



REPORT TO THE MSUNDUZI MUNICIPAL COUNCIL

File Reference: 3.10.1.1
Report Number: AC 01/2020-21

Author: Chairperson and Audit Committee

NOT CONFIDENTIAL
FOR CONSIDERATION

1st Level: COUNCIL (24/02/2021)

SUBJECT: AUDIT COMMITTEE REPORT FOR THE PERIOD 01 JULY 2020 TO 31 DECEMBER 2020

DATE: 26 JANUARY 2021

1. PURPOSE

The purpose of this report is to apprise Council on the Audit Committee's progress in carrying out its oversight responsibilities in terms of section 166 of the Municipal Finance Management Act (Act 56 of 2003) as amended (MFMA) read with circular 65 published by the National Treasury on the outcome of the work done by the Audit Committee during the period 01 July 2020 to 31 December 2020 (Quarters 1 and 2).

2. DELEGATIONS

The Audit Committee is a sub-committee of Council.

3. ANNEXURES

N/A

3 LEGISLATIVE PROVISIONS / POLICIES

3.1 In terms of provisions of section 166 (2) (b) of the Municipal Finance Management Act of 2003 ("the MFMA"), an Audit Committee is an independent advisory body which must advise the Municipal Council, the political office bearers, the Accounting Officer and Management staff of the municipality on matters relating to:

- (i) Internal financial control and internal audits;
- (ii) Risk management
- (iii) Accounting policies;
- (iv) The adequacy, reliability and accuracy of financial reporting information;
- (v) Performance management;
- (vi) Effective governance;
- (vii) Compliance with the Act, the annual Division of Revenue Act and other applicable legislation;
- (viii) Performance evaluation; and
- (ix) Any other issues referred to it by the municipality

4 BACKGROUND

- 4.1** The Audit Committee of the Municipality submits its report to Council in terms of the provisions of section 166 (2) (b) of the MFMA and covers the financial period from 01 July 2020 to 31 December 2020.
- 4.2** The report records the outcome of the work done by the Audit Committee for the period indicated above. The committee from time to time made recommendations as preventative or corrective measures to the weaknesses identified either by Internal Audit Unit or from reports and information supplied to the Audit Committee. This report also serves to bring to the Council's attention matters, which may significantly impact the financial condition or affairs of the organisation.
- 4.3** The advice or recommendations contained in this report have been made based on information supplied to the Audit Committee and is subject to change after due consideration of any new information it may receive as well as subsequent deliberation with the municipality.

5 MOTIVATION/DISCUSSION

5.1 Membership

The Audit Committee consists of the members listed hereunder and meets as a minimum, four times a year as per the approved Audit Committee Charter. The composition of the committee is a minimum of three members as per section 166 (4) (a) of the MFMA.

5.2 Committee Membership

Following the two members' contracts coming into an end, two new members that were appointed to the audit committee. The composition of the committee is reflected below:

Mr MM Madliwa - Chairperson
Mr V Dlamini– New member
Mr LJ Quayle – New member
Ms B Kemp
Mr M Shongwe

5.3 Overview of Activities

The Committee held 3 meetings during Quarters 1 and 2 of 2020/21 (the period **01 July 2020 to 31 December 2020**).

An additional meeting was scheduled for 8 December 2020. This meeting was rescheduled at the request of the Office of the City Manager, due to the visit by the Deputy Minister of Public Service and Administration and to accommodate for all the relevant protocols to be adhered to facilitate this visit at the City Hall. Due to other Council and operational commitments (midyear reporting, for example), the meeting was rescheduled for 2 February 2021.

Attendance at meetings was as follows:

Member's name	15 September 2020	27 October 2020	20 November 2020
Mr MM Madliwa	√	√	√
Ms B Kemp	√	√	√
Mr M Shongwe	√	√	√
Mr E.V. Dlamini	■	■	√
Mr L.J. Quayle	■	■	✘

- ✓ Attended
- ✘ Did not attend
- Not yet appointed

5.4 Audit Committee Responsibilities

The Audit Committee has complied with its responsibilities arising from section 166 of the Municipal Finance Management Act, Act 56 of 2003, (MFMA) and clause 14(2) (a) of the Municipal Planning and Performance Management Regulations of 2001.

The Audit committees work is guided and regulated by the Audit Committee Charter, which is reviewed, amended and ratified by Council on an annual basis or when need arises because of changes in legislation and has discharged all its responsibilities as contained therein.

5.5 Internal Audit Function, Resources & Systems of Internal Control

- 5.5.1 In terms of S165 (1) of the MFMA, each municipality is required to have an Internal Audit function. The Internal Audit Charter (reviewed and approved by the Audit Committee on 16 July 2019) regulates the work of the Internal Audit activities.
- 5.5.2 The Internal Audit Plan was also approved by the Committee on 25 June 2020. In order to appropriately carry out its mandate, the Internal Audit Activity (IAA) needs to be adequately resourced.
- 5.5.3 In terms of the organogram, IIA should have a staff complement of twenty two (22) but currently has ten (10) incumbents. This translates to a vacancy rate of more than fifty four percent (54%) as at 31 December 2020. This lack of resources, whilst improved from the previous report, remains concerning as it continues to impact negatively on the IIA's critical role of providing adequate assurance and assist the municipality in achieving its strategic objectives as well as its ability to support the Audit Committee through producing audit reports for its review.
- 5.5.4 S165 (3) of the MFMA allows the municipality to co-source the internal audit function if the Municipality requires assistance to develop its internal capacity. Circular 65 of the MFMA also provides guidance on Outsourcing or Co-sourcing of Internal Audit Activity.

- 5.5.5 Due to the very high vacancy rate indicated in the above paragraph, the IAA has therefore, a co-sourced arrangement with a panel of audit firms on contract over a three (3) year period. Whilst this arrangement may be justifiable, there may be issues of lack of on the ground presence which may affect the audit firms' ability to maintain awareness of the municipality's risks and controls.
- 5.5.6 There is a process of structural review of the IIA to ensure that it is geared towards the future growth of the municipality and to ensure that it has the capacity to be responsive to the risks to which the municipality is exposed. The Committee is, however, concerned that this process is taking too long as it is now over a year since it was initiated, and implementation continues to take unacceptably long.

Although the Committee notes with appreciation the steps that have been taken in the 2nd quarter to fill the vacancies in internal audit, the Committee still noted with concern that the Committee's ability to effective is severely compromised without internal audit being effective. The effectiveness of internal audit also impacts management, because internal audit plays a critical role in the combined assurance model. Internal audit must maintain independence, and this is catered for by its reporting structure on governance matters through the audit committee and council, and it needs to be effectively resourced, which is an administrative matter. The resourcing applies not only to the filling of vacancies, but also to the availability of funding to continue the work of internal audit and internal audit's consulting.

5.6 Internal Audit Plan Update

- 5.6.1 The table below provides a list of the Internal Audit reports submitted to the committee during the period under review. The committee noted the Internal Audit findings and the overall assessment of the control environment as well as the detailed recommendations proposed to strengthen controls and the management comments thereof. Management is urged to implement the recommendations proposed.
- 5.6.2 It is of concern that many of the Internal Audit Reports indicate that the design and the operation of the systems of internal control are inadequate and ineffective, respectively and require urgent attention. This assessment is ongoing and to date there are no indications in any improvements, even slight.
- 5.6.3 Furthermore, the Audit committee is concerned that many of the recommended actions from previous Internal Audit Reports and resolutions taken by the Audit Committee are not being actioned and may result in negative audit outcomes. This concern has been reported to Council previously. The committee re-iterates this concern and recommends that management be held accountable for clear reduction in the number of unresolved recommendations, and tangible improvement to the system of internal control. The Committee would, however, like to acknowledge the recent change in the format and quality of reporting, with the hope that better reporting will enable more effective resolution going forward. Tracking of the implementation of IIA recommendations revealed the following-

Refer to the table below for Internal Audit reports considered by the Audit Committee during Quarters 1 and 2 the 2020/2021 financial year.

Year	Total	Resolved	Unresolved
2016/17	130	90	40
2017/18	347	246	101
2018/19	209	168	41

Internal Audit reports considered during the period 01 JULY 2020 to 31 DECEMBER 2020.

#	Description of Internal Audit Report	Overall assessment of the control environment	Significant findings
Quarter 1 and 2			
1	<u>FINAL INTERNAL AUDIT REPORT ON THE REVIEW OF ADEQUACY AND EFFECTIVENESS OF THE IT GOVERNANCE STRATEGY AND FRAMEWORK (REF:3.10.1.1)</u>	The design of the system of internal controls is inadequate and the operation of the system of internal controls is ineffective	<ol style="list-style-type: none"> 1. Lack of IT Strategy and IT Governance Framework 2. Outdated ICT Charter in place 3. Business benefits realization exercise not performed 4. Outdated IT organogram in place 5. No business continuity or disaster recovery plan in place 6. Lack of updating of IT risk register 7. IT policies and procedures not fully approved
2	<u>INTERNAL AUDIT REPORT ON MOTOR VEHICLE DRIVER'S LICENSING CENTRE: COMMUNITY SERVICES: PUBLIC SAFETY (REF: 3.10.1.1)</u>	The design of the system of internal controls is inadequate and the operation of the system of internal controls is ineffective	<ol style="list-style-type: none"> 1. No departmental policy or procedure manual at the Driving Licence Testing Centre 2. No evidence of training for eNaTis operators 3. No senior management approval of the Driving Licence Testing Centre monthly banking summary and daily activity sheets 4. Inadequate controls in the application process 5. Application forms for licence cards issued are not kept in a secure place 6. Inadequate record management system 7. Application forms for licence cards not received for review 8. Professional driving permits not accompanied by required supporting documents 9. Unsatisfactory working conditions 10. Actual revenue analysis insufficient to meet expenditure obligations 11. Reconciliations not signed by relevant signatories
3	<u>FINAL INTERNAL AUDIT REPORT OF THE</u>	The design of the system of internal controls is inadequate and the operation of the system of internal controls is ineffective	<ol style="list-style-type: none"> 1. Establishment of the forestry as a municipal trading entity Catastrophic

#	Description of Internal Audit Report	Overall assessment of the control environment	Significant findings
	<p>MUNICIPAL FORESTRY (REF:3.10.1.1)</p>		<ol style="list-style-type: none"> 2. Inadequate handover process from NCT Forestry Co-operative Limited to the Msunduzi municipal forestry Catastrophic 3. Inadequate controls in relation to supply chain management processes High 4. Inadequacies in relation to the appointment of a board High 5. Lack of an approved municipal forestry policy 6. No succession plan in place High 7. Unregulated use of the cascades mountain biking park High 8. Inadequacies relating to the municipal forestry business plan High 9. Inadequate controls relating to the security and safeguarding of the municipal forestry High 10. Inadequacies in relation to the harvesting of mature compartments of forestry High 11. Municipal forestry budget overruns and inadequacies relating to the transfer of unit funds High 12. Inadequacies in relation to the membership with the fire protection association High 13. Inadequacies in relation to the annual plan of operations and the roads management strategy High 14. Inadequacies relating to the insurance of the municipal plantation High
4	<p>FINAL INTERNAL AUDIT REPORT ON THE AUDIT OF THE 2018/2019 ANNUAL REPORT (REF: 3.10.1.1)</p>	<p>The design of the system of internal controls is inadequate and the operation of the system of internal controls is ineffective</p>	

#	Description of Internal Audit Report	Overall assessment of the control environment	Significant findings
5	<u>FINAL INTERNAL AUDIT REPORT ON THE REVIEW OF THE ANNUAL FINANCIAL STATEMENT FOR THE YEAR ENDED 30 JUNE 2020: SAFE CITY MSUNDUZI NP (REF: 3.10.1.1)</u>		<ol style="list-style-type: none"> 1. Variance in the 2019 employee costs presented 2. Amount in the AFS's not reconciling to the GL.
6	<u>FINAL INTERNAL AUDIT REPORT ON THE REVIEW OF THE ANNUAL FINANCIAL STATEMENT FOR THE YEAR ENDED 30 JUNE 2020 (REF: 3.10.1.)</u>	<p>The design of the system of internal controls is partially adequate and the operation of the system of internal controls is partially effective</p>	<ol style="list-style-type: none"> 1. Consumer Debtors balances do not agree with the GL 2. Consumer Debtors balances do not agree with prior periods 3. Working paper file is inadequate 4. Prior period errors not adequately disclosed 5. Amounts on the AFS's do not agree with the GL 6. Consumer impairment incorrectly disclosed 7. Statement of Changes in Net Assets incorrect 8. Cash Flow Statement incorrect
7	<u>FINAL INTERNAL AUDIT REPORT ON THE AUDIT OF PERFORMANCE INFORMATION FOR QUARTER 4 OF 2019/20 AND ANNUAL PERFORMANCE REPORT</u>	<p>The design of the system of internal controls adequate and the operation of the system of internal controls is ineffective</p>	<ol style="list-style-type: none"> 1. Annual performance targets were not achieved 2. Inconsistency and non-alignment of KPI's reported in the Service Delivery Budget and Implementation (plan (SDBIP) and Annual Performance report. 3. Non-alignment of KPIs reported in the Performance Agreements and Annual Performance Report and SDBP. 4. No Reasons for deviation from target were furnished 5. Lack of verification or review of the performance information reported by departments 6. Inaccurate information provided on SDBIP

#	Description of Internal Audit Report	Overall assessment of the control environment	Significant findings
			<ul style="list-style-type: none"> 7. Reasons provided for deviation from target in the SDBIP are incomprehensible and not relevant 8. Targets set are not achievable. 9. Annual actual information recorded on SDBIP no specific. 10. Section 57 Managers annual performance assessments were not finalised timely. 11. Lack of supporting documentation provided for KPI's 12. Partially achieved targets stated as fully achieved targets. 13. Portfolio of Evidence Files not Submitted for Audit Purposes 14. Incorrect recording of annual achievements 15. Reports generated are not signed off by the General Managers, City Manager and Senior Managers as evidence of adoption. 16. Template for compilation of POE and final SDBIP reports not filed and signed off 17. POE file not referenced 18. Inaccurate source documents provided on POE 19. Incomplete supporting documentation provided

Financial Management and Reporting

5.7

IIA conducted a review of the Financial Statements as at 30 June 2020 to assess the credibility of the Annual Financial Statements at year end, that are free of material misstatements. The Committee members also conducted a review of the draft Annual Financial Statements and submitted comments to management. The Committee supported the submission of the Annual Financial Statements, with changes recommend by IA and the Committee, to the AGSA on 30 October 2020, but raised concerns relating to the credibility of the debtors' book.

The committee expressed concern at the non-submission of relevant financial management reports to the Committee. For example, no reports were presented at the August 2020 meeting, at which time, the Committee had not been presented with Section 71 and 66 reports for a period of 6 months. The Committee reviewed Section 71, S52 and S66 reports relating to the 1st quarter on 20 November 2020 and raised concerns relating to the overdue amounts due to Eskom, amongst other issues. The Committee also re-iterated concerns at the insufficient progress on the expenditure of conditional grants.

The municipality continues to face challenges in financial management most importantly the declining revenue base as well as the ever increasing debtor's book and decrease in cash resources which pose a threat in the financial health of the municipality. These challenges are aggravated by the current COVID-19 pandemic that has affected the municipalities' ability to collect its debtors despite it having appointed a team of debt collectors to assist.

Again, Council's attention is drawn to the unacceptably high debtor's book (more than R4 billion) which is continually increasing thus posing a threat to cash flow, financial viability and future sustainability of the municipality. The Committee has requested the presentation of a detailed analysis of debtors for the purposes of stratifying the debtors book into debtors that pay well and the pay badly and then further to understand the behaviours of delinquent consumers. In understanding this data, more effective debt management processes can be recommended.

Council is advised to continue to vigorously implement its Credit Control and Debt Collection Policy and take measures to reduce debt to acceptable levels.

The municipality is faced with challenges in financial administration in particular in the culture of month end discipline. IAA identified this weakness and embarked on consulting activity that seeks to inculcate a culture of month end discipline in an effort to address these issues that pose as a threat to quality annual financial statements. The Committee tasked the Accounting Officer to monitor this assignment on a regular basis and take effective disciplinary steps against senior managers who are non-compliant.

Despite the cancellation of the internal audit "month-end discipline" project, the Audit Committee strongly recommends that the assessment of and reporting against the processes put in place by this project continue and remain as a standing item on the Audit Committee meeting agendas. This month-end discipline is the cornerstone of effective financial management within the municipality. Failure to continue to track this, and failure to dedicate adequate resources to these internal control processes and the internal control environment, will result in continued financial management failures. The Audit Committee hereby reports its concern at the termination of this project.

The Committee engaged management at every meeting on the impact of and management of the ICD and Disaster Management Act requirements in respect of the Covid-19 pandemic, both in terms of service delivery as well as in terms of the municipality's resource management.

5.8 Performance Management Reporting

A performance management system entails a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed.

There is a process to review and finalise the organisational structure for presentation to the City Manager. OPMS and IPMS with standard operating procedures have been approved and performance management cascaded from level one (1) to level (3) with its management situated in the Office of the City Manager. A decision has been made for HR to cascade it to all levels. However, the implementation thereof, is dependent on the final approval of the reviewed structure proposed.

The Audit Committee supports that performance management be cascaded to level 4 managers and below, however the worrying factor is that even at level one to three the culture of performance management is not yet effective and matured.

5.9 Risk management

A report on Risk Management Report on Municipal Six Strategic risks with risks tolerance determined and assessed was submitted was submitted to the Audit Committee during the period under review. It is a concern that management has not developed performance indicators and the performance targets that have clear timeframes, key performance indicators, risk/action owners against every intervention to address the six strategic risks and these should comply with smart principle (Specific, Measurable, Attainable, Relevant and Time-bound).

As previously reported to Council, there remains a general lack of commitment by management to implement and own the risk management strategy as evidenced by the slow progress and/or lack of feedback in its implementation. Once again during this quarter, no risk management reports were presented by management to the Committee, despite this being a standing agenda item, and despite concerns being raised by the Committee at every meeting. Risk management is a critical function within financial management, transparency, accountability and good governance at the municipality. Failure to implement effective risk management is a substantial failure of the financial management and governance structures.

It is noted that the long-outstanding appointment of a Chief Risk Office was finalised in the second quarter, and that this appointee should be effectively dealing with the concerns and shortcomings related to risk management in the next quarters.

5.10 Information & Communication Technology(ICT)

The Committee expressed its dissatisfaction on the ongoing non-submission of ICT Governance reports which detail the activities performed by IT for period 01 July to 31 December 2020 causing a limitation to the oversight function that the Committee should be providing. The same concern was previously raised for the period 01 January 2020 to 30 June 2020.

The Committee resolved to provide the guidelines on the expected content of the ICT Governance reports in order to empower the Committee to sufficiently provide adequate oversight. These guidelines have since been shared with management.

The Committee was pleased to note the eventual establishment of the ICT Steering Committee and the ICT Technical Committee to address the ongoing and long-standing ICT issues within the municipality. It was however concerning to note management's concern at the non-attendance of officials at the ICT Technical Committee. This represents a lack of accountability and responsibility within the management structures at the municipality, and the Committee urges senior management to lead by example and ensure that the structures put in place at the municipality are attended by those delegated to attend, and that the participation is effective and impactful.

The Committee once again expressed concern at the length of time that the proposed hand over of SAP from the budget and treasury unit to corporate services. This matter has been in progress for well over a year. Updates are requested from management at every meeting, and the responses at every meeting are that the handover is in progress. This matter is an entirely internal matter, and the committee is concerned that lack of co-operation between units is the underlying reason for this delay. The impact of failure to complete this process is the lack of certainty regarding the ownership of various processes and responsibilities, and therefore the risk that the municipality's ICT systems continue to fail to produce timely, relevant and reliable information for financial management and service delivery reporting, and that the municipality continues to make service delivery decisions based on poor quality management information.

5.11 External audit: Auditor-General: South Africa (AGSA)

The Committee continues to interact with the Auditor-General with a view to ensuring acceptable relationships between management, internal audit and the Auditor-General. The Auditor-General has a standing invitation to all Audit Committee meetings.

The Committee continues to track management's implementation of the action plans to address findings raised by the Auditor-General in previous audit and management reports. The Committee's focus is likewise on improving the quality of the action plans put forward by management, as the quality of these in terms of SMART actions that are properly planned and resourced, accountable individuals and realistic timeframes, is critical to the effective, sustainable resolution of the root causes for findings raised. The Committee is pleased to report that there is strong representation from and support for this process by representatives of the National Treasury in attendance at the Audit Committee meetings.

The Committee has noted with concern and hereby escalates this concern that there appears to be a belief that the responsibility for the implementation of the action plans in terms of

findings raised by the AG lies with Finance only. The majority of the findings raised by the AG relate to service delivery matters and ICT. The Committee strongly recommends that management adopt an attitude of transversal responsibility in developing action plan items and in the implementation and monitoring thereof across all responsible business units. This concern was supported by National Treasury.

5.12 Legal & Compliance

Procurement in the municipality is not consistently implemented observing the Supply Chain Management legislation these actions result in issues of Unauthorised, Irregular, Fruitless and Wasteful expenditure. Compliance with legal and financial implications should always be properly articulated to allow for appropriate decision making.

In its review of irregular, fruitless and wasteful and unauthorised expenditure, the Committee raised specific concerns related to the emergency deviations being approved relating to the costs that were being incurred to strip-and-quote for municipal vehicles that required repairs, which were outside of the general maintenance of municipal vehicles. The committee urged management to ensure that old municipal vehicles be scrapped as part of Council's disposal policy. It was noted that there was a long list of municipal vehicles that were sent in for strip-and-quote, and that this was cause for a possible question of fruitless and wasteful expenditure. This concern relates back to asset management and the proper planning for the maintenance and replacement of municipal assets and municipal fleet, and is hence escalated for the specific attention of Council.

5.13 Anti-Fraud and Corruption

The incidents of overtime fraud, absenteeism and abuse of municipal vehicles is still a challenge in the Municipality. In just three cases investigated and reported to the Audit Committee during period under review the municipality incurred losses of more than **R877 000.00**. The municipality has suffered losses of more than **R41 million** as a result of fraud excluding losses of **R1 291 655.00** caused by absenteeism between the period July 2019 to 31 December 2020.

In each and every Audit Committee meeting there are forensic investigation reports on overtime fraud, absenteeism, abuse of motor vehicles, etc. These incidents are as a result of greediness and weak systems of internal control. Management has failed to strengthen the systems of internal control around overtime and utilisation, management of fleet, absenteeism, etc. There is lack of recovery of losses incurred by the Municipality in this regard. The Accounting Officer is urged to prioritize recovery of all losses suffered by municipality.

5.14 Effectiveness of the submissions to the Audit Committee

The Committee would like to escalate its concern at the ongoing lack of timely submission of reports to the committee and the trend of requests for presentations at our committee meetings not being adhered to.

Reports that have been tabled at the Strategic Management Committee that should be presented at the subsequent audit committee are not always presented to the Committee. Reports that are standing items are not presented to the Committee or, when presented, are not the latest available reports (for example the s66 and s71 reports). Whilst there are always reasons provided for these, mostly these relate either to failure by the Council secretariat to ensure that committees within the

Council structures effectively communicate between them on matters which are due for escalation to the next level. The City Manager and his Management were instructed to take more responsibility for and ownership of the promises that they make to the submit reports to the Audit Committee; including the number of items that have been long outstanding.

5.15 Conclusion and Recommendations

The Audit Committee wishes to express its sincere appreciation to the Accounting Officer, Senior Management, Executive Committee, Council and staff for their cooperation and support and recommends that:

Council notes the report by the Audit Committee.

6 SUBMITTED BY:

for
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Signed by the Acting Chair on behalf of the Audit Committee
Mrs B MacCallum (nee Kemp)
Msunduzi Municipality Audit Committee
Date: