



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

FINAL MANAGEMENT REPORT

Mkhondo Local Municipality

30 June 2014





MANAGEMENT REPORT

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FINAL MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE MKHONDO LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 June 2014

INTRODUCTION

1. Our responsibility is to:

- express an opinion on the financial statements
- express a conclusion in the management report on the usefulness and reliability of the reported performance information for selected development objectives, and report the material findings in the auditor's report
- report on material findings relating to compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

Our engagement letter sets out our responsibilities and those of the accounting officer in detail.

2. This management report includes audit findings arising from the audit of the financial statements, reporting on predetermined objectives and compliance with legislation for the year ended 30 June 2014. These findings were communicated to management, and the report also details management's response to these findings. The report furthermore includes information on the internal control deficiencies that we had identified as the root causes of the matters reported. Addressing these deficiencies will help to improve the audit outcome.
3. The management report consists of an executive summary and annexures containing the detailed audit findings.

EXECUTIVE SUMMARY

SECTION 1: Interactions with stakeholders responsible for oversight and governance

4. During the audit cycle, we met with the following key stakeholders who are responsible for oversight and governance to communicate matters relating to the audit outcome of the municipality:

Stakeholder	Number of interactions
Council	0
Municipal public accounts committee	1
Mayor of the Mkhondo Local Municipality	1
Municipal manager	7
Audit committee	4

5. At these interactions, we shared information such as the audit strategy, key controls and communications of audit findings that was discussed at the meetings. Some of the stakeholders made commitments to implement initiatives that can improve the audit outcome. The commitments given and the progress of previous commitments are included in part F of section 2, which deals with the assessment of assurance providers.

SECTION 2: MATTERS RELATING TO THE AUDITOR'S REPORT
PART A – MISSTATEMENTS IN THE FINANCIAL STATEMENTS

6. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the municipality's system of internal control. These material misstatements also constitute non-compliance with section 122 of the MFMA.
7. The misstatements that were not corrected form the basis for the disclaimer of opinion on the financial statements.

Material misstatement			Impact	Impact
			R	R
Financial statement item	Finding	Occurred in prior year	Current year	Prior year
Material misstatements not corrected				
Accumulated surplus and deficit	Opening balances misstated, transactions in appropriation account not supported, expenditure recorded in incorrect period, Opening balances misstated (Payables, Taxes and transfers, gains on disposals of assets, property rates, bulk purchases, fair value adjustments).	Yes	R 1 237 647 024,00	R 1 229 663 462,00
Unspent conditional grants	Differences between grant registers and GL, differences between income and expenditure	No	R 3 287 480,75	R 0,00
Cash and cash equivalents	Difference between AFS and Bank confirmation	No	R 432 572,96	R 0,00
Cash flow statement	Cash flow statement is misstated	No	R 5 789 382,00	R 0,00
Commitments	Commitments incomplete, misstatements.	Yes	R 26 400 159,00	R 50 409 019,00
Irregular expenses	SCM findings not corrected appropriately, population not amended for findings raised	No	R 69 121 066,00	R 0,00
Investment property	Assets not verified, population changed without proof submitted for audit purposes	Yes	R3 550 000,00	R 19 588 600,00



Property, plant and equipment	Assets duplicated/not recorded on FAR. Assets not verified/limitation of scope, additions not recorded appropriately. Differences between GL/TB/AFS, Journals without supporting information, WIP not recorded	Yes	R 1 204 556 699,00	R 1 187 880 829,00
Expenditure - General, Bulk purchases, Repairs and maintenance	Expenditure recorded in the accounting records of the municipality includes costs of property, plant and equipment, transactions not related to correct financial year and others are inclusive of value added tax, Transactions relating to the current financial were not recorded in the accounting records of the municipality. I was unable to obtain sufficient appropriate evidence to support the journals processed	Yes	R 174 499 172,00	R 157 204 686,00
Consumer receivables	I was unable to obtain sufficient appropriate audit evidence for the impairment of consumer receivables	Yes	R 114 064 056,00	R 93 788 144,00
Payables - Sundry creditors and Trade payables	Duplication of accounts, retention incorrectly calculated, unrecorded liabilities, limitation of scope.	Yes	R 82 063 897,00	R 32 883 571,00
Consumer deposits	Consumer Deposits: Amount could not be verified. Entire population misstated	No	R 3 054 631,00	R 0,00
Receivables (VAT)	VAT Receivable: Journals not supported by appropriate documentation - Actual limitation	No	R 2 187 625,75	R 0.00
Related parties	Overstatement of amount owed to Treasury - Actual misstatement	No	R 301 663,18	R 0,00
Unauthorised expenditure	Unauthorised expenditure - Not complete - Actual misstatement	Yes	R 2 090 968,57	R 43 209 491,00
Service charges	Invoices not sent to residents -Entire population misstated	Yes	R 103 172 017,00	R 98 269 841,00
Income from agency fees	Fees not paid over, income incomplete	No	R 212 379,00	R 0,00
Property rates	Property rates not complete: System valuation roll not updated with supplementary role amendments - Entire population misstated	Yes	R 19 951 677,00	R 18 622 388,00



Contingent liabilities	Amounts disclosed does not agree to the legal confirmations	No	R 24 656 691,86	R 0,00
Material losses	Free basic services not accounted for, 2013 amounts adjusted without supporting evidence	Yes	R 27 969 250,92	R 23 497 358,00



PART B – MATTERS TO BE BROUGHT TO THE ATTENTION OF THE USERS

EMPHASIS OF MATTER PARAGRAPHS

8. The following emphasis of matter paragraphs will be included in our auditor's report to draw the users' attention to matters presented or disclosed in the financial statements:

Restatement of corresponding figures

9. As disclosed in note 42 to the financial statements, the corresponding figures for the prior balance sheet date have been restated as a result of an error discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

Material losses

10. As disclosed in note 49 of the annual financial statements, material losses amounting to R27 252 134,25 (2013: R22 144 405,94) were incurred as a result of electricity losses, which represent 31% (2013: 28%) of total electricity purchased. Material losses amounting to R717 116,67 (2013: R1 352 951,85) were incurred as a result of water distribution losses, which represent 84% (2013: 85%) of total water purchased.

Material impairments

11. As disclosed in note 11 of the annual financial statement, the receivables balance has been significantly impaired. The impairment of consumer debtors amounts to R114 064 056,00 (2013: R97 737 604,00) which represents 86% (2013: 87%) of total consumer debtors. The contribution for debt impairment was R19 646 494,00 (2013: R18 823 525,00).

ADDITIONAL MATTER PARAGRAPHS

12. The following additional matter paragraphs will be included in our auditor's report to draw the users' attention to matters regarding the audit, the auditor's responsibilities, and the auditor's report:

Unaudited supplementary schedules

13. The supplementary information set out on pages 98 to 100 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.

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 thereon.

PART C – CONCLUSIONS ON REPORTED INFORMATION RELATING TO THE PERFORMANCE OF THE MUNICIPALITY AGAINST PREDETERMINED OBJECTIVES

Included below are our conclusions on the reported performance information for selected development objectives presented in the annual performance report.

15. As required by sections 4 and 20 of the PAA, read with the general notice issued in terms thereof, our responsibility is to express a conclusion on the usefulness and reliability of selected development priorities presented in the annual performance report.
16. We were unable to conclude on the usefulness and reliability of the reported performance information, as the annual performance report of the municipality was not presented for auditing, as required by section 46 of the Municipal Systems Act and section 121(3)(c) of the MFMA.
17. The accounting officer is responsible for the preparation and fair presentation of the annual performance report in accordance with the identified performance management and reporting framework, as defined in paragraph 6 of the general notice issued in terms of the PAA. This framework deals with the planning, management, monitoring and reporting of performance against predetermined objectives. The accounting officer is also responsible for internal controls determined by management as necessary to enable the preparation of an annual performance report that is useful and reliable.
18. Although the annual performance report was not submitted for auditing, we audited performance information in respect of the following selected material development priorities as contained in the strategic planning and performance management documents:
 - a. Development priority 1: Basic service deliver on pages x to x
 - b. Development priority 4: Financial Viability and Management on pages x to x
19. We assessed the information to determine whether the performance 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)*.
20. The material findings in respect of the selected development priorities are as follows:

Basic service delivery

Usefulness of performance information

Measurability of indicators and targets

Performance targets not specific and/or measurable and/or time bound and indicators not well defined and verifiable)

Basis for disclaimer of conclusion

21. The FMPPI requires the following:
 - Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable and the period or deadline for delivery of targets must be specified.
 - Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

The measurability of planned targets and indicators could not be assessed due to a lack a proper systems and processes and formal standard operating procedures.



Financial viability and management

Usefulness of performance information

Measurability of indicators and targets

Performance targets not specific, measurable, time bound and indicators/measure not well defined and verifiable

Basis for disclaimer of conclusion

22. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable and the period or deadline for delivery of targets must be specified.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

The measurability of planned targets and indicators could not be assessed due to a lack a proper systems and processes and formal standard operating procedures.

PART D – FINDINGS ON NON-COMPLIANCE WITH LEGISLATION

23. Included below are material findings on non-compliance with specific requirements in key applicable legislation.

Strategic planning and performance management

24. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Budgets

25. 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 Municipal Finance Management Act.

Annual financial statements, performance report and annual report

26. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.

Procurement and contract management

27. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
28. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
29. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
30. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
31. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
32. 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).
33. 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 and SCM regulation 28(1)(a).
34. Contracts and quotations were awarded to bidders based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
35. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
36. 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.

37. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
38. Contracts and 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, as required by SCM regulation 13(c).
39. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
40. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

Expenditure management

41. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the Municipal Finance Management Act
42. An effective system of expenditure control, including procedures for the approval / authorisation / withdrawal / payment of funds, was not in place, as required by section 65(2)(a) of the Municipal Finance Management Act.
43. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act
44. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the Municipal Finance Management Act.

Revenue management

45. An adequate management, accounting and information system which accounts for revenue / debtors / receipts of revenue was not in place, as required by section 64(2)(e) of the Municipal Finance Management Act.
46. An effective system of internal control for debtors / revenue was not in place, as required by section 64(2)(f) of the Municipal Finance Management Act.
47. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the Municipal Finance Management Act.
48. Accounts for service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the Municipal Finance Management Act.

Asset management and liability management

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

Consequence management

51. 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)(ii) of the Municipal Finance Management Act.
52. Unauthorised, irregular and fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the Municipal Finance Management Act.



53. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the Municipal Financial Management Act.







HR compliance








































54. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels reg14(2)(b)

PART E – INTERNAL CONTROL

IMPLEMENTATION OF THE DRIVERS OF INTERNAL CONTROL

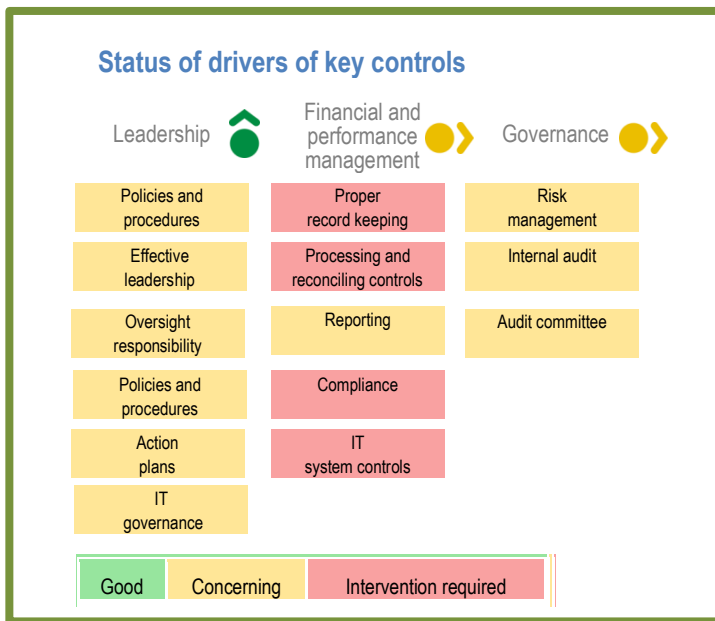
55. Below is our assessment of the implementation of the drivers of internal control, based on significant deficiencies identified during our audit of the financial statements, the annual performance report and compliance with legislation. Significant deficiencies occur when internal controls do not exist, are not appropriately designed to address the risk, or are not implemented, which either had or could cause the financial statements or the annual performance report to be materially misstated and material instances of non-compliance with legislation to occur.

56. When the required preventative or detective controls are in place, it is assessed with a ; when progress on the implementation of such controls was made but improvement is still required or where actions taken are not sustainable, it is assessed with a ; while  indicates that internal controls are not in place and intervention is required to design and implement appropriate controls. The movement in the status of the drivers from the previous year-end to the current year-end is indicated collectively for each of the three audit dimensions (namely financial statements, performance reporting, and compliance with legislation) under the three fundamentals of internal control (namely leadership, financial and performance management, and governance), with  (improved),  (unchanged) or  (regressed).

	Financial statements		Performance reporting		Compliance with legislation	
	Current year	Prior Year	Current year	Prior year	Current year	Prior year
Leadership						
Overall movement from previous assessment						
• Provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the best interests of the entity						
• Exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls						
• Implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored						
• Establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities						
• Develop and monitor the implementation of action plans to address internal control deficiencies						
• Establish an information technology governance framework that supports and enables the business, delivers value and improves performance						

	Financial statements		Performance reporting		Compliance with legislation	
	Current year	Prior Year	Current year	Prior year	Current year	Prior year
Financial and performance management						
Overall movement from previous assessment	↔		↔		↔	
• Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting	☹	☹	☹	☹	😊	☹
• Implement controls over daily and monthly processing and reconciling of transactions	☹	☹	☹	☹	☹	☹
• Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information	😊	😊	😊	😊	😊	😊
• Review and monitor compliance with applicable legislation	☹	☹	☹	☹	☹	☹
• Design and implement formal controls over information technology systems to ensure the reliability of the systems and the availability, accuracy and protection of information	☹	☹	☹	☹	☹	☹
Governance						
Overall movement from previous assessment	↔		↔		↔	
• Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored	😊	😊	😊	😊	😊	😊
• Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively	😊	😊	😊	😊	😊	😊
• Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation	😊	😊	😊	😊	😊	😊

57. The figure below provides the overall status of the drivers of key controls.



LEADERSHIP

Effective leadership

58. Management established a formal code of conduct which addressed appropriate ethical and moral behaviour, but the code was not communicated to all staff and staffs were not trained to properly understand the code and implement it.

Oversight responsibility

59. The accounting officer does not adequately review the financial statements and the annual performance report prior to their submission for audit and thus the following matters were not identified and corrected:

- Financial statements were subject to material misstatements, some of which have been corrected
- There was a limitation of scope relating to Annual Performance information

Human resource management

We identified the following shortcomings in human resource management relating to predetermined objectives:

60. The municipality did not have sufficient capacity to plan, manage and report on its performance.
61. The municipality did not properly plan and provide training on performance information planning, management and reporting.
62. The municipality did not hold performance management and reporting staff accountable for shortcomings identified during the internal and external audit processes.
63. Memo for vacant posts not compiled

64. Acting allowances overstated as the agreements were not signed to the work being performed
65. No debt route forms
66. The verification process for new appointments did not cover criminal record checks / citizenship verifications / financial record checks / qualification verifications / reference checks
67. The overall vacancy rate increased from 33.12% in the previous year to 37.86% in the current year

Policies and procedures

68. Management does not have documented policies and procedures to guide the operations of the municipality, resulting in numerous instances of non-compliance with the MFMA, as detailed under the “findings on compliance with laws and regulations” section of this report. In addition, management did not take corrective action on the following internal control deficiencies identified during our audit:
 69. The municipality did not have documented and approved internal policies and procedures to address planning, implementation, monitoring and reporting processes and events pertaining to performance management and reporting.
 70. The municipality did not have documented and approved internal policies and procedures to address the process of collection/recording/processing/monitoring/reporting of performance information
 71. The municipality did not have key controls to address the systems of collection/collation/verification/storage of performance information. The details are as follows:
 - No standard operating procedures
 - The municipality did not develop and implement proper performance planning and management practices to provide for the development of performance indicators and targets.

Action plans to address internal control deficiencies

72. The municipality developed a plan to address internal and external audit findings, but adherence to the plan is not monitored on a timely basis by the appropriate level of management.

Information technology governance framework

73. Management did not implement appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored

FINANCIAL AND PERFORMANCE MANAGEMENT

Proper record keeping

74. The municipality did not have a system of record management that provides for the maintenance of information that supports the reported performance contained in the annual performance report. This includes information that relates to the collection, collation, verification, storing and reporting of actual performance information.
75. As indicated in our engagement letter, we agreed that all information requested for purposes of the audit would be submitted within 2 working days of the request by the auditors. Despite this agreement, management did not always supply the documentation requested timeously in the following instances:
 - Performance information

- Payables
- Revenue
- Expenditure

Daily and monthly processing and reconciling of transactions

76. Management did not implement the following daily and monthly controls as designed for the entity's business processes:
- Cash and bank
 - Debtors
 - Fixed Assets

Regular, accurate and complete financial and performance reports

77. As indicated in part A of section 2, the financial statements contained numerous misstatements that were corrected. This was mainly due to staff members not fully understanding the requirements of the financial reporting framework.

Compliance monitoring

78. Non-compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored.

Information technology systems

79. There was no basic understanding at the municipality of the importance of the Information Security Officer function and these functions were therefore not formally assigned to a specific person.
80. There was a lack of monitoring by the ICT unit of the performance of the service provider who administers the firewall as no reports were provided for review of firewall threats and vulnerabilities.
81. The user account management procedures were inadequately designed resulting in certain monitoring and review processes not being implemented.
82. The lack of formal change management procedures was due to inadequate oversight by management over the change management process.
83. There was inadequate planning to ensure that a Business Impact Analysis (BIA) is conducted to develop a Business Continuity Plan (BCP) and that the Disaster Recovery Plan (DRP) is developed to support this BCP.
84. The municipality was not aware of the need for testing of backups through restores and the maintenance of a backup register.

GOVERNANCE

Risk management activities and risk strategy

85. Note that the yellow faces reflected for the establishment of the IT governance framework and the risk management activities only relates to the adequate design of the framework itself. It specifically refers to the fact that a Corporate Governance of ICT Policy Framework (CGICTPF), applicable to all National and Provincial Departments, Provincial Administrations, Local Government, Organs of State and Public Entities, had been established by the Department of Public Service Administration (DPSA) and approved by Cabinet. The CGICTPF has been reworked into the Municipal Corporate Governance of ICT Policy framework (MCGICTPF) which will be finalised and approved in the 2014-15 financial year. The implementation of the framework will commence in the 2015-16 financial year.

Internal audit



86. The internal audit unit operated effectively during the current period as per their legislated mandate. Recommendations were made to management on the improvements on the internal controls to ensure reliable reporting on both financial and performance information as well as compliance with legislation. This has not however resulted into improvement on the controls due to management lack of implementation of recommendation which led to the disclaimer assessment on the impact this unit had.

Audit committee

87. The audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management on the improvements on the internal controls to ensure reliable reporting on both financial and performance information as well as compliance with legislation. This has not however resulted into improvement on the controls due to management lack of implementation of recommendation which led to the disclaimer assessment on the impact this committee had.

SUMMARY

88. The matters above, as they relate to the basis for the qualified opinion, findings on the annual performance report and findings on non-compliance with legislation, will be summarised in the auditor's report as follows:

Leadership

89. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
90. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.

Financial and performance management

91. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting resulting in insufficient audit evidence for audit purposes.
92. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
93. Management didn't prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
94. Management didn't review and monitor compliance with applicable laws and regulations

Governance

95. The internal audit unit and audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management on the improvements on the internal controls to ensure reliable reporting on both financial and performance information as well as compliance with legislation. This has not however resulted into improvement on the controls due to management lack of implementation of recommendation which led to the disclaimer assessment on the impact this unit had.

PART F – ASSESSMENT OF ASSURANCE PROVIDERS

- 96. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance, and one of the important oversight functions of council is to consider auditees’ annual reports. To perform their oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report also includes our auditor’s report, which provides assurance on the credibility of the financial statements and the annual performance report as well as on the auditee’s compliance with legislation.
- 97. Our reporting and the oversight processes reflect on past events, as it takes place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.
- 98. We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in part E of section 2) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

Assurance levels	
Senior management	<i>Provides some assurance</i>
Internal audit	<i>Provides some assurance</i>
Audit committee	<i>Provides some assurance</i>
Municipal council	<i>Provides some assurance</i>
CFO	<i>Provides some assurance</i>
Municipal Manager	<i>Provides some assurance</i>
Head : SCM	<i>Provides some assurance</i>
MPAC	<i>Provides some assurance</i>
Mayor	<i>Provides some assurance</i>

Assurance provider	Reason for the assessment of the assurance provider
Municipal council	Council needs to ensure that key management positions are filled to ensure stability in leadership.
Municipal Public Accounts Committee (MPAC)	MPAC has engaged management and others that are charged with governance and reported to council over issues brought to its attention however additional emphasis needs to be given to the evaluation of monthly budget statements, mid-year budget and performance assessments, financial statements and the annual report as non-achievement of targets on the performance side and several control weaknesses in the financial and compliance side were noted for 2013/14.
Mayor	The Mayor needs to be more visible
MM	The MM needs to be more involved in the financial aspects of the Municipality and enforce processes in Performance and compliance issue areas
Senior management (overall)	Senior management should design standard operating procedures to ensure adherence with the policies adopted by the municipality. This will also ensure that the control activities identified as key controls to support financial and performance reporting are actually being applied properly. Quarterly financial statements and compliance checklists should be done to prevent errors/instances of non-compliance
CFO	The CFO and the finance unit do not have adequate sufficiently skilled resources to perform all the functions that are required for complete and accurate financial reporting. Although controls have been designed and implemented, little or no monitoring is undertaken to ensure that these are being followed. The CFO has been recently appointed and did not have an opportunity to influence the 2013/14 financial year.
Head of SCM	The SCM Manager has not developed a comprehensive SCM checklist combined with an effective document management system to ensure that the municipality complies with all legislative and regulatory requirements before an award is made.
Internal audit	Internal audit recommendations need to be taken more seriously. Information needs to be provided to them in time in order to evaluate.
Audit committee	Audit committee recommendations need to be taken more seriously. Information needs to be provided to them in time in order to evaluate. Four sets of financials were provided to the audit team and the audit committee need to ensure that the financials are adequately reviewed prior to submission

STATUS OF IMPLEMENTATION OF COMMITMENTS AND RECOMMENDATIONS

99. Below is our assessment of the progress in implementing the commitments made by senior management, the accounting officer and the audit committee to address prior and current year audit findings:

No.	Commitment	Made by	Date	Status
	None provided			

PART G – OTHER REPORTS

100. The following audits that relate to the municipality are in progress or have been completed.

INVESTIGATIONS

101. The municipality performed an investigation, which covered the period 30 June 2013 to 30 June 2014. The investigation was initiated based on an allegation of possible misappropriation of the municipality's assets. The ongoing investigation has resulted in the suspension of six employees. These proceedings are currently in progress.

SECTION 3: SPECIFIC FOCUS AREAS

PART A – PROCUREMENT AND CONTRACT MANAGEMENT

SIGNIFICANT FINDINGS FROM THE AUDIT OF PROCUREMENT AND CONTRACT MANAGEMENT

102. The audit included an assessment of procurement processes, contract management and related controls. To ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system, the processes and controls need to comply with legislation and minimise the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices. A summary of the findings from the audit are as follows:

Irregular expenditure

103. In total, R48 558 699,00 of the irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. 73% (2013: 100%) of this irregular expenditure was identified during the audit process and not detected by the monitoring processes of the municipality. The root cause of the lack of effective prevention and detection is due to a lack of skills of employees.

Awards to persons in the service of the state

104. SCM Regulation 44 prohibits awards to persons or to entities owned/managed by them if they are in the service of the auditee (i.e. employee and councillors) or if they are in service of any other state institution. The audit included the identification of such prohibited awards. Further testing was also performed to determine whether the legislated requirements with regard to declarations of interest were adhered to.

105. The findings were as follows:

Finding	Number and value of awards made	Number of officials/councillors identified	Number of providers	Further non-compliance or irregularities regarding the awards			
				Provider did not submit declaration of interest	Provider did not declare interest (declaration submitted)	Official/councillor did not declare interest	Official/councillor or was involved in the awarding of the contract / quotation
Awards to officials and/or councillors of the municipality	0	0	0	0	0	0	0
Awards to officials of other state institutions	21 R1 471 367,90	0	21	8	20		0

Procurement processes

106. The following findings on procurement processes resulted from the testing of 46 (some without fixed amounts) contracts/tenders and thirty eight price quotations with a total value of R3 435 459,87

Procurement need and economy



107. Three major projects were procured without a proper needs assessment being conducted in the form of a project evaluation.

List of accredited prospective providers

108. The following shortcomings in the administration of the list of accredited prospective providers were identified:

- The list is not updated at least quarterly to include new suppliers that qualify for listing
- The list of approved prospective providers is not specified per commodity and type of service.

Procurement process – quotations

109. Two awards to the total value of R168 046,45 were procured without inviting at least three written price quotations from prospective suppliers and the deviation was not approved by a properly delegated official. Eighteen quotations to the total value of R2 226 251,26 were procured from suppliers who did not have tax clearance from the South African Revenue Service (SARS) confirming that their tax matters were in order.

Procurement process – competitive bidding

110. The preference point system was not applied appropriately in the procurement of four competitive bids to the total value of R12 384 900,50.

Procurement process – construction contracts

111. Eight construction contracts with a total value of R13 822 424,28 were awarded to contractors whose CIDB grading was below the required grading for the value of the particular contract.

Contract management

112. One contract was extended. Proof of this extension acceptance by consultant was not provided for audit purposes. The total expenditure in the current year was R5 455 078,93

Internal control deficiencies

Leadership

113. Oversight responsibility was not exercised regarding compliance as well as related internal controls.

114. The implementation of action plans was not monitored to address internal control deficiencies.

Financial and performance management

115. Controls were not implemented over daily and monthly processing and reconciling of transactions.

116. Regular, accurate and complete financial and performance reports, which were supported and evidenced by reliable information, were not prepared

PART B – SERVICE DELIVERY / GOVERNANCE / MONITORING / OVERSIGHT MATTERS

Water and Sanitation

117. The audit included an assessment of specific service delivery aspects relevant to the department. For the financial year under review, we focused on the following:

Basis Water services

118. The municipality did not adopt a water services development plan

119. Access to basic water is not reported as a key performance indicator.

120. The backlog in the provision of water will not be eradicated in 2014.

Basic sanitation services

121. Access to basic sanitation is not reported as a key performance indicator

122. The backlog in the provision of sanitation will not be eradicated in 2014

Roads Infrastructure

123. The audit included an assessment of specific service delivery aspects relevant to the department. For the financial year under review, we focused on the following:

124. The municipality does not have an approved policy in place for the planning, management and reporting of road infrastructure

125. Council approved a policy on road infrastructure, however the policy has not been implemented

126. The municipality has not achieved its target for the maintenance of roads

127. The municipality has not achieved its target for the construction of new roads.

128. The municipality has not achieved its target for the upgrading of roads.

129. The municipality did not budget for planned maintenance in its operational budget.

130. The municipality does not have an approved road maintenance plan which clearly indicates the strategy to be followed for the financial year.

131. The municipality does not have a plan to address the backlogs relating to roads infrastructure.

132. Although the municipality has a road asset management system in place the system does not provide information on the following: maintenance planning, maintenance history and backlogs

Conditional grants

133. The audit included an assessment of the effectiveness of the municipality's utilisation of conditional grants received. For the financial year under review, we focused on the following grants:

- Municipal Infrastructure Grant (MIG)*
- Municipal Systems Improvement Grant (MSIG)*
- Local Government Financial Management Grant (FMG)*

134. Summary of allocations and spending

	MIG	MSIG	FMG
Total available to spend	R97 237 749,22	R958 213,85	R1 805 805,82
Total amount utilised/ spent in current financial year	R93 626 406,90	R1 271 596,71	R1 805 805,82
Unspent allocation	R3 611 324,32	-0	0
Percentage of under/(over)spending	4%	-33%	0%

135. **Municipal Infrastructure Grant**

Key project(s) selected	MIG/MP0668/W/07/10 - Installation of water reticulation in eThandukukhanya ext 6 & 8	
MIG outputs linked to selected key project	Additional poor households receiving basic water and sanitation services	
Total project budget (from initiation to completion)	R8 886 734,71	
Actual amount spent on the project - current year	R5 067 691,92	
Total amount spent from initiation to date	R5 067 691,92	
Planned completion date	30/06/2014	
Planned project target /key milestone for the current year	Reticulation to 627 HH and 6ML reservoir	
Project status as at year end	Completed	

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

136. **Municipal Systems Improvement Grant**

Key MSIG priorities output selected	Information systems that support effective service delivery	
Amount allocated per selected priority output	R958 213,85	

Actual amount spent per selected priority output	R1 271 596,71	
Key planned target for the current year	Accurate and complete financial books of accounts	

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

137. Financial Management Grant

Key FMG priorities output selected	Skills development	
Amount allocated per selected priority output	R1 805 805,82	
Actual amount spent per selected priority output	R1 805 805,82	
Key planned target for the current year	Facilitate implementation of training interventions	

- The municipality did not evaluate its performance in respect of programmes or functions funded by the Local Government Financial Management Grant allocation, as required by section 12(5) of the Division of Revenue Act

PART C – FINANCIAL INDICATORS

138. Management is responsible for the sound and sustainable management of the affairs of the municipality and for implementing an efficient, effective and transparent financial management system for this purpose, as regulated by the MFMA.
139. Our audit included a high-level assessment of selected financial indicators as at year-end. The purpose of the assessment is to provide management with an overview of financial indicators to enable timely corrective action where financial health and service delivery may be at risk. The information should be used to complement, rather than substitute, management's own financial assessment.
140. We assessed the municipality's financial indicators according to the following areas:
- Budget management
 - Expenditure management
 - Revenue management
 - Asset and liability management
 - Cash management
 - Grant management

We show our assessment of the financial indicators in the table below and give high-level comments on the risks posed by the assessment of the financial indicators.

MFMA: Financial indicator assessment table

FINANCIAL INDICATORS			
(Limitation = unable to obtain sufficient appropriate information)		AS AT 30 JUNE 2014	AS AT 30 JUNE 2013
BUDGET MANAGEMENT			
1.1	Percentage over-spending of the final approved operating expenditure budget	3.2%	10.6%
1.2	Percentage under-spending of the final approved capital budget	43%	63.6%
EXPENDITURE MANAGEMENT			
2.1	Creditor-payment period	178 days	80 days
REVENUE MANAGEMENT			
3.1	Debtor-collection period (before impairment)	387 Days	352 Days
3.2	Debtor-collection period (after impairment)	54 Days	48 Days
3.3	Debtors impairment provision as a percentage of accounts receivable	86%	86.5%
3.4	Debtors impairment provision as a percentage of revenue from goods and services rendered on credit	91.1%	83.9%
3.5	Percentage water losses incurred	84%	85%
3.6	Percentage electricity losses incurred	31%	28%
ASSET AND LIABILITY MANAGEMENT			

FINANCIAL INDICATORS			
(Limitation = unable to obtain sufficient appropriate information)		AS AT 30 JUNE 2014	AS AT 30 JUNE 2013
4.1	A deficit for the year was realised (total expenditure exceeded total revenue)	Yes	Yes
4.2	A net current liability position was realised (total current liabilities exceeded total current assets)	Yes	Yes
4.3	A net liability position was realised (total liabilities exceeded total assets)	No	No
4.4	Percentage of PPE and/or intangible assets impaired	0 %	0.2 %
4.5	Percentage of loan receivables (loans awarded) and/or investments impaired	0 %	0 %
CASH MANAGEMENT			
5.1	The year-end bank balance was in overdraft	No	No
5.2	Net cash flows for the year from operating activities were negative	No	No
5.3	Cash and cash equivalents as a percentage of operating expenditure	6.6 %	9.6 %
5.4	Creditors as a percentage of cash and cash equivalents	321.8%	96.4%
5.5	Current liabilities as a percentage of net cash inflows for the year from operating activities	-134.1%	-284%
5.6	Non-current liabilities (long-term debt) as a percentage of net cash inflows for the year from operating activities	-39%	-89.7%
5.7	Employee benefit obligation as a percentage of net cash inflows for the year from operating activities	23.2%	54.5%
GRANT MANAGEMENT			
6.1	Percentage under-spending of conditional grants received for the year	2.3%	21.9%
6.2	Percentage by which unspent conditional grants received exceeded cash available at year-end	Not exceeded	Not exceeded
OVERALL ASSESSMENT			
Overall the results of the above financial indicator evaluation is assessed as:			
<i>The above assessment is based on financial statement amounts, adjusted for uncorrected misstatements that resulted in the modification of the audit opinion.</i>			

Financial Health Assessment: Creditors' payment period is 177 days and is significantly above the norm of 30 days. Therefore service delivery may be affected as contractors and suppliers may not supply goods and services to the municipality

The collection of debts by consumer debtors remains a significant challenge for the municipality. Provision for doubtful debts amounted to 86% of gross consumer debtors and debt collection days remained significantly above the norm after the impairment.

The electrical distribution loss is 31% which and is having a negative impact on the revenue that should have been generated by the municipality.

PART D – CONSULTANTS

141. The audit included an assessment of the use of consultants. In the public sector environment, the partnership between the private and public sector has become important in driving strategic goals. To optimise the value of this partnership, we identified areas that need attention to get the best value for money.

142. The table below shows the extent and nature of the municipality's use of consultants:

Type of consultancy services	Number of consultants	Actual expenditure		
		Current year – incurred before year-end	Incurred after year-end on [financial reporting and/or preparation of performance information] for current year	Prior year
Financial reporting services	1	R800 726,36	R0,00	R5 664 932,40
Preparation of performance information	0	R0,00	R0,00	R0,00
IT-related services	0	R0,00		R0,00
Other consultancy services		R9 290 200,43		R5 354 744,74

143. The table below assesses the reasons for the appointment of consultants and whether the audit identified any uncorrected misstatements or material findings on performance information in the areas for which the consultant was responsible. We also provide our assessment of the reason for such misstatements or findings. If our audit identified any findings on the contract, the area of finding is also indicated.

Name of consultant	Description of service	Value of contract	Reason for appointing consultant	Recurring appointment	Uncorrected misstatements or material findings identified in areas of consultant's responsibilities	Reasons for findings or misstatements not prevented by use of consultant	Areas of finding
<i>Ditsibi technologies and solutions</i>	<i>AFS preparation and asset register maintenance</i>	<i>Not fixed</i>	<i>Lack of skills</i>	Yes	Yes	<i>Department did not effectively management the project</i>	<i>Transfer of skills/ Performance management and monitoring</i>
<i>Zandile Management</i>	<i>Debt collection</i>	<i>Contract not obtained</i>	<i>Lack of skills and vacancies</i>	Yes	No	<i>Department did not effectively management the project</i>	<i>Transfer of skills/ Performance management and monitoring</i>
<i>Black Dot</i>	<i>Valuation services</i>	<i>R4 000 000</i>	<i>Lack of skills</i>	Yes	No	<i>Department did not effectively management the project</i>	<i>Transfer of skills/ Performance management and monitoring</i>

144. We identified the following findings on the use of consultants as a result of testing the contracts listed in the table above.

Planning and appointment processes

145. Consultants were appointed without a proper needs assessment having been performed.

Transfer of skills

146. Conditions or clauses for the transfer of skills were not included in the contract.

147. Measures to monitor the transfer of skills according to the contract were not implemented.

148. There was no evidence that skills transfer or training programmes had taken place.

Performance management and monitoring

149. Consultancy services were provided and consultants were paid without a signed contract to regulate the work of the consultant.

150. The payments under the contract exceeded the approved budgeted amount.

151. Measures to monitor contract performance and delivery were not defined and implemented.

152. Measures applied to monitor consultancy projects were insufficient and could not ensure effective contract management.

153. No evaluation was performed to compare the consultant's services rendered and the deliverable against the initial project objectives and needs.

154. No remedial action was taken in instances where the consultant was not performing in accordance with the contract.

155. Uncorrected material misstatements or audit findings were identified by the auditors on the work performed by the consultant or in areas of the consultant's responsibilities.

156. Contracts for consultancy services did not stipulate an end date or a fixed budget.

157. Final deliverables delivered by consultants did not match those described in the terms of reference.

Internal control deficiencies

Leadership

158. Oversight responsibility was not exercised regarding financial and performance reporting and compliance as well as related internal controls.

159. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.

160. The implementation of action plans was not monitored to address internal control deficiencies.

Financial and performance management

161. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting resulting in insufficient audit evidence for audit purposes.

PART E – FRAUD

- None identified

SECTION 4: EMERGING RISKS

Accounting and compliance matters

162. The ASB had issued the following additional standards of GRAP, these standards have been approved by the minister and effective date has been set to be 1st July 2015.

- *GRAP 105 Transfers of functions between entities under common control*
- *GRAP 106 Transfers of functions between entities not under common control*
- *GRAP 107 Mergers*
- *GRAP 108 Statutory receivables*

163. The ASB had issued the following additional standards of GRAP, these standards have been approved by the minister and effective date has not been set:

- *GRAP 18 Segment reporting.*

Corporate governance of information and communication technology policy framework

164. Corporate governance of information and communication technology policy framework

- The Department of Public Service and Administration (DPSA), in cooperation with the government information technology officer (GITO) council, developed the corporate governance of information and communication technology policy framework (CGICTPF), which is applicable to all spheres of government, organs of state and public enterprises. Parliament approved the CGICTPF for implementation on 21 November 2012.
- The CGICTPF provides the political and executive leadership with a set of principles and practices that must be complied with, together with a phased implementation approach to be followed for corporate governance of information and communication technology (ICT).
- Through a directive from the minister of Cooperative Governance and Traditional Affairs (CoGTA), the national ICT coordination and monitoring structure for local government was established to develop the implementation requirements and guideline specific to local government. Key stakeholders in the local government sector form part of this ICT coordination and monitoring structure.
- In 2014-15, this structure reworked the CGICTPF and drafted the municipal ICT governance policy framework. Different forums such as councils, MinMEC and municipal managers are currently consulting on the draft municipal ICT governance policy. It is envisaged that the municipal ICT governance policy framework will be finalised and approved during the 2014-15 financial year and implemented from the 2015-16 financial year.

Subsequent events

- None identified

SECTION 5: RATINGS OF DETAILED AUDIT FINDINGS

165. For the purposes of this report, the detailed audit findings included in annexures A to C have been classified as follows:

- Matters to be included in the auditor's report: These matters should be addressed as a matter of urgency.
- Other important matters: These matters should be addressed to prevent them from leading to material misstatements of the financial statements or material findings on the performance report and non-compliance with legislation in future.
- Administrative matters: These matters are unlikely to result in material misstatements of the financial statements or material findings on the performance report and non-compliance with legislation.

SECTION 6: CONCLUSION

166. The matters communicated throughout this report relate to the three fundamentals of internal control that should be addressed to achieve sustained clean administration. Our staff remain committed to assisting in identifying and communicating good practices to improve governance and accountability and to build public confidence in government's ability to account for public resources in a transparent manner.

Yours faithfully

Bomkazi Bhobho
Deputy Business Executive: Mpumalanga Business Unit

30 November 2014

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