PORTFOLIO COMMITTEE ON CO-OPERATIVE GOVERNANCE AND TRADITIONAL AFFAIRS

Engagement on the state of Kannaland Local Municipality 2020-21

23 November 2022

AUDITOR-GENERAL SOUTH AFRICA

MISSION

The Auditor-General of South Africa has a constitutional mandate and, as the supreme audit institution (SAI) 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 (SAI) that enhances public sector accountability.

AGSA STRATEGY 2030
making a difference in the lives of our people

We will realise our strategic aspiration by focusing on six strategic goals

Strategic aspiration

To have stronger, more direct and consistent impact on improving the lived reality of ordinary South Africans

Theory of change

Sustainably and efficiently shift public sector culture through insight, influence and enforcement

Accountability ecosystem

Broad-based, effective network of stakeholders driving and deepening public sector accountability

Insight

Generate audit insights that illuminate understanding, drive action and yield results

Influence

Move stakeholders from mere awareness of our messaging to action on and advocacy of our messaging

Enforcement

Apply powers to directly and indirectly recover resources lost to the state and taxpayers and ensure application of consequences for wrongdoing

Shift public sector culture

Move a critical mass of auditees towards organisational cultures charcterised by transparency, integrity and accountability

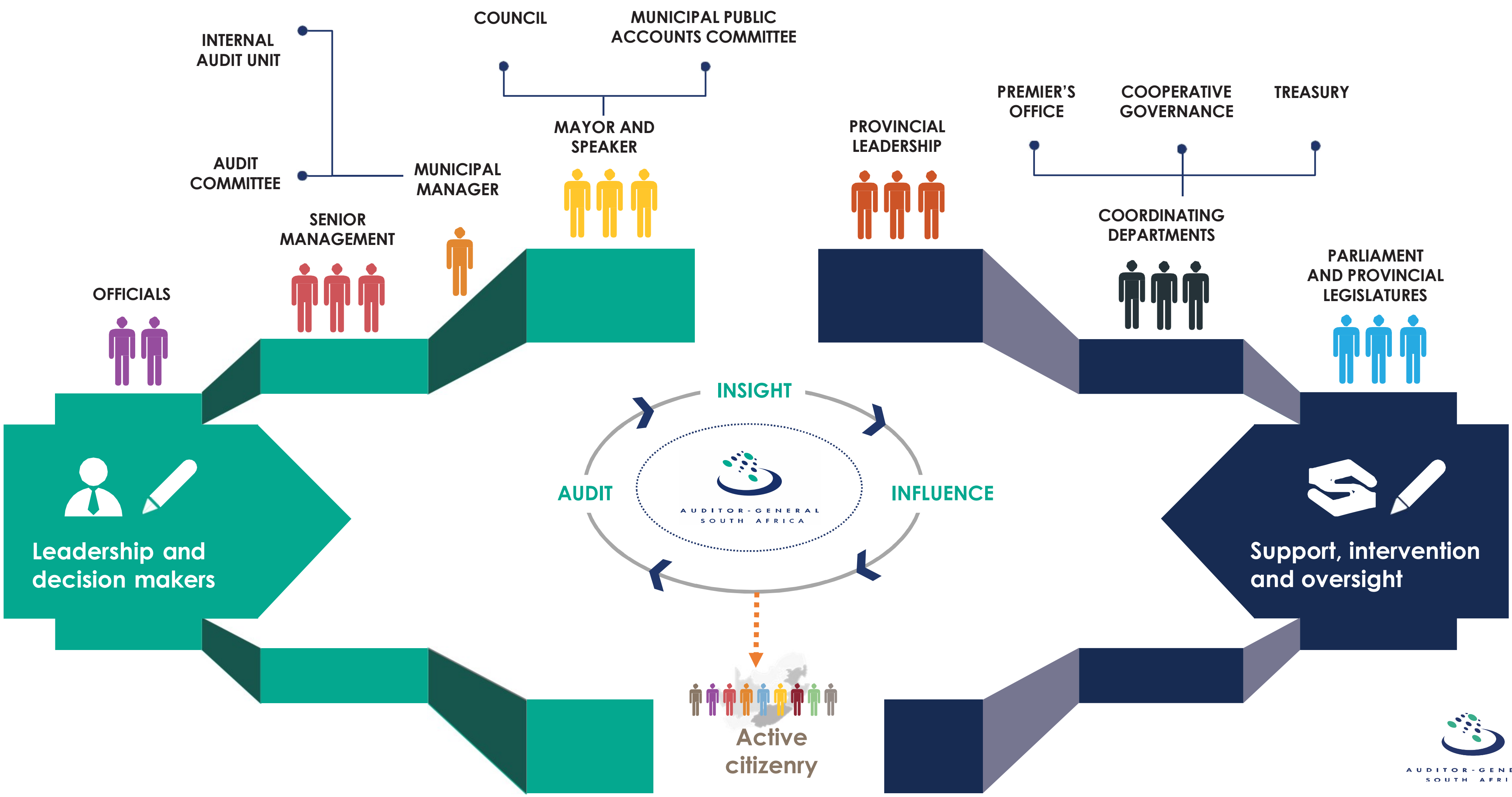
Sustainably

Acquire, develop and maintain the quantity, quality and configuration of people, resources and capabilities to safely achieve and sustain our desired levels of impact

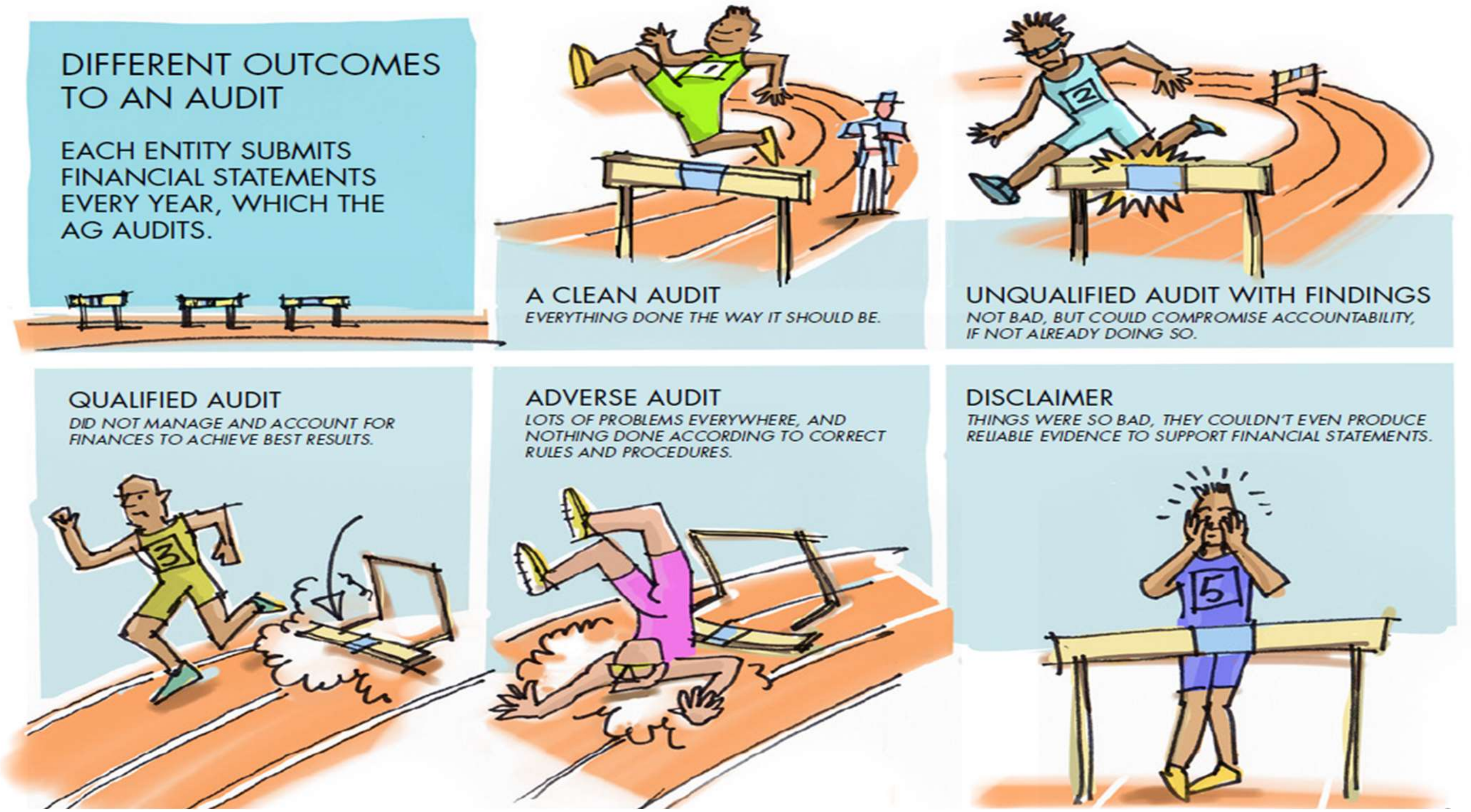
Efficiently

Unlock latent capacity in the existing resource base and our people and lower the cost and effort with which we derive each marginal unit of quality, insight, influence and enforcement

Accountability ecosystem



Audit outcomes



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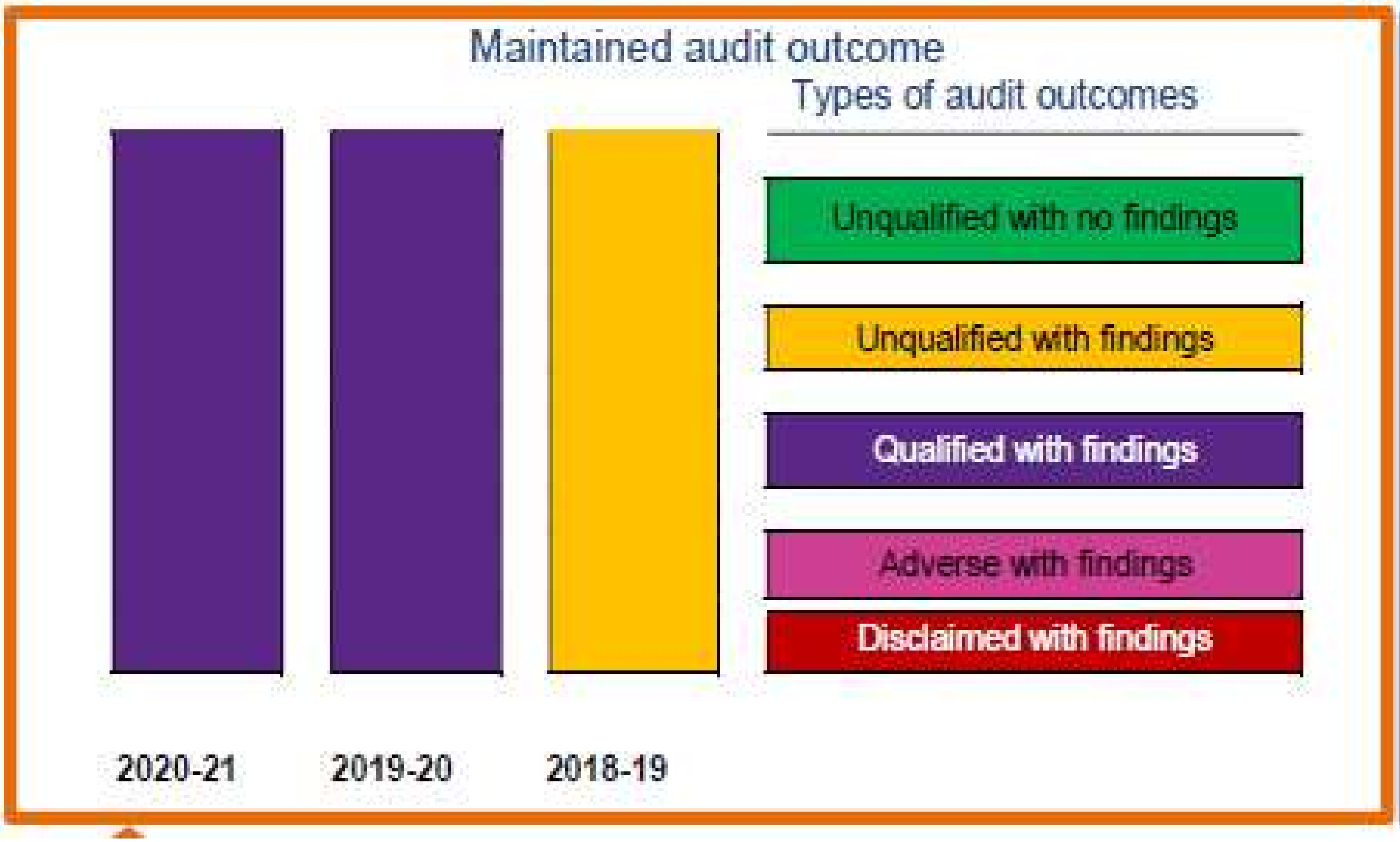
Audit opinion history



Remained qualified with findings on performance information and compliance with laws and regulations

Financial statements
- Qualified

Performance information
- Material findings

Compliance with laws and regulations
- Material non-compliance identified

Internal control deficiency
- Significant deficiencies identified

Overall message

- 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. However, on 7 October 2021 the Western Cape High Court ruled that the administration be declared unlawful and as a result it was ended.

- The financial statement outcome of being qualified with findings has stagnated since the previous year. This outcome resulted from material limitations and disagreement misstatements for assets, liabilities, expenditure and disclosures.

- The municipality did not have effective governance structures. There was no internal audit for the fifth consecutive year, consequently rendering the functioning of the audit committee ineffective.

- Although an MPAC as a council committee was in existence it did not exercise its oversight responsibility of ensuring the municipality's operations are managed effectively as required by the MFMA. This was worsened by the continued instability in the key management positions at the municipality.

- The audit of performance information resulted in material misstatements being identified as targets were changed in the Service Delivery Budget Implementation Plan (SDBIP) without council approval. These failures in controls should be addressed as these could negatively affect the audit outcomes in future years.

- Material non-compliances were reported due to the misstatements in the annual financial statements identified through the audit process and hence the financial statements submitted were not prepared in accordance with the MFMA. Furthermore, the other non-compliance areas relate to Strategic planning and performance management, consequence management, expenditure management and procurement and contract management.

Finance unit and its resources

What we found:

01

The financial statements were again submitted late (30 September 2021), mainly as a result of the impact of the COVID 19.

02

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.

03

The municipal manager, Mr R Stevens, was suspended on 30 November 2020 and was eventually terminated (resigned) in July 2021. Since his suspension a number of people have acted as the municipal manager and to date (November 2022) the position has not been filled.

04

The CFO, Mr R Butler, acted as the MM for a period, which resulted in other people having to act in the CFO's position.

05

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.

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 **R15,5 million** while the expenditure for consultants for the current year was **R2,1 million** in relation to the 2019-20 financial year and a further expense in the next year of **R1,9 million** was the consultant cost for the 2020-21 financial year.

- Although consultants were used to prepare the financial statements, numerous material misstatements were identified, some that were subsequently corrected, however it did not result in an unqualified audit outcome, due to the **municipality's inability to maintain proper records supporting the financial statement disclosure.**

Name of consultant	Nature of services	Paid by	R-value
Finovo	Combination of financial reporting services including the preparation of 2019-20 financial statements	Municipality	2 097 383
Ducharme	Combination of financial reporting services including the preparation of the 2020-21financial statements	Municipality	1 931 323

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Quality of submitted financial statements

Types of misstatements

Each identified misstatement is classified as either a disagreement misstatement or a limitation misstatement.

- **Disagreement misstatement** - audit evidence is available with respect to a financial statement item, but there is a disagreement with management on the amount that the auditee has recorded or recognised in the accounting records and in the financial statements including the amount that is supported by the audit evidence (or if not an amount, the classification, presentation or disclosure of an item).

- **Limitation misstatement** – audit evidence with respect to a financial statement item is not available or is not adequate in the circumstances. Under these circumstances, the auditor is uncertain and cannot conclude whether the financial statement item is free from material misstatement.

The qualification areas can be classified into one of the above types of misstatement. Refer to next slide. D for disagreement and L for limitation.

Financial statements

The municipality received qualifications in the following areas:

Current assets
Receivables from exchange transactions (D)
Statutory receivables from non-exchange transactions (D)

Current liabilities
Payables from exchange transactions (D and L)
VAT payable (L)

Non-current liabilities

Employee benefits (L)

Revenue

Revenue from non-exchange – transfers and subsidies (L)

Expenditure

Employee related costs (L and D)

Cash flow statement

Cash flows from operating expenditure (L and D)

Statement of comparison of budget and actual amounts (D)

Disclosure notes
Going concern (D)
Correction of error (D)
Unauthorised expenditure (L)
Irregular expenditure (D)
Financial instruments (L and D)
Contingent liabilities (L)

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What do the financial statements say? The stark reality

Income statement

Revenue

Total = R177 million

The total revenue (excluding equitable share and conditional grants) was R114,8 million, but not all is recoverable (see balance sheet). Of their total revenue of **R177 million**, **R62,2 million** **(35,1%)** 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 **R66,7 million.**

Expenditure

Total = R182,0 million

- Goods and services are procured, but the suppliers are not paid – the average creditors payment period was **210 days**
- R133,3 million of expenditure was irregular (R21,4 million for the current year. (As per the qualification paragraph the full extent of irregular expenditure is not reflected in the financial statements)
- R23,1million of expenditure was unauthorised (**R6,7million** for the current year). (As per the qualification paragraph we were unable to obtain sufficient evidence to support the figures reflected in the financial statements).

Net result

The municipality incurred a net deficit of **R5,1million** for the year and there are unspent conditional grants of **R30,9 million**

Balance sheet

- The total creditors at year end was **R54,9 million**. The cash available at year end was **R48,8 million** The creditors were greater than available cash at year end
- The municipality continues not being able to pay its creditors within the prescribed 30 days, incurring fruitless and wasteful expenditure in the form of interest paid amounting to R3 442 178.
- The unspent conditional grants of **R30,9 million** is not all cash backed as the cash available at year end was **R48,8 million** which must be utilised for expenditure and creditors too. There is an increase in unspent grants is due to the delay in projects as well as cost containment measures put in place by the municipality.
- The debtors balances are not recoverable. **95,6%** of the debtors balance has been provided for as impaired(see financial sustainability heading below). The municipality wrote off bad debt of **R208 442.**

Quality of submitted performance report

Performance report

There were material misstatements in the annual performance report submitted for auditing on the reported performance information of key performance area 2: to provide adequate services and improve our public relations

Management subsequently corrected only some of the misstatements, as a result material findings on the usefulness of the reported performance information were raised in the audit report.

The material findings on usefulness were as follows:

NKPI 1 – Number of formal residential properties that receives piped water connected to the municipal water infrastructure network as at 30 June 2021.
The target of 4 940 per the approved service delivery budget implementation plan was changed without the necessary approval.

NKPI 2 – Number of formal residential properties connected to the municipal electrical infrastructure network (excluding Eskom areas) (prepaid and conventional) as at 30 June 2021.
The target of 3 791 per the approved service delivery budget implementation plan was changed without the necessary approval.

Non-compliance – procurement and contract management

Non-compliance -PCM

- Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM Regulation 17(1)(a) and (c). Similar non-compliance was also reported in the prior year.

- Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM Regulation 43. Similar non-compliance was also reported in the prior year.

- Some of the contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of the Preferential Procurement Policy Framework Act 5 of 2000 and the Preferential Procurement Regulations 2017, regulation 11.

- Some of the quotations were accepted from 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). Similar non-compliance was also reported in the prior year

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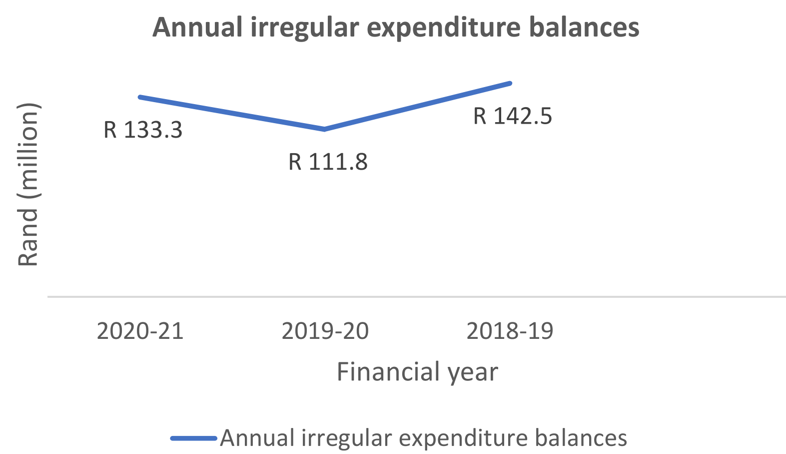
Irregular expenditure



Irregular expenditure is not complete

Qualification paragraphs:

- Not all payments in contravention of SCM requirements were disclosed
- The narrative disclosures is not accurate

Root causes of irregular expenditure incurred

- Bid awarded to suppliers whose tax matters were not in order
- Bids awarded to suppliers who did not score the highest points in the evaluation process
- Conflict of interest not provided
- Three quotes not obtained
- Deviations not justifiable
- Bids not advertised for required minimum days
- Bids not evaluation on the preferential points system, including BBEE requirements not being taken into account
- Suppliers not accredited

Non-compliance with laws and regulations

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 were submitted on 30 September 2021.

- 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.
    - Material misstatements of non-current assets, current assets, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, however the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

- The Service Delivery Budget Implementation Plan (SDBIP) for the year under review did not include monthly revenue projections by source of collection and the monthly operational and capital expenditure by vote, as required by section 1 of the MFMA.

- A mid-year performance assessment was not performed, as required by section 72(1)(a)(ii) of the MFMA.

- The SDBIP was revised during the year without the approval of the council following approval of an adjustments budget, as required by section 54(1)(c) of the MFMA.

- The performance management system and related controls were inadequate as it did not describe how the performance measurement and review processes should be organised and managed, as required by the Municipal Planning and Performance Management Regulations 2001, regulation 7(1).

Non-compliance with laws and regulations

Expenditure management

- An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 65(2)(b) of the MFMA.

- Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the unauthorised expenditure incurred as indicated in the basis for qualification paragraph. The majority of the unauthorised expenditure was as a result of spending in excess of the budget.

- Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R3,4 million as disclosed in note 51.2 to the annual financial statements, in contravention of 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, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. The majority of the irregular expenditure was caused by non-compliance with the municipality's supply chain management policy.

Non-compliance with laws and regulations

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.
- Allegations of financial misconduct against senior managers were not always investigated, as required by the Local Government: Disciplinary Regulations for Senior Managers 2011, regulation 5(3) and section 171(4) of the MFMA.
- Allegations of financial misconduct laid against officials of the municipality were not investigated by the disciplinary board, relevant treasury or an independent investigator or team of investigators appointed by council, as required by the municipal regulations on financial misconduct procedures and criminal proceedings 2014, regulation 5(4).
- Allegations of fraud which exceeded R100 000 were not reported to the South African Police Service, as required by section 34(1) of the Prevention and Combating of Corrupt Activities Act, 2004 (PRECCA).

Root causes, recommendations and commitments

Overall root causes of significant findings

- Leadership did not exercise adequate oversight regarding the implementation of action plans to address prior year audit findings and internal control deficiencies, which resulted in repeat audit findings on compliance with laws and regulations and material misstatements in the financial statements and the annual performance report. This can be attributed to the instability at leadership level as well as the absence of an established internal audit unit in order to assist management in ensuring that there is an effective process for the identification of internal control deficiencies as well as to recommend corrective action in order to improve the internal control environment at the municipality and address the recommendations of the prior year. This was also exacerbated by the shortened period between the 2020-21 and the 2019-20 audits, due to the delayed sign-off of the 2019-20 audit.

- Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is available and accessible to support financial reporting. Skills shortages at senior management levels, over reliance on consultants and management's lack of accountability to implement and monitor adherence to policies and processes to ensure that the financial statements are supported by valid, accurate and complete supporting information, resulted in material misstatement of the financial statements and non-compliance with section 122 of the MFMA.

- The continuing instability and capacity challenges in key positions that has resulted in a lack of effective monitoring and oversight over internal controls that could have ensured the correct and timely approval of adjustments to targets within the SDBIP.

- The municipality does not have the capacity and the skills necessary to ensure that processes are implemented effectively to facilitate compliance with prescribed legislation.

Root causes, recommendations and commitments (continued)

Key recommendations to, and commitments by, accounting officers and authorities

- Management must intensify their review processes prior to the submission of the financial statements to detect such misstatements. These reviews should consist of ensuring that underlying accounting records agree to the information contained in the financial statements, that the financial statements comply with all the relevant standards and that they cast and cross cast. The majority of the misstatements could have been easily detected by such a review.
- Basic controls need to be implemented, adhered to and monitored, and the municipality should strive to attract and retain skilled personnel. The instability experienced in key leadership positions must be addressed as a matter of urgency as to remedy the culture of non-adherence to policies and processes.
- CoGTA to continue to exercise their oversight role over Kannaland Municipality

Root causes, recommendations and commitments (continued)

Commitments by executive authority

- Basic daily and monthly controls will be embedded in the municipality's processes to ensure proper record keeping that supports the information contained in the financial statements and the annual performance report.
- Effective governance structures to be put in place such a functional internal audit unit that supports the audit committee in its risk and audit oversight role and that will ensure that risk assessment and risk monitoring processes do not occur as required.
- Intensify review processes to ensure that quality financial statements are submitted for audit and detect misstatements. These reviews will consist of ensuring that underlying accounting records agree to the information contained in the financial statements, and that the financial statements comply with all the relevant standards.

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