Local government audit outcomes | MFMA 2018-19

Kannaland Municipality

Financial sustainability and financial controls

Portfolio Committee on Co-operative Governance
and Traditional Affairs – 1 September 2020

AUDITOR-GENERAL
SOUTH AFRICA

Important to note

Local government in the Western Cape consists of 32 auditees, broken down into 1 metropolitan municipality, 24 local municipalities, 5 district municipalities and 2 municipal entities. The municipal entities are classified as small entities and therefore are not included in this analysis. One audit was outstanding at the cut-off date, namely that of Kannaland Municipality. Therefore this presentation is based on the **audits of 30 municipalities as at 31 January 2020**.

Audit outcomes are indicated as follows:

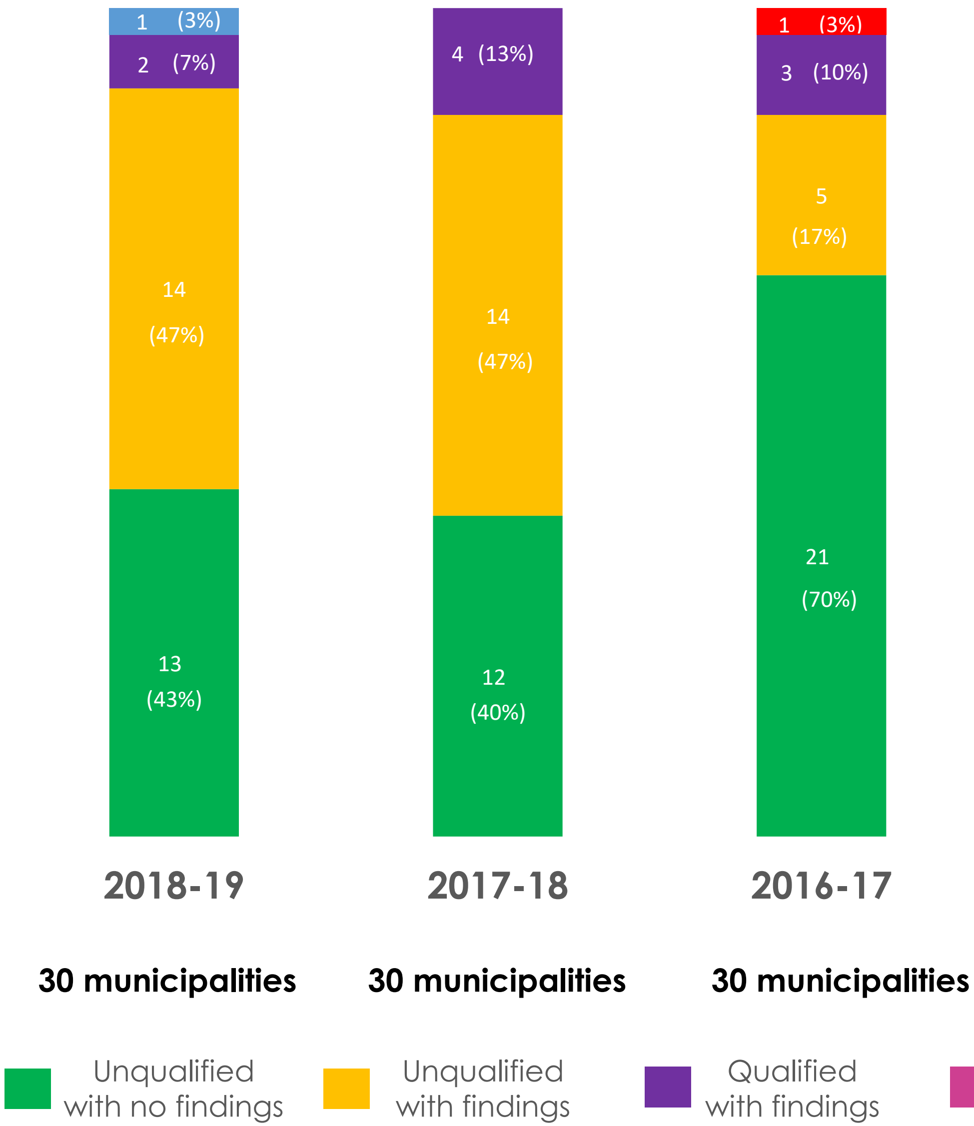
- Unqualified with no findings
- Unqualified with findings
- Qualified with findings
- Adverse with findings
- Disclaimed with findings
- Outstanding audits

Movement from the previous year is depicted as follows:

- Improved
- Unchanged
- Regressed

Movement of 5% or less: Slightly improved · Slightly regressed

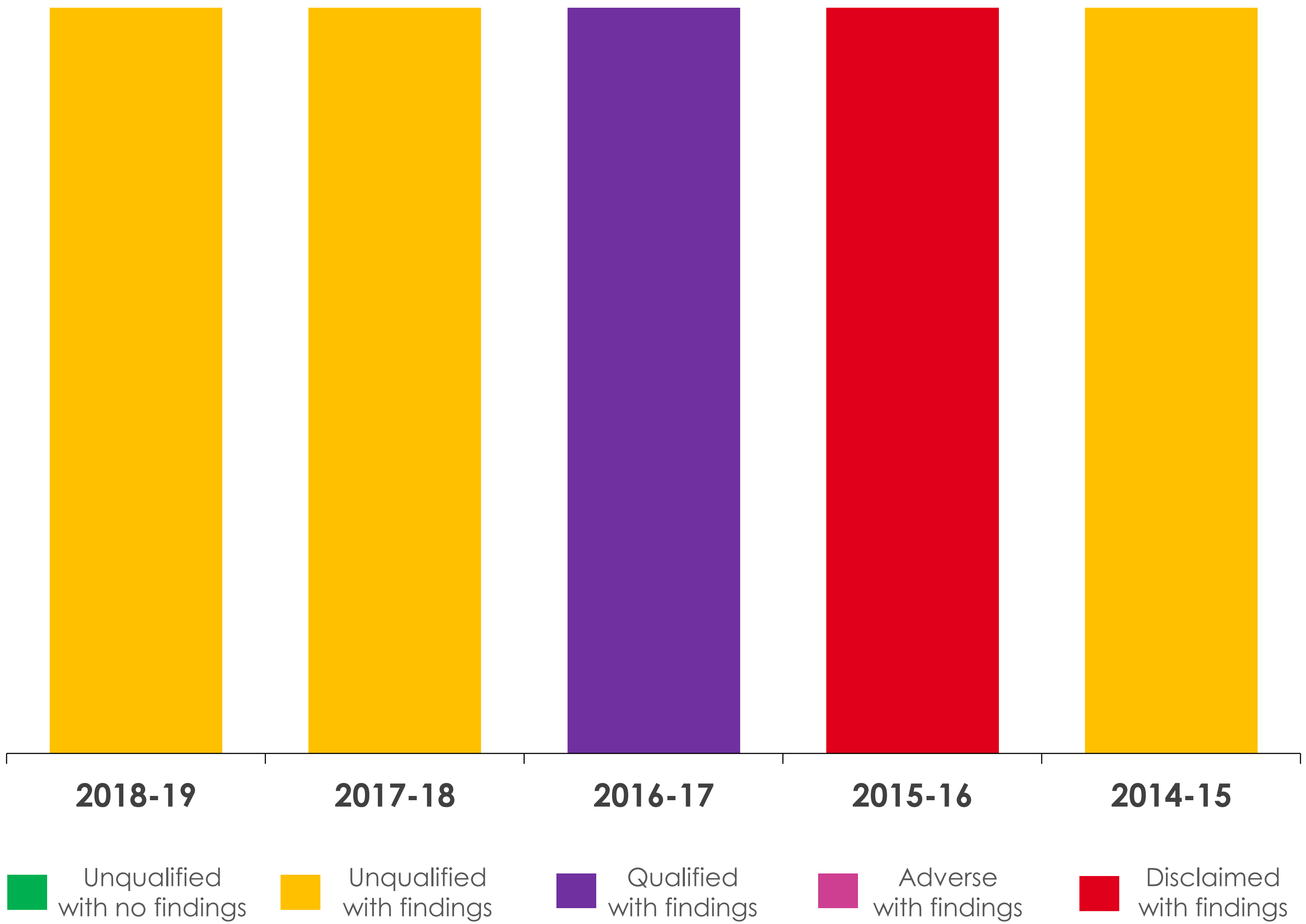
Movement in municipal audit outcomes – All WC municipalities



Audit outcomes – Kannaland Municipality	
2018-19	Audit not finalised as at 31 January 2020
2017-18	Unqualified with findings
2016-17	Qualified
2015-16	Disclaimer
2014-15	Unqualified with findings

The cut-off date for reporting of audit outcomes is set as 31 January 2020
Note: Kannaland subsequently finalized on 28 February 2020

Kannaland Municipality five year audit outcome history



Section 139 intervention

- Kannaland Municipality was placed under mandatory provincial intervention in terms of section139(5) of the Constitution read with section139(1) of the Municipal Financial Management Act, 56 of 2003 (MFMA) from December 2016.
- The interventions in the municipality had a positive impact on the municipality's financial disciplines, although not to the desired level, due to the lack of sufficient funding and other governance challenges. This was exacerbated by the ongoing drought in the area and the negative impact thereof on the local economy and employment opportunities in the district.
- The nature of these interventions and their success are further dependent on the co-operation and the effectiveness of the governance structures. The municipality did not have internal audit for the third consecutive year, consequently rendering the functioning of the audit committee ineffective.
- Although a MPAC as a council committee was in existence it did not exercise its oversight responsibility of ensuring the municipality's operations are managed effectively. This was worsened by the continued instability in the key management positions.
- The combined impact of the shortage of skills, instability in key officials, ineffective internal controls systems and lack of oversight resulted in an inability to implement corrective actions to address prior years' audit findings.

Finance unit and its resources

- The financial statements were again submitted late (in October 2019), partially as a result of the impact of the systemic problems experienced with the 2017-18 financial statements and external audit.

- Skills and capacity in the finance unit were inadequate. This resulted in the municipality relying on consultants for the preparation of their financial statements without a proper plan for transfer of skills.

- The chief financial officer and budget manager positions were only filled permanently in the last half of the 2018-19 financial year.

- The basic daily and monthly controls were not embedded in the municipality's processes to ensure proper record keeping, timely, accurate and complete processing and reconciliation of transactions.

- In addition, the computer systems and software in use are not very sophisticated and cannot be upgraded due to a lack of funds. The municipality lost data during 2018-19 due to a lack of firewalls to prevent hacking. The data could not be recovered as their systems do not include regular backups of all data.

The use of consultants

- **Inadequate capacity and skills challenges** in the finance unit as detailed above resulted in Kannaland Municipality heavily relying on consultants for the preparation of financial statements without a proper plan for the skills transfer.

- The salary cost for the finance unit was **R10,2 million** while the cost of consultants for the current year was **R2,9 million** in relation to the 2017-18 financial year. A further cost of **R1,07 million** was the consultant cost for the 2018-19 financial year.

- Although consultants were used, there were numerous material misstatements that were subsequently corrected to achieve an unqualified audit outcome, this was partly due to the **municipality's inability to maintain proper records to support the information presented in the financial statements.**

Name of consultant	Nature of services	Paid by	R-value
Mubesco	Preparation of financial statements 2017-18	Municipality	2 908 660
Finovo	Preparation of financial statements 2018-19	Municipality	1 076 178

Quality of submitted financial statements & performance report

Financial statements

Financial statements submitted for audit contained material misstatements in the following areas:

- Non-current assets
- Current assets
- Non-current liabilities
- Revenue
- Expenditure and
- Disclosure notes

These were amongst others due to to lack of proper record keeping, daily and monthly reconciliations not performed and lack of proper review and monitoring processes to detect, prevent and correct errors.

Performance report

There were material misstatements in the annual performance report submitted for auditing on the reported performance information of key performance area 1: *to provide access to reliable infrastructure that will contribute to a better quality of life for Kannaland citizens*

Management subsequently corrected the misstatements, as a result no material findings on the usefulness and reliability of the reported performance information were raised in the audit report.

What does the financial statements say? The stark reality

Income statement

Revenue

Total = R158 million

The total revenue (excluding equitable share and conditional grants) was R99,8 million, but not all is recoverable (see balance sheet). Of their total revenue of **R158 million**, **R58,2 million** **(36,8%)** was from the grants and subsidies. This high percentage of funding from grants indicates the municipality's dependency on this funding to pay operational expenses like salaries and wages of **R58,7 million.**

Expenditure

Total = R137,8 million

- Goods and services are procured, but the suppliers are not paid –the average creditors payment period was **144 days**
- R142,5 million of expenditure was irregular (**R12,4 million** for the current year)
- R95,8 million of expenditure was unauthorised (**R4,1 million** for the current year)

Net result

The municipality incurred a net surplus of **R10,8 million** for the year although there is an unspent conditional grant of **R14,2 million**

Balance sheet

- The total creditors at year end was **R48,6 million**. The cash available at year end was **R11,6 million** The creditors were greater than available cash at year end
- The unspent conditional grants of **R14,2 million** is not all cash backed as the cash available at year end was **R11,6 million**
- The debtors balances are not recoverable. **93,2%** of the debtors balance has been provided for as impaired(see going concern heading below). The municipality wrote off bad debt of **R8,6 million**

Financial sustainability

Line item	2018-19	2017-18
Gross service debtors	R71 086 997	R68 022 668
Impairment provision as a % of service debtors	93,2%	92,6%
Cash and cash equivalents	R11 631 234	R1 548 713
Unspent conditional grants	(R14 231 073)	(R12 885 864)
Total revenue, excluding grants	R99 867 762	R98 936 697
Fruitless and wasteful expenditure	R1 570 519	R1 748 047

- The growing consumer debt and the related impairment, indicates that the municipality is in dire financial straits, as well as heavily reliant on grants to the extent of having already spent some of the conditional grant funding on operational needs in the period under review. This situation is not expected to improve soon due to the harsh drought and the resulting financial difficulties for the municipality's consumers.
- The bad economical environment and drought has also resulted in a decrease in own revenue in real terms when compared to the prior year, as the year-on-year increase is less than inflation.
- The municipality continues not being able to pay its creditors within the prescribed 30 days, resulting in the incurring of fruitless and wasteful expenditure in the form of interest paid, which is an expense that the municipality can ill afford.
- Mandatory provincial intervention is currently taking place to prepare an appropriate recovery plan for the municipality.

Supply chain management non-compliance is the main cause of irregular expenditure

Balance of unresolved irregular expenditure increased to R142,5 million

Annual irregular expenditure	2018-19	2017-18	2016-17
Irregular expenditure	R142,5 million	R130,0 million	R111,5 million

- The total amount identified for 2018-19 amounted to R12,4 million. (See the next slide for the detailed analysis)
- The lack of funds played a major role in limiting expenditure on big value projects which in turn decreased the risk of non-compliance to the SCM processes.
- Of the irregular expenditure reported for 2018-19 R5,3 million relates to non-compliance with Municipal SCM Regulation 32 (i.e. the “piggy back” regulation) which application was previously regarded as complying with the prescripts, but which is now regarded as irregular after the application was tested in a court of law.
- The irregular expenditure of prior years were not properly investigated, as the Council did not table it to the MPAC. The lack of such investigations has delayed any recovery of losses through the implementation of consequence management in those instances where municipal officials acted illegally or with fraudulent intent. There is a need for the council and municipal public accounts committee to give urgent attention to performing their oversight functions.

Non-compliance – procurement and contract management

Nature of non-compliance that resulted in the incurring of irregular expenditure	Rand -Value
Non-compliance with SCM 32 requirements	R5 336 055
Three written quotations not invited	R3 602 173
Open ended contract	R1 045 346
Preferential procurement prescripts not complied with	R305 897
Competitive bidding not invited	R88 242
Declaration of interest not submitted by suppliers	R347 707
(The remaining R1,7 million of irregular expenditure resulted from other non compliance and was not procurement related.)	

Other procurement related non-compliance

- The performance of contractors were not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

Non-compliance - other

Annual financial statements, performance and annual reports

- The annual financial statements were not submitted to the auditor-general for auditing, within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
- The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA.
    - Misstatements in provisions, property, plant and equipment, unspent conditional grants, taxes, interest received, grants revenue, finance charges, contracted services, transfers and subsidies, and disclosure items, identified by the auditors in the submitted financial statements have been corrected, resulting in the financial statements receiving an unqualified audit opinion.

Consequence management

- Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
- Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
- Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Non-compliance – other (continued)

Expenditure management

- Reasonable steps were not taken to prevent unauthorised expenditure amounting to R4,1 million as disclosed in note 43.1 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was as a result of spending in excess of the budget.

- Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R1,6 million as disclosed in note 43.2 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was caused by late payments which attracted penalties and interest.

- Reasonable steps were not taken to prevent irregular expenditure amounting to R12,4 million as disclosed in note 43.3 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the municipality's supply chain management policy.

- Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA. This was caused by the municipality's inability to pay outstanding accounts for current services due to severe cash flow constraints.

Non-compliance – other (continued)

Grant management

- The municipality was unable to provide sufficient appropriate audit evidence that the municipal infrastructure grant was spent for their intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Dora. This was due to unspent grants not being cash backed.

Strategic planning and performance management

- The IDP was not drafted considering the integrated development process and proposals submitted to it by the district municipality, as required by section 29(3)(b) of the Municipal Systems Act, 2000 (Act no. 32 of 2000) (MSA).

Human resource management

- The municipality was unable to provide sufficient appropriate audit evidence that the municipal manager and senior managers signed performance agreements within the prescribed period, as required by section 57(2)(a) of the MSA.
- A senior manager who was previously dismissed for financial misconduct was re-appointed before the expiry of a 10-years term, contrary to section 57A(3) of the MSA.
- Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted, as required by section 67(1)(d) of the MSA.

Maintenance of infrastructure and infrastructure projects

The municipality incurred R2,1 million in repairs and maintenance for 2018-19, while the carrying value of property, plant and equipment was R325,5 million (0.6%), while the National Treasury norm is 8%.

Poorly maintained assets and aging infrastructure contributed to distribution losses. Kannaland disclosed water losses of **41,9%** to the value of **R5,1 million**.

The municipality did not have infrastructure maintenance policy and there were no conditional assessments performed to inform the infrastructure maintenance plans, their approach is rather reactive than pro-active.

Infrastructure with the cumulated expenditure of R14.5 million was disclosed as taking significant longer period than expected, this was amongst others due to budget constraints. These include the following:

Infrastructure projects	as at June 2019	as at June 2018
Electricity project (Surya Powers)	R4,5 million	R4,5 million
Water supply (Swartberg dam)	R2,9 million	R2,9 million
Ladysmith waste water treatment works	R7 million	R7 million

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