determine whether any adjustments were necessary to the bulk purchases balance of R30,7 million as disclosed in note 34 to the statement of financial performance.

General expenses

16. In terms of the GRAP 1: *Presentation of financial statements*, information must represent faithfully the transactions and other events it either purports to either represent, or could reasonably be expected to represent. The municipality did not:
 - Accurately record all general expenses related to the financial year as supplier invoices did not agree to recorded values in the general ledger.
 - Recognise all general expenses relating to the financial year in the financial statements of the municipality.
 - Reconcile the general ledger back to the financial statement; this was evident by the material differences identified.
 - Account for free basic services in terms of GRAP 1: *Presentation of financial statements* in the financial statements.
17. As a result, expenditure, disclosed on the statement of financial performance was understated by R8,4 million and payables understated by the same amount.
18. Further to this, sufficient appropriate audit evidence was not available to support transactions relating to expenditure. This was due to weak internal controls and poor record management for expenditure. I was unable to confirm expenditure by alternative means. Consequently, I could not determine whether any adjustments were necessary to the expenditure balance of R72 million as disclosed on the statement of financial performance.

Irregular expenditure

19. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 32 of the MFMA. As a result, the irregular expenditure disclosed in note 49 is understated by R48 million. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure.

Unauthorised expenditure

20. The municipality is required to disclose unauthorised expenditure in terms of section 1 and 125(2)(d) of the MFMA. The municipality did not disclose all the unauthorised expenditure. As a result unauthorised expenditure is understated by R12 million as disclosed in note 47 to the financial statements.

Commitments

21. The municipality did not accurately disclose all capital expenditure commitments as required by GRAP 17 Property, plant and equipment. Commitments were calculated using the incorrect contract and payment values. In addition certain capital expenditure contracts were excluded from the commitments listing. Consequently, commitments as disclosed in note 41 to the financial statements were understated by at least R9 million.

Receivables from exchange transactions

22. The municipality did not account for receivables correctly as the debtor's age analysis does not agree with the financial statements, as required by GRAP 1: *Presentation of financial statements*. Receivables from exchange transactions presented in the statement of financial position was therefore understated by R22,4 million and Revenue from exchange transactions was also understated by the same amount.

Receivables from non-exchange transactions

23. The financial statements and general ledger did not reconcile, as required by GRAP 1: *Presentation of financial statements*. Receivables from non-exchange transactions presented in the statement of financial position is therefore understated by R2,1 million and Revenue from non-exchange transactions is also understated by the same amount.
24. Sufficient appropriate audit evidence was not available to support sundry deposits and sundry debtors as presented in the statement of financial position and disclosed in note 4 to the financial statements, as there was no documentation to support the balances reported.
25. I was unable to confirm the receivables from non-exchange transactions by alternative means. Consequently, I could not determine whether any adjustments were necessary to the receivables from non-exchange balance of R7,7 million as disclosed in note 4 to the financial statements.

Revenue from non-exchange transactions

26. The municipality did not account for revenue from non-exchange transactions correctly as the valuation roll did not reconcile back to the financial statements, as required by GRAP 1: *Presentation of financial statements*. Revenue from non-exchange transactions presented in the statement of financial performance was therefore understated by R52,1 million and Receivables from non-exchange transactions was also understated by the same amount.

Revenue from exchange transactions: Licences and permits

27. Sufficient and appropriate evidence was not available to support revenue relating to traffic fines and licences from exchange transactions as presented in the statement of financial performance, due to a lack of systems and processes in place at the municipality.
28. I was unable to confirm the revenue from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to revenue from exchange transactions disclosed at R3,7 million in the statement of financial performance.

Unspent Conditional Grants

29. Sufficient appropriate audit evidence was not available to support unspent conditional grants and receipts presented in the statement of financial position and disclosed in note 16 to the financial statements, as the unspent portion is not cash backed and the grant revenue is not kept in a separate bank account and the unspent conditional grants and receipts portion did not reconcile to the 3rd party confirmation.
30. I was unable to confirm the unspent conditional grants and receipts by alternative means. Consequently, I could not determine whether any adjustments were necessary to unspent conditional grants and receipts balance of R1,2 million as disclosed in note 16 to the financial statements.

Cash and cash equivalents

31. Sufficient appropriate audit evidence was not available to support cash and cash equivalents presented in the statement of financial position and disclosed in note 3 to the financial statements, as there was no documentation to support the material reconciling items disclosed on the bank reconciliation.
32. I was unable to confirm the cash and cash equivalents by alternative means. Consequently, I could not determine whether any adjustments were necessary to the cash and cash equivalents balance of R678 485 as disclosed in note 3 to the financial statements.

Adverse opinion

33. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Municipality as at 30 June 2016, its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

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

Restatement of corresponding figures

35. As disclosed in note 54 to the financial statements, the corresponding figures for 30 June 2015 were 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.

Fruitless and wasteful expenditure

36. As disclosed in note 48 to the financial statements, fruitless and wasteful expenditure of R14,7 million (2015: R8,4 million) was incurred by the municipality during the year ended 30 June 2016. This was as a result of interest and penalties charged on late payments made by the municipality. No disciplinary action has been taken for the expenditure.

Impairments

37. As disclosed in note 30 to the financial statements, impairments to the amount of R7,8 million (2015: R8,2 million) were incurred as a result of a write-off of irrecoverable trade debtors.

Financial sustainability

38. As disclosed in note 45 to the financial statements, financial sustainability indicators have been disclosed by management.

Additional matter

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

Events after reporting date

40. As disclosed in note 46 to the financial statements, the Raymond Mhlaba Local Municipality was subsequently established by the amalgamating the Nkonkobe Local Municipality and Nxuba Local Municipality on 6 August 2016.

Report on other legal and regulatory requirements

41. In accordance with the Public Audit Act of South Africa, 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

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

- Development objective 2: Service Delivery and Infrastructure Development on pages x to x

43. 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)*.

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

45. The material findings in respect of the selected development objective are as follows:

Development objective: Service Delivery and Infrastructure Development

Usefulness of reported performance information

46. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 30% of the indicators were not verifiable. This was due to inadequate supporting documentation being provided for audit purposes.

47. The FMPPI requires that the performance targets should specify the period and the deadline for the delivery. All of the targets were not time bound. This was due to most of the projects being multi-year and performance was not specific in terms of what needs to be achieved on a year-to-year basis.

Reliability of reported performance information

48. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of the actual achievements against planned objectives, indicators and targets. The reported performance information was not

reliable when compared to the evidence provided.

Additional matters

49. I draw attention to the following matters:

Achievement of planned targets

50. Refer to the annual performance report on pages x to x; x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified and adverse conclusions expressed on the usefulness and reliability of the reported performance information in paragraphs 13 and 16 of this report.

Unaudited supplementary

51. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. We have not audited these schedules and, accordingly, we do not express a conclusion on them.

Compliance with legislation

52. 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:

Budget

53. 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.

Financial Statements, performance and annual reports

54. 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 identified by the auditors in the submitted financial statements were not adequately corrected which resulted in the financial statements receiving an adverse audit opinion.

Procurement and Contract management

55. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
56. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services as required by SCM regulation 28(2).
57. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the PPR.
58. Bid adjudication committees were not always composed in accordance with SCM regulation 29(2).
59. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of Preferential Procurement Regulations 9 (PPR).
60. 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).
61. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the PPPFA.
62. 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).
63. I could not obtain sufficient appropriate audit evidence 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.
64. I could not obtain sufficient appropriate audit evidence that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
65. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
66. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
67. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).
68. I could not obtain sufficient appropriate audit evidence that contract were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Expenditure Management

69. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.
70. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 99(2)(a) of the MFMA.
71. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional Grants

72. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant allocation, as required by section 12(5) of the Division of Revenue Act.

Revenue Management

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

Consequence management

74. 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) of the MFMA and the municipal budget and reporting (MBR) regulations 75(1).

Asset management

75. 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.

Internal control

76. 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 adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

77. Slow response to audit messages and effective leadership remained a challenge. The roles and responsibilities for recording and filing financial and performance information had been communicated to all relevant staff. However, there was 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 raised during the audit.
78. 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.
79. Prolonged vacancies in key positions resulted in instability, which had a negative impact on the municipality's ability to respond to the previous period's findings. The absence of this leadership resulted in inadequate direction within the municipality to direct and guide the strategies and operations of the municipality.
80. 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

81. 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 adverse audit opinion. This was because adequate daily and monthly financial processing and reconciliations did not always take place prior to the preparation of the financial statements, and the audit process was used to correct the financial records.
82. 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 included information related to the collection, collation, verification, storing and reporting of actual performance information.
83. The municipality's compliance monitoring process was not effective when implementing controls and monitoring them to ensure that non-compliance with its laws and regulations was prevented or detected. This contributed to repeat compliance findings in 2015-16.

Governance

84. 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.
85. The audit committee was not effective in strengthening the control environment within the municipality, as numerous material misstatements were identified during the audit. Furthermore, recurring findings on performance reporting and compliance matters were identified during the audit process.

Auditor - General

Eastern Cape
30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence