

# Final Report of the auditor-general to the Eastern Cape Provincial Legislature and the Council for Inxuba Yethemba Municipality

## Final Report on the audit of the financial statements

### Opinion

1. I have audited the financial statements of the Inxuba Yethemba Municipality set out on pages ... to ..., which comprise statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, and cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Inxuba Yethemba Municipality as at 30 June 2016, and its financial performance and cash flows for the year then ended in accordance with 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, 2016 (Act No. 11 of 2016) (DoRA).

### Context for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Emphasis of matters

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

### Restatement of corresponding figures

7. As disclosed in note 49 to the financial statements, the corresponding figures for 30 June 2016, have been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2017.

## **Material Impairments – Receivables and Consumer Debtors**

8. As disclosed in note 4, 5 and 6 to the financial statements, material impairments to the amount of R135.9 million (2016: R116.9 million) were incurred as a result of a non-payment by trade debtors.

## **Unauthorised expenditure**

9. As disclosed in note 39 to the financial statements, unauthorised expenditure to the amount of R20.5 million was incurred.
10. As disclosed in note 39 to the financial statements, unauthorised expenditure to the amount of R26.7 million that was incurred in the previous years was not investigated.

## **Irregular expenditure**

11. As disclosed in note 41 to the financial statements, irregular expenditure to the amount of R49.3 million was incurred, as a proper tender process had not been followed as well as non-compliance with SCM regulations.
12. As disclosed in note 41 to the financial statements, irregular expenditure to the amount of R43.6 million that was incurred in the previous years was not investigated.

## **Fruitless and Wasteful expenditure**

13. As disclosed in note 40 to the financial statements, fruitless and wasteful to the amount of R7.2 million was incurred.
14. As disclosed in note 40 to the financial statements, fruitless and wasteful expenditure to the amount of R2.0 million that was incurred in the previous years was not investigated.

## **Other matters**

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

## **Unaudited disclosure notes**

16. In terms of section 125(2)(e) of the MFMA the entity is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **Unaudited supplementary information**

17. The supplementary information set out on pages 41 does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

## **Responsibilities of the accounting officer**

18. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with GRAP and the requirements of the MFMA and 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.

19. In preparing the financial statements, the accounting officer is responsible for assessing the Inxuba Yethemba municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

20. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
21. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

22. 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 material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
23. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

24. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
Development priority – Technical Services	x – x
Development priority – Community Services	x – x
Development priority – LED	x – x

25. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. I did not identify any material findings on the usefulness and reliability of the reported performance information for the selected priorities.

### **Other matters**

27. I draw attention to the matters below.

#### **Achievement of planned targets**

28. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year and explanations provided for the under / overachievement of a significant number of targets.

## **Report on audit of compliance with legislation**

### **Introduction and scope**

29. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
30. The material findings on compliance with specific matters in key legislations are as follows:

### **Financial Statements and Annual Report**

31. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current liabilities and revenue identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.

32. The 2015/16 annual report was not published for the local community to submit representations in connection with the annual report as required by section 127(5)(a) of the MFMA.
33. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.
34. The oversight report adopted by the council on the 2015/16 annual report was not made public, as required by section 129(3) of MFMA.

### **Budgets**

35. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R20.5 million, as disclosed in note 39 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by the over-expenditure of employee costs, interest to trade creditors and employee benefit interest costs and impairment losses.

### **Conditional Grants**

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

### **Consequence Management**

37. Unauthorised 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 Municipal Finance Act.
38. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act.
39. 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)(b) of the Municipal Finance Management Act.

### **Expenditure Management**

40. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.
41. Effective steps were not taken to prevent irregular expenditure amounting to R42.8 million as disclosed in note 41 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with SCM regulations.
42. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R7.2 million, as disclosed in note 40 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

## **Procurement and Contract Management**

43. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the paving of Vukuzenzele.
44. Some of the contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and Preferential Procurement Regulations. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the Hillside Community side.
45. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the fencing of the Cradock disposal site.
46. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the 15 projects.
47. 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. Similar non-compliance was also reported in the prior year.
48. Awards were made to providers whose directors / principal shareholders were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
49. Some of the competitive bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services AND/OR at least one SCM practitioner of the municipality, as required by SCM regulation 28(2). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the Fencing of Cradock disposal site.
50. Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). This non-compliance was identified in the procurement processes for the Construction of Hillside Community Hall, Paving Vukuzenzele, Ripple control, Fencing of Cradock disposal site and Municipal land audit.
51. Some of the contracts 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). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the Construction of Hillside Community Hall.

## **Human Resource Management**

52. Senior managers failed to disclose financial interests within 60 days from date of appointment, as required by regulation 36(1)(a) on appointment and conditions of employment of senior managers.
53. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.
54. The municipal manager and or senior managers did not sign performance agreements within the prescribed period, as required by section 57(2)(a) of the MSA.

## **Strategic planning and performance management**

55. The local community was not consulted on the drafting and implementation of the IDP as required by section 29(1)(b)(ii) of the MSA on drafting of the IDP and/or municipal planning and performance regulation 15(1)(a)(i).
56. The IDP was not drafted considering the integrated development process and proposals submitted by the district municipality as required by section 29(3) of the MSA.
57. The local community was not afforded the opportunity to comment on the final draft of the IDP before adoption, as required by section 42 of the MSA and municipal planning and performance management regulation 15(3).
58. The review of the IDP was not done in accordance with the results of the performance evaluation or to the extent that changing circumstances demanded as required by section 34(a) and 41(1)(c) of the MSA.
59. A mid-year performance assessment was not performed as required by section 72(1)(a)(ii) of the MFMA.
60. Amendments to the IDP were made without making the proposed amendments available for public comment and /or consultation with the local municipality as required by municipal planning and performance management regulations 3(4)(b), 3(6)(a) and 15(1)(ii).
61. A performance management system was not established or adopted as required by section 38(a) of the MSA and municipal planning and performance management regulation 8.
62. The performance management system and related controls were not maintained as it did not describe how the performance planning/ monitoring/ measurement/ review/ reporting/ improvement processes should be conducted or organised and managed, as required by municipal planning and performance management regulation 7(1).

## **Other information**

63. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the audit committee's report. The other information does not include the financial statements, the auditor's report thereon and those selected development priorities presented in the

annual performance report that have been specifically reported on in the auditor's report.

64. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
65. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
66. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

#### Internal control deficiencies

67. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for opinion, and the findings on compliance with legislation included in this report.
  - There has been instability in leadership during the year due to the rotation of the acting position for the accounting officer. This has resulted in accounting officer not overseeing the monitoring of internal controls, which caused numerous non-compliance with legislation. The accounting officer also did not hold management accountable for transgressions and did not implement any consequence management. Furthermore, the municipality did have an audit intervention plan however it was not monitored on a regular basis.
  - Management did not implement daily and monthly controls in the budget and treasury office and municipal manager office on a timeous basis. There is a lack of understanding of the applicable financial reporting framework and performance information reporting requirements by officials. Furthermore there was no process for monitoring compliance on a regular basis, which has resulted in the numerous compliance findings as reported above.
  - The municipality did not implement appropriate risk activities. Risk strategy to address risks were not adequately developed and monitored. There was no adequately resourced and functioning internal audit unit and reports were not available from this unit. The audit committee did not evaluate and monitor responses to risks and did not adequately perform their oversight function on the effectiveness of the internal control environment, performance reporting and compliance with laws and regulation. Further the audit committee did not advise accounting officer and council on the effectiveness of



internal control environment, compliance with applicable legislation/ accounting standards and on the usefulness and reliability of predetermined objectives.

*Auditor - General*

East London

30 November 2017



AUDITOR - GENERAL  
SOUTH AFRICA

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## **Annexure – Auditor-general’s responsibility for the audit**

68. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected programmes and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

69. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:

- identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit 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.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
- conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease operating as a going concern.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

## **Communication with those charged with governance**

70. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
71. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.