



Auditing to build public confidence

**AUDITOR-GENERAL
SOUTH AFRICA**

Ngqushwa Municipality

Audit Report

For the year ended 30 June 2015

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Ngqushwa Local Municipality set out on pages ... to ..., which comprise the separate statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Payables from exchange transactions

6. The municipality did not have adequate systems to maintain records of accounts payable for goods and services received but not yet paid for, which resulted in trade payables and general expenses being understated by at least R4 million (2014: R11,6 million). It was impracticable for me to determine the full extent of the understatement in payables from exchange transactions and general expenses.
7. In addition, I was unable to obtain sufficient appropriate audit evidence for the amount disclosed as trade payables in note 14 to the financial statements as requested information was not submitted and I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade payables of R31,2 million (2014: R27,7 million) as disclosed in the financial statements.

Value-added tax (VAT)-receivable

8. The municipality did not have adequate systems to maintain records of the VAT receivable nor was sufficient appropriate audit evidence available to identify, reconcile and disclose all VAT transactions relating to the VAT receivable amounting to R8,5 million (2014: R4,1 million) as disclosed in note 7 to the financial statements. I was unable to confirm the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustments relating to the VAT receivable were necessary.
9. In addition, the municipality did not account for VAT in accordance with GRAP 1, *Presentation of financial statements* in the financial statements. Invoices that had been paid and claimed from the South African Revenue Service (SARS) during the year, as well as invoices that were not VAT compliant were incorrectly included in the VAT receivable at year-end. Consequently, the VAT receivable as disclosed in note 7 to the financial statements is overstated by R1,3 million (2014: R2,2 million) and the accumulated surplus is overstated by R1,3 million (2014: R2,2 million).

Government grants revenue

10. Included in government grants revenue is municipal infrastructure grants (MIG), I was unable to obtain sufficient appropriate audit evidence for the amount disclosed as MIG revenue in note 22 to the financial statements as requested information was not submitted and I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to MIG revenue of R27,5 million (2014: R27,8 million) as disclosed in the financial statements.

Repairs and maintenance

11. The municipality did not account for repairs and maintenance in accordance with GRAP 1, *Presentation of financial statements* in the financial statements. An invalid trade creditor was incorrectly off-set against repairs and maintenance. Consequently, repairs and maintenance as disclosed in note 28 to the financial statements are understated by R3,2 million and the accumulated surplus is overstated by R3,2 million.
12. In addition, I was unable to obtain sufficient appropriate audit evidence for the amount disclosed as repairs and maintenance in note 28 to the financial statements as

requested information was not submitted and I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to repairs and maintenance of R957 132 (2014: R3,8 million) as disclosed in the financial statements.

Irregular expenditure

13. As the municipality did not have adequate systems to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA, the irregular expenditure for the current and prior year, disclosed in note 40 to the financial statements is understated. Due to the lack of systems it was impracticable to determine the full extent of the understatement of the irregular expenditure. Consequently, I was unable to determine whether any further adjustments were necessary to the current and prior year irregular expenditure of R48,5 million (2014: R28,1 million) as disclosed in note 40 to the financial statements.

Unauthorised expenditure

14. Sufficient appropriate audit evidence could not be obtained for unauthorised expenditure incurred in prior years and included in the current year's closing balance as requested information was not submitted. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the current and prior year unauthorised expenditure of R51,3 million (2014: R28,8 million) as disclosed in note 38 to the financial statements.

Aggregation of immaterial uncorrected misstatements

15. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the disclosure notes:
 - Fines and penalties are understated by R586 008.
 - Employee-related costs are overstated by R1million.
 - Remuneration of councillors is overstated by R945 331
 - Receivables from non-exchange transactions are overstated by R1,6 million.
 - Receivables from exchange transactions are understated by R645 815.
 - Property, plant and equipment is understated by R390 854.
 - Unspent conditional grants are understated by R384 615.
 - Commitments are overstated by R468 884.
 - Remuneration of key management personnel disclosure is understated by R1 million.
 - Cash flow statement: movement in working capital disclosed in note 31 to the financial statements is overstated by R1,8 million.

16. I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm the following elements by alternative means:
- Employee-related costs of R1,1 million included in the disclosed amount of R44,9 million disclosed in note 23 to the financial statements.
 - Receivables from non-exchange transactions of R151 517 included in the disclosed amount of R11,8 million disclosed in note 6 to the financial statements.
17. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Corresponding figures

18. I identified the following misstatements that are included in the corresponding figures disclosed in the current period's financial statements:
- General expenses disclosed in note 30 to the financial statements are understated by R14,7 million.
 - Employee related costs disclosed in note 23 to the financial statements are overstated by R2 million.
 - The accumulated surplus disclosed in the statement of financial position is overstated by R12 million.
 - Commitments disclosed in note 32 to the financial statements are overstated by R9,5 million.
 - The net cash flow from operating activities disclosed in the statement of cash flows is understated by R6,5 million.
 - Cash flow statement: movement in working capital disclosed in note 31 to the financial statements are understated by R8,5 million.
19. In addition, I was unable to obtain sufficient appropriate audit evidence regarding the amounts disclosed for the following:
- General expenses reflected as R38,6 million disclosed in note 30 to the financial statements.
 - Employee related costs reflected as R40,5 million disclosed in note 23 to the financial statements.
 - Accumulated surplus reflected as R157,5 million in the statement of financial position.
 - Commitments reflected as R14 million disclosed in note 32 to the financial statements.
20. I was unable to obtain sufficient appropriate audit evidence for the above by alternative means. Consequently, I was unable to determine whether any adjustments to these amounts and the accumulated surplus were necessary.

21. My audit opinion on the financial statements for the period ended 2013-14 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements in the corresponding figures

22. The corresponding figures in the financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position:
- Receivables from non-exchange transactions are overstated by R1,1 million.
 - Finance lease obligation: current portion is overstated by R1,6 million.
 - Finance lease obligation: non-current portion is understated by R1,5 million.
 - Unspent conditional grants are understated by R1 million.
 - Provisions are understated by R292 276.

Qualified opinion

23. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ngqushwa Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Material impairments

25. As disclosed in note 27 to the financial statements, material losses of R12,7 million (2014: R10,5 million) were incurred as a result of the significant impairment of debtors due to poor collection practices.

Restatement of corresponding figures

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

Additional matters

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

Unaudited disclosure notes

28. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement as stated in note 41 to the financial statement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Unaudited supplementary schedules

29. The supplementary information set out on page 60 relating to SCM deviation register 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.

Report on other legal and regulatory requirements

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

31. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2015:
- Development priority 1: service delivery and infrastructure development on pages x to x
 - Development priority 2: local economic development on pages x to x
 - Development priority 4: municipal transformation and institutional development on pages x to x
32. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
33. 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 (FMPPPI)*.
34. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
35. The material findings in respect of the selected development priorities are as follows:

Service delivery and infrastructure development

Usefulness of reported performance information

Consistency of objectives and targets

36. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No.32 of 2000) (MSA) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of ninety percent (90%) of the reported objectives were not consistent with those in the approved IDP. This was due to a lack of review of the completeness of reporting documents by management.
37. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan (SDBIP) adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the SDBIP in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives and targets in the annual performance report, without adoption by the municipal council. This was due to the lack of adequate systems and processes to ensure the municipality complies with laws and regulations.

Measurability of indicators and targets

38. Performance targets were not specific in clearly identifying the nature and required level of performance, as required by the FMPPI.
39. Performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use. Performance indicators were also not verifiable.
40. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions and proper systems and processes and formal standard operating procedures or documented system descriptions.

Reliability of reported performance information

41. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the lack of formal standard operating procedures or documented system descriptions as well as the auditee's records not permitting the application of alternative audit procedures.

Local economic development as well as municipal transformation and institutional development

Usefulness of reported performance information

Consistency of objectives and targets

42. Section 41(c) of the MSA requires the IDP to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Significantly important objectives, indicators and targets of the reported objectives were not consistent with those in the approved IDP. This was due to a lack of review of the completeness of reporting documents by management.
43. Section 54(1)(c) of the MFMA determines that the SDBIP adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the SDBIP in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the annual performance report, without adoption by the municipal council. This was due to the lack of adequate systems and processes to ensure the municipality complies with laws and regulations.

Measurability of indicators and targets

44. Performance targets were not specific in clearly identifying the nature and required level of performance, as required by the FMPPPI.
45. Performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use. Performance indicators were also not verifiable.
46. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions and proper systems and processes and formal standard operating procedures or documented system descriptions.

Reliability of reported performance information

47. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations we considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the lack of formal standard operating procedures or documented system descriptions as well as the auditee's records not permitting the application of alternative audit procedures.

Additional matters

48. I draw attention to the following matters:

Achievement of planned targets

49. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs 37 to 46 of this report

Unaudited supplementary schedules

50. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

51. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

52. Measurable performance targets for the financial year with regard to each of the development priorities and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the municipal planning and performance management regulation 12(1) and 12(2)(e).
53. Revisions to the SDBIP were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
54. Contrary to section 46(1)(b) and (c) of the MSA, the annual performance report for the year under review did not include:
 - a comparison with the previous financial year and
 - measures taken to improve performance.
55. Annual performance agreements did not exist for all senior managers and were not linked to the measurable performance objectives approved with the budget and to the SDBIP, as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
56. The performance management system and related controls were not adequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement as well as how it was to be conducted, organised and managed, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Annual financial statements, performance report and annual report

57. 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 and the supporting records could not subsequently be provided, which resulted in the financial statements receiving a qualified audit opinion.

Audit committee

58. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation such as DoRA, as required by section 166(2)(a)(vii) of the MFMA.
59. The audit committee did not review and make recommendations to the council on the performance management system, as required by municipal planning and performance management regulation 14(4)(a)(ii).
60. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).

Internal audit

61. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with DoRA, as required by section 165(2)(b)(vii) of the MFMA.
62. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
- the unit did not advise the accounting officer and report to the audit committee on matters relating to accounting procedures and practices as well as loss control.

Procurement and contract management

63. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations had been awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as the municipality did not have a proper record keeping system.
64. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
65. Quotations 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, contrary to SCM regulation 13(c).
66. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they

are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

67. Contracts were awarded to bidders based on preference points that had not been allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
68. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
69. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
70. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
71. Quotations were awarded to providers whose tax matters had not been declared by SARS to be in order, contrary to SCM regulation 43.

Human resource management and compensation

72. An acting municipal manager was appointed for more than six months and an acting chief financial officer (CFO) was appointed for more than three months without approval by the member of the executive council in contravention of sections 54A(2A) and 56(1)(c) of the MSA.
73. The competencies of the CFO, head of the SCM unit and SCM officials were not assessed in a timely manner to identify and address gaps in competency levels as required by, municipal regulation on minimum competency levels 13.
74. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by municipal regulation on minimum competency levels 14(2)(a).
75. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the municipal regulation on minimum competency levels 14(2)(b).
76. The municipality did not develop and adopt appropriate systems and procedures to monitor, measure and evaluate performance of staff, in contravention of section 67(d) of the MSA.
77. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Expenditure management

78. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
79. An effective system of expenditure control, (including procedures for the payment of funds,) was not in place, as required by section 65(2)(a) of the MFMA.

80. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors, as required by section 65(2)(b) of the MFMA.
81. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

82. Sufficient appropriate audit evidence could not be obtained that all of the municipal infrastructure grant allocation had been spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.

Revenue management

83. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
84. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Liability management

85. An adequate management, accounting and information system was not in place to account for liabilities, as required by section 63(2)(a) of the MFMA.
86. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

87. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality in previous years was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

88. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

89. There were prolonged vacancies in key senior management positions, which resulted in leadership instability that undermined accountability. The absence of leadership resulted in there being inadequate direction within the municipality to direct and guide the strategies and operations of the municipality.

90. The leadership was not able to implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place, performance was monitored and consequence management was applied where necessary. This contributed to the material misstatements identified in the financial statements, the findings on predetermined objectives and non-compliance with laws and regulations.
91. In addition, the municipality did not implement and monitor the audit action plan and, as a result, numerous internal control deficiencies identified in the previous year re-curred in the current year.

Financial and performance management

92. The municipality did not prepare regular, accurate and complete financial reports, and did not perform daily and monthly processing and reconciling of transactions throughout the financial year. As a result, the municipality was unable to produce financial statements that were free from material misstatements.
93. The municipality did not have a proper record management system to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting. This resulted in some amounts disclosed in the financial statements not being supported by relevant accounting records.
94. There were no review processes to monitor compliance with all applicable laws and regulations within the municipality. As a result, non-compliance with laws and regulations was not effectively identified or prevented and municipal officials were not held accountable for transgressions in this regard.

Governance

95. The municipality did not have adequate risk management processes in place. As a result, there were no processes to identify all risks to which the municipality was exposed and no mitigating controls were in place for the risks that have been identified.
96. The internal audit unit was not effective in its review of internal controls and compliance with laws and regulations. This was largely as a result of the lack of co-operation from management and capacity shortages, in terms of skills and resources in the unit.
97. The impaired functioning of the internal audit unit impacted the effectiveness of the audit committee.

Auditor-General

East London

15 December 2015



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SOUTH AFRICA

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