

LEKWA LOCAL MUNICIPALITY 2020/21 AUDIT OUTCOME

Portfolio Committee on Cooperative Governance and traditional affairs

MFMA
2020-21

12 October 2022



AUDITOR-GENERAL
SOUTH AFRICA



MISSION

The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

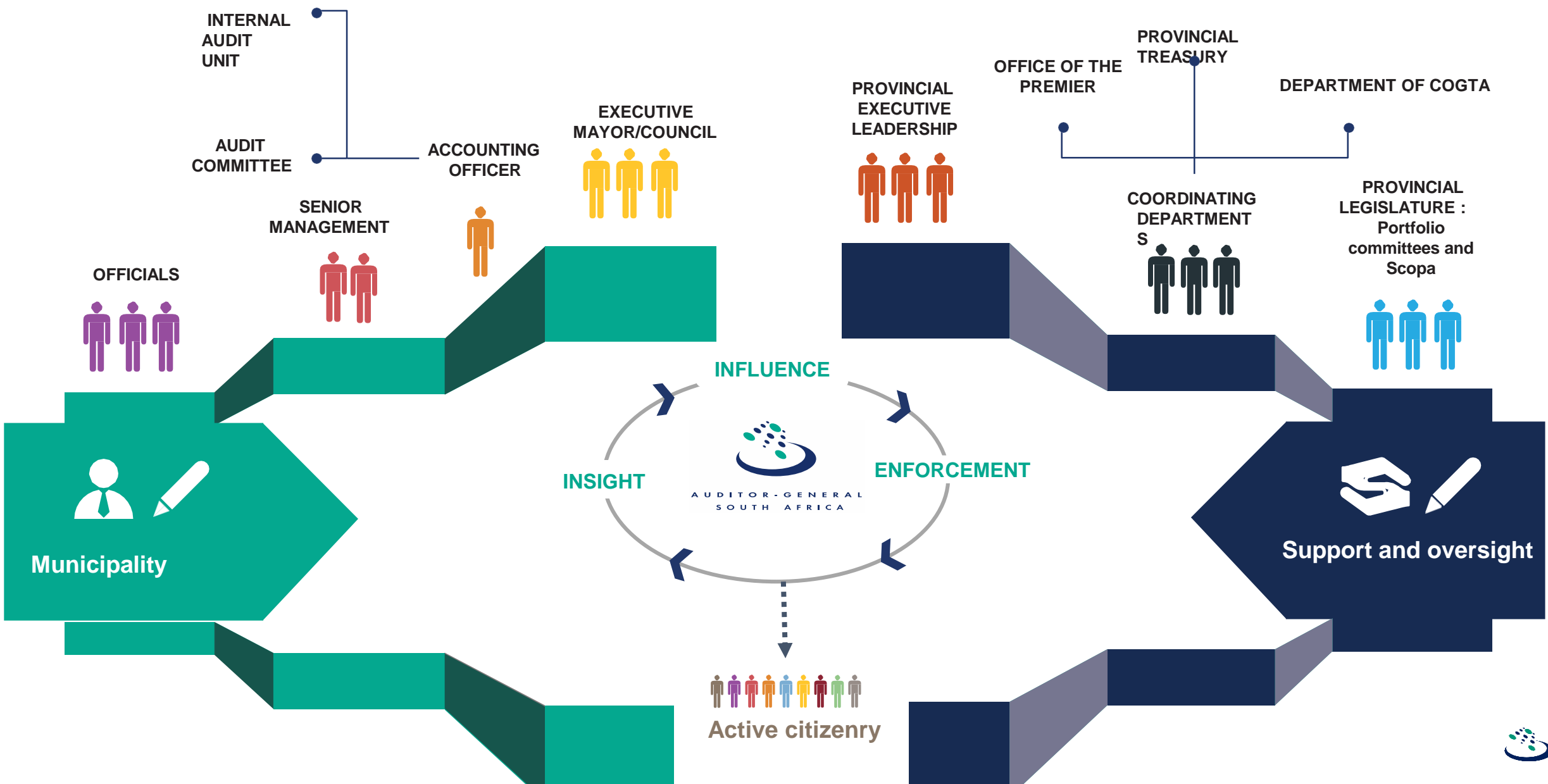


VISION

To be recognised by all our stakeholders as a relevant supreme audit institution that enhances public sector accountability.



We all have role to play in enabling the local government accountability ecosystem

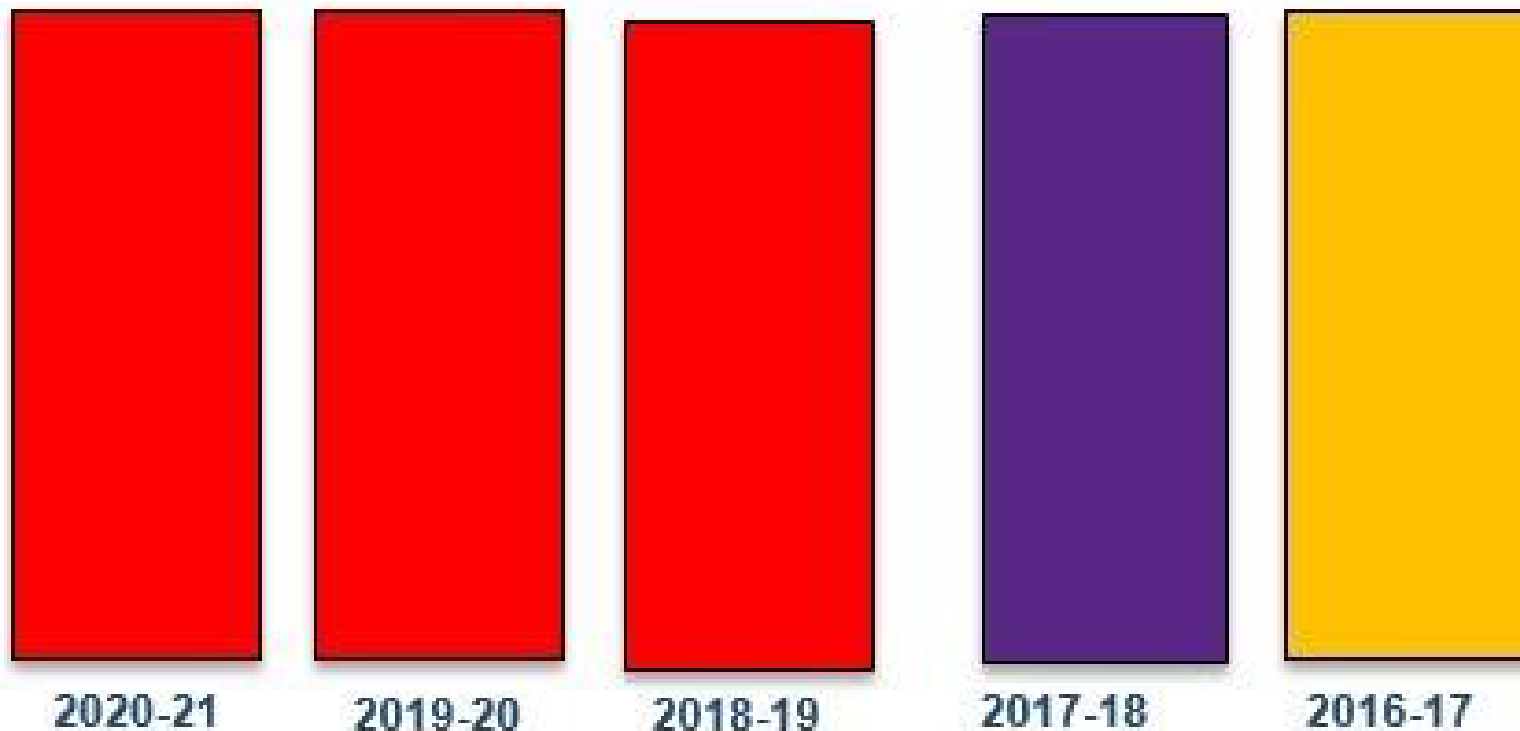


Audit Outcomes



Stagnation in audit outcomes

Types of audit outcomes



- Unqualified with findings
- Qualified with findings
- Disclaimer of opinion



Financial management



AREAS OF DISCLAIMER AUDIT OPINION

No	Areas of qualification	No	Areas of qualification
1	Cash and cash equivalent	10	Property rates
2	Property, plant and equipment	11	Bulk purchases
3	Investment property	12	Contract services
4	Inventory	13	Operational cost
5	Value Added Tax (VAT)	14	Commitments
6	Receivables from exchange transactions	15	Fruitless and wasteful
7	Receivables from exchange transactions	16	Irregular expenditure
8	Trade and other payables from exchange	17	Net cash flows fro operating and investing activities
9	Service charges	18	Prior period error note



- In the past three financial years the municipality's opinion has been a disclaimer, whilst the preceding two financial years before then the municipality received an unqualified with findings in 2016-17 and regressed to qualified in 2017-18. And further regressed into a disclaimer of opinion in 2018-19, 2019-20 and 2020-21.
- It must be noted that most material misstatements on cash and cash equivalents, property, plant and equipment, receivables, payables, Value Added Tax (VAT), commitments, irregular expenditure and provisions were repeat findings whilst misstatement on inventory, investment property, expenditure, cash flows and prior period error note were new findings. This is indicative of the worsening situation at municipality and lack of adequate/ ineffective action plan to address the problems that are known at the municipality.
- The misstatement on cash and cash equivalents, property, plant and equipment, VAT, payables and provision were mainly due to lack of reconciliation being performed. Where these reconciliations were made available, the audit process identified material differences that could not be explained or supported, thus rendering the limitations to the audit process.
- It was also of great concern that the long outstanding items on the bank reconciliation have not been resolved at that reporting date, this is an area susceptible to fraud and needs to be prioritised in order to give this municipality a chance to survive and be able to carry out its mandate. These matters were taken up with the acting municipal manager, the administrator and the executive mayor.
- Whilst the issues on revenue were mainly the prior year's correction that were recorded as part of current year's transaction and lack of supporting document for estimate billing on the water and electricity -this is indicative of lack of controls around the billing system, which is a critical area of revenue generation for the municipality.



Performance Information



- Misstatements were identified on the usefulness of performance information for service delivery and infrastructure development. Some targets disclosed in the SDBIP were not consistent when compared with the targets disclosed in the APR, in addition some of the indicators had no targets for the year under review.
- Regular reviews of the SDBIP against quarterly indicators and targets as well as at year-end were not properly performed, by the performance reporting unit and internal audit unit.
- 50% of the planned targets on indicators relating to key projects were not achieved and there are delays in completion and/or implementation of key infrastructure projects which negatively impact on communities not having access to basic services.
- Material irregularity was raised due to the municipality's failure to discharge its service delivery mandate resulting in substantial harm to the community. This is due to the municipality financial challenges. The financial recovery plan was developed and is being implemented.





Compliance with key legislation



No	Areas of non- compliance
1	Financial statements, performance reports and annual reports
2	Strategic planning and performance management
3	Expenditure Management
4	Revenue Management
5	Assets Management
6	Consequence Management
7	Procurement and contract Management
8	Conditional grants



- Non-compliance with key legislation remains a problem area for the municipality.
- Majority of the non-compliance identified in the current year are recurring findings, management as well as governance committees should be concerned about this trend. We are concerned with the on-going non-compliance on a yearly basis.
- Senior management has to focus on the key non-compliance matters and intensify the monitoring controls implemented to prevent them from recurring. Governance structures must closely monitor management's progress.



Material irregularities



The MI process was implemented at the municipality.

means any **non-compliance** with, or **contravention** of, legislation, **fraud**, **theft** or a **breach of a fiduciary duty** identified during an audit performed under the Public Audit Act that **resulted in** or is **likely to result in** a **material financial loss**, the **misuse** or **loss of a material public resource**, or **substantial harm to a public sector institution** or the **general public**





Lekwa LM MIs

Notified date	Response	MI description	Status of MI	Status description
11 June 2021	20 November 2021	<p>Full and proper records not kept</p> <p>The lack of full and proper records of the financial affairs of the municipality is likely to result in substantial harm to the public sector institution as the municipality is likely to be unable to discharge its service delivery mandate if these matters are not urgently addressed</p>	AO is taking appropriate action by implementing the financial recovery plan	The tracking of the financial recovery plan by the AO will be monitored by the audit team
13 April 2022	17 May 2022	<p>SARS penalties and interest</p> <p>Lekwa failed to timeously pay PAYE and other taxes to SARS within the stipulated date and as a result they incurred penalties and interest</p>	Evaluation of response	The notification of material irregularities was issued to the accounting officer and his responses were received. We are currently in the process of evaluating the responses.





Unauthorized, irregular and Fruitless & wasteful (UIFW) expenditure



Category	Opening balance (R)	2018-19 (R)	2019-20 (R)	2020-21 (R)	Closing balance (R)
Unauthorised expenditure	818 230 700	-	288 111 565	233 469 317	1 339 811 582
Irregular expenditure	319 260 111	69 656 409	72 499 545	40 751 096	502 167 158
Fruitless & wasteful expenditure	210 536 843	120 085 776	119 811 633	11 518 648	461 924 514



- The closing balance of UIFW expenditure continues to increase, indication that the municipality is not dealing with the UIFW expenditure, resulting in consequence management material findings.
- The fruitless and wasteful expenditure of R11 518 648 for the year under review this was due to the late submission and payment of VAT, PAYE, SDL and UIF. The closing balance of Fruitless and Wasteful expenditure was R461 924 514.
- Irregular expenditure of R40 751 096 was identified in the current year. The closing balance of irregular expenditure is R502 167 158.
- The controls put in place by the municipality to ensure compliance on SCM processes are not being adhered to at all times, resulting in repeat findings on non-compliance with SCM Regulations. The majority of the irregular expenditure in the current year is due to multi-year projects that are being spent on.
- The unauthorised expenditure of R233 469 317 incurred relates to the overspending of the approved operational expenditure budget. The closing balance of unauthorised expenditure is R1,339 811 582.
- The municipality need to ensure that stringent controls are in place and monitored to ensure that compliance with laws and regulations are adhered to, and investigations of UIFW expenditure must be timeously conducted and consequence management must be implemented.



Assurance providers



Internal audit



Audit committee



Municipal council MPAC

- Internal audit unit was not fully capacitated to ensure that deficiencies in internal controls are picked up during the year under review and recommendations to the management are implemented to improve the control environment.
- There were vacancies within the unit, and the audit plan not fully executed and/ or covering all the financial and performance management risks areas where the misstatements were identified.
- Furthermore, recommendations from internal audit units were not fully implemented.

- The audit committee did not ensure that the internal audit unit was fully resourced and capacitated and that their plans are fully executed and cover the risk areas.
- There was numerous non-compliance with laws and regulations identified during the audit. The committee should be concerned with this trend

- The council was dissolved during the year when the municipality was placed under administration. Therefore, UIFW was not investigated and delayed consequence management in this area as new council was sworn in December 2021.
- There has been an instability at administration level, as the position of the municipal manager was vacant during the year under review.



Financial Viability



- We have expressed a disclaimer of audit opinion on the financial statements. Consequently, the information in the financial statements is not sufficiently reliable to enable us to perform meaningful analyses of individual financial viability indicators. Our assessment of the municipality's financial viability was therefore limited to an 'unfavourable' overall assessment, indicating that intervention is required.
- Based on the figures as per the financial statement, a deficit of R 329 983 528 was realised in the current year(2020/21). The municipality operated with an unfunded budget during the year under review and as a result, it incurred further unauthorised expenditure. As reported earlier in this report, the municipality is struggling with cash management even with the basic control of performing proper cash reconciliations regularly.



Recommendations and commitments



In summary, efforts to improve the municipality's audit opinion to an unqualified opinion with no findings is achievable. We requested the executive mayor to monitor the effective implementation of the following recommendations:

- The municipality should relook at the budget process to ensure that a reasonable and achievable budget is being prepared and submitted to council for approval. Council should interrogate the budget and ensure that the budget it approves is funded. This will demonstrate council's consideration of spending within the available resources and avoid unauthorised expenditure.
- The implementation of the approved Financial Recovery Plan (FRP) should be closely monitored to ensure that the required financial objectives and improved financial sustainability is being achieved.
- The recording, reviewing and reporting processes and controls relating to financial statement and performance reporting on a daily and monthly as well as year-end processes should be improved.
- Senior management must vigorously monitor the progress made in implementing the audit action plan and to ensure the continued willingness by all stakeholders to implement the recommendations made by various assurance providers.



- Improvement in monitoring controls in the form of detailed planning sessions by project, senior and executive managers to align the technical indicator definitions to the requirements of the performance management reporting framework and detailed reviews by the senior and executive management prior to the approval of performance indicators by council.
- All levels of management to review and monitor compliance with all applicable legislation as well as enhancing the preparation process and review of the annual financial statements. An enhanced effort must be made for those non-compliance findings that are recurring.
- In dealing with the repetitive UIFW expenditure, investigations should be specific and consequence management should be applied vigorously.



- Internal audit supported by the audit committee should include reviewing the control environment at the municipality focusing on the following aspects:
 - Reviewing the adequacy of the design of the current internal controls for all the various cycles.
 - Review the effective implementation throughout the year, of those internal controls that are already adequately designed.
 - Communicate to management and report to audit committee the gaps identified with recommendations on how to address them.



- The National Treasury (NT) provided the municipality with the FRP that is aimed to assist with financial rescue and stabilizing the financial management at the municipality.
- A cabinet representative was seconded, to oversee the intervention on behalf of the national executive and to ensure the implementation of the FRP by the municipality.
- Furthermore, the FRP has been submitted on monthly basis to NT for reviews and comments on the progress made by the municipality in addressing the challenges entailed in the FRP.



Following the release of the 2020-21 MFMA audit outcomes, department of CoGTA and Provincial Treasury assembled a joint audit support plan in improving the state of affairs of local municipalities. The following were identified as critical areas for supporting Lekwa Local Municipality, amongst other municipalities in the province with similar challenges:

- Lack of oversight
- Quality of AFS/ Internal control environment
- Unfunded budget
- Incomplete revenue baseline
- Record management
- Cost of service/ contract management
- Capacity of the administration
- Infrastructure planning



The executive mayor, has also made the following commitments during the 2020-21 audit outcomes debrief session:

- To ensure full implementation of the financial recovery plan,
- To ensure that the audit report is thoroughly discussed in council, and
- MPAC to investigate the root causes of the audit findings.



- Some improvements in the Annual Financial Statement (AFS) submitted for audit have been noted, as the underlying records agreed with the AFS figures.
- There has been some effort made by management in addressing the prior periods misstatements that have led into a disclaimer audit opinion.
- The audit process will unfold if there are any misstatements in the prior and current year's figures.
- The flow of information requested for audit purposes has improved compared to the previous financial years.
- Implementation of some of the commitments received are still in progress.



THANK YOU



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