

ANNUAL REPORT OF THE AUDIT COMMITTEE TO THE COUNCIL OF THE NELSON MANDELA BAY MUNICIPALITY (2017/2018)

OBJECTIVE

The purpose of this report is to present the Audit Committee's progress to date in carrying out its oversight responsibilities, including oversight for the statutory audit process including the Audit Committees review meetings to 30 June 2018.

TERMS OF REFERENCE

The mandate of the Audit Committee is legislated in terms of section 166 of the Municipal Finance Management Act, 2003 (MFMA) which requires the Audit Committee to advise the Accounting Officer and Council on matters relating to: Internal financial control and internal audits; risk management; adequacy, reliability and accuracy of financial reporting and information; Accounting policies; performance management and evaluation; effective governance; Compliance with the MFMA, the Annual Division of Revenue Act (DORA) and any other applicable legislation and / or policies and any other issues referred to it by the municipality.

The Audit Committee is also required to fulfill the functions of a Performance Management Committee constituted in terms of sections 38 and 41 of the Municipal Systems act No 32 of 2000 and Regulation 14(2) of the Local Government: Municipal Planning and Performance Management Regulations, 2001. Review and advise in terms of the provisions of the local Government: Municipal Performance Regulations for Municipal Managers and Managers directly accountable to Municipal Managers, 2006.

The MFMA also requires the Audit Committee to review the annual financial statements, respond to Council on matters raised by the Auditor General and carry out investigations into the financial affairs of the Municipality.

The Audit committee assists Council in fulfilling its oversight responsibilities in helping to ensure high quality financial and performance management reporting as well as effective internal control.

COMPOSITION OF THE AUDIT COMMITTEE AND ATTENDANCE

The Audit Committee comprises five independent members. The City Manager, the Executive Mayor and the Auditor General (hereinafter referred to as the AG) have standing invitations to all Committee meetings. An independent member chairs the Committee. Both the Internal and External Auditors have unrestricted access to the Audit Committee. The Audit Committee have held meetings as set out below from August 2017 to June 2018.

Names of members	Appointed / Resigned
Greg Billson (Chairman)	April 2014
Jose Neves	April 2014
Michelle Nicholls	September 2014 / August 2017
Tracy Cumming	September 2014
Loren Smith	September 2014 / August 2017
Sakhiwo Glen Zamisa	November 2017
Younus Amod	November 2017

Meetings Dates are as follows:

21 August 2017	Internal Audit high risk dashboard review
21 August 2017	Special Audit Committee meeting – AFS and performance report review
29 August 2017	Special Audit Committee meeting – AFS and performance report review cont.
17 November 2017	Audit Steering Committee review
27 November 2017	Audit Steering Committee review – AG Close out meeting
01 December 2017	Quarterly Audit Committee meeting
17 April 2018	Special Audit Committee meeting – performance report review
02 May 2018	Special Audit Committee meeting – IDP and budget review
07 May 2018	Quarterly Audit Committee meeting
21 June 2018	Quarterly Audit Committee meeting

1. Internal financial control and internal audits

The Internal Audit unit completed and issued final reports in respect of +- 50% of its audit plan for the 2017/18 financial year. The under-performance in respect of executing the audit plan is as a result of the under capacity within the internal audit directorate. Additionally the Director Internal Audit was suspended during the first quarter of 2018 which further impacted on the performance of the unit.

The Internal Audit Division reports to the Audit Committee on a quarterly basis in respect of the progress achieved in executing the audit plan. Amendments to the audit plan are approved by the Audit Committee.

Internal Audit review :

- Effective, efficient and transparent financial management, performance management and internal control systems are maintained by council.
- The Audit Committee reviewed the adequacy, reliability and accuracy of financial reporting and information.
- The Audit Committee reviewed and agreed to the Accounting policies in place when reviewing the financial statements.
- Internal financial control were considered in reviewing the findings of internal audits.
- Management draw conclusions on the adequacy and effectiveness of the system of internal controls through the review of Internal Audit assurance reports.
 - Management response to reported weaknesses in control, deficiencies in systems and recommendations for improvement in certain instances is lacking.
 - The Audit Committee noted that in certain instances, management do not address high risk findings and agree that such findings will not be addressed through a process of signing a notice that those recommendations to address high risk findings will not be implemented. The Audit Committee and City Manager should be made aware of any instances where management will not consider implementing recommendations in respect of high risk findings.
- The Risk Committee have worked with management to ensure relevant policies and procedures are in place and these are adequate, effective and regularly updated.
- In reviewing whether management encourage ethical and lawful behavior, financial discipline and accountability for the use of public resources, consideration should be given to greater accountability and consequence management being implemented in cases of mismanagement of resources. Additionally, it is imperative that instances of mismanagement of resources are dealt with expediently.
- Internal Audit have prepared, in consultation with the Audit Committee and for their approval:
 - A three year rolling strategic internal audit plan
 - An annual internal audit plan
 - The plan addresses the high risk areas identified in consultation with the Risk Committee. Consideration should be given to adequately resourcing the Internal Audit Division.

- Internal Audit monitors the risk and opportunity profile regularly and proposes revisions to the audit plan accordingly, with the approval of the Audit Committee.
 - Internal Audit plans indicate the scope of each audit in the annual internal audit plan
- The Audit Committee have not determined whether Internal Audit were subjected to an independent quality review, in accordance with the standards for the professional practice of internal auditing as prescribed by the institute of internal auditors.
- The Audit Committee reviewed internal audit charter.
- The Audit Committee have reviewed the organization structure, competence and qualifications of the IA sub-directorate. The Internal Audit Directorate is under-capacitated. Trainee staff who are inexperienced should not be considered as Internal Audit capacity as these staff do not have the requisite experience and require time from the experienced staff who are engaged in executing the audit plan.
- In evaluating of the adequacy of performance of the Internal Audit sub-directorate, including the degree of co-operation with external auditors, the Audit Committee consider the performance of Internal Audit adequate, with the exception of not executing the full audit plan, where this is as a result of capacity constraints within the directorate.
- The assurance reports together with recommended remedial action is considered adequate. Effective action by management in addressing high risk findings remains inadequate. As a result repeat findings year on year are the result of not effectively addressing noted high risk findings.
- Quality assurance review results are often concerning where the executive directorship and management need to actively work on addressing those agreed upon findings together with implementing the recommended and agreed to remedial action. A close proactive working relationship between the executive management and internal audit is essential.
- The Audit Committee have noted that no restrictions or limitations are placed on the Internal Audit sub directorate in the execution of their mandate.
- Internal Audit, the director / acting director Internal Audit and risk assurance and other specialists in the third line of assurance are independent from management that designed and implemented the controls
- A review of the quarterly performance reports submitted by Internal Audit takes place including:
 - Supply Chain Management, irregular expenditure, financial management, IT within various directorates, compliance with Policies

and Regulations, Corporate Governance, major capital projects, water losses, compliance with the Division of Revenue Act (DORA), HR effectiveness, Assistance to the Poor program me (ATTP), leave accrual, financial statement close process, income from electricity, status of records, procurement within the Electricity and Energy Directorate, and the critically important area of mSCOA implementation.

- Internal Audit conducted four (4) quarterly reviews of the AG action plan for 2016/2017 (Monitoring control matrix) which show that most directorates achieved limited progress in addressing Internal Audit and Auditor General high risk findings. This remains a high risk to the Municipality in future qualifications or new emphasis of matters. There is limited evidence of action taken to address *high risk repeat* audit findings.
- Only high risk findings are reported on through the Monitoring Control Matrix. With the lack of progress noted in addressing internal Audit and Auditor General high risk findings, it must be assumed that similarly, limited progress is being achieved in addressing lower risks identified.
- The lack of progress in addressing audit findings results in the municipality:
 - Conducting operations in a weak control environment,
 - Being exposed to increased high risks of inaccurate information and errors,
 - Management being unable to detect incidents of possible fraud.
- Both Internal Audit and the Audit Committee reviewed the Annual Financial Statements prior to submission thereof to the Auditor General.
- The Committee further received copies of all Communications of Audit Findings throughout the audit. The final Auditor General Audit Report and Management Report were also considered.

2. Auditor General – External audit

- The Audit Committee met with the Auditor General to review whether the Auditor General felt there were any restrictions placed on the external audit. The Auditor General noted that there were no restrictions, though in certain instances there was a resistance to co-operating. Management are to be advised that full co-operation is required with the external auditors from the Auditor General's office.
- The Audit Committee did not review the audit plan of the external auditors to determine whether all critical risk areas were addressed. The audit plan

was not provided to the Audit Committee for review by the external auditors.

- No significant disagreements between external auditors and management were noted.
- No material unsolved accounting and auditing problems were noted.
- The Audit Committee did not have any significant audit matters to disclose that arose from the audit.
- The Audit Committee met with internal and external auditors during the year without management being present so as to create an opportunity for views and concerns to be raised that may not be appropriate in an open forum.
- The Audit Committee considers the performance of external auditors to be adequate.

3. Combined assurance

- The Audit Committee has not adequately determined whether a combined assurance model to achieve the following is in place:
 - Adequacy and effectiveness of the internal control environment
 - The integrity of information used for reporting and decision making
- The Audit Committee will oversee that the scope of combined assurance is informed by the risk and opportunities that materially affect the ability of the municipality to create value in the 2018/19 financial year.

4. Forensic investigations

- Feedback by management and evidence on the resolutions of numerous forensic investigations dating back to 2013 remain outstanding.
- Substantial costs have been incurred through forensic investigations undertaken with limited or no evidence of action in respect of forensic findings.
- Recommendations and required actions in respect of forensic reports should be concluded as soon as possible following the finalization of these reports.

5. Risk Management control and Corporate Governance

- The timeous implementation of the Municipal Standard Chart of Accounts (mSCOA) remains a high risk facing the municipality.
- The Audit Committee, through the review of assurance reports, oversees:

- Financial reporting risks
- Internal financial controls
- Fraud risks as it relates to financial reporting
- IT risks as they relate to financial reporting
- The Audit Committee together with the Risk Management Committee considers that the internal audit work carried out will assist in improving the effectiveness of risk management, control and governance processes.
- The Audit Committee has further reviewed those recommendations made by the Risk Committee
- The Risk Management Committee continues to contribute effectively to identifying high risk areas. The Risk unit remains under capacitated where additional resources would contribute to identifying additional risks providing for an improved control environment.

6. Financial Reporting

- The Audit Committee have reviewed the expertise, resources and experienter of the municipalities finance function which are considered to be adequate. The Executive Directorship has been filled by an acting position for in excess of one year. This is not ideal where a permanent appointment to this role should be pursued.
- The Audit Committee do consider that the financial disclosures made by management are objective, complete, timely and show council's financial position, results of operations, plans and long term commitments.
- Through the Annual Financial Statement review process, the Audit Committee have considered the quality, value and effectiveness of financial information produced together with the accounting policies with recommendations for amendments and changes being effected. The financial statements were approved by council prior to the Audit Committee review thereof.

7. Performance management and evaluation

- The Audit Committee is responsible to report to council, the political office bearers, the accounting officer and management on matters relating to performance management:
 - The Audit Committee reviewed the performance management report for the 2017/2018 year. The performance management report was considered accurate by the Audit Committee.

- A special Audit Committee meeting was held on 2 May 2018 to review the Integrated Development Plan for 2017/18 together with the Budget for 2018/19.
- The Audit Committee reviewed the relevance of noted indicators together with their measurability in relation to services performed. The Chairman of the Audit Committee further chaired the section 57 managers annual performance reviews with the office of the COO.
- An improvement has been noted in senior management being held accountable for their performance, although it is critical that a culture of accountability and consequence management be driven down through all levels within in the institution.

8. IT Governance

- The Audit Committee will provide input on IT governance, controls, access and safeguarding of information in the municipality together with the appropriateness of disaster recovery and continuity plans supporting IT risk, regular testing and evaluation of plans, systems and processes during the 2018/19 financial year.

9. Legal and Policy compliance

- Excessive costs have been noted in outsourcing legal services.
- A review of legal services should be conducted to determine whether limitations in capacity or competencies exist which has resulted or contributed to excessive outsourced external legal costs

10. Effective governance

- A number of scheduled Audit Committee meetings were either delayed to later start times or postponed due to either Internal Audit not being prepared with the required agenda information or by request of Municipal Management. The Audit Committee dates should be scheduled in the calendar of meetings for the year where dates are not amended to allow management to schedule such meetings in their respective calendars. The Audit Committees effectiveness is compromised where required senior management representation are unable to attend meetings.
- The numerous delays and breakdowns in council meetings has negatively impacted on the adjustments budget approval and ultimately the

performance management targets of the Municipality with projects being unable to proceed resulting in non-delivery of services to the city ahead of year end.

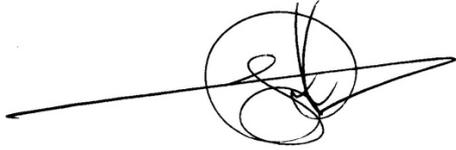
- The Audit Committee is required to consider matters relating to the discharge by management and the council of their duties relating to risk management and safeguarding of assets, financial and operational controls, the operation of adequate systems and the reliability and credibility of financial reporting. As noted, identified high risk finding and forensic investigative findings should be dealt with expediently to ensure optional performance within an effective control environment into the future.
- No evidence of medium to long term succession planning for all key positions is noted.

Supply chain management

- A municipality may enter into a contract where such contract will extend beyond three years, provided the provisions of S33 of the MFMA are complied with. Further S78(c) states that, "...each senior manager must take all reasonable steps ... to ensure that any unauthorized, irregular or fruitless and wasteful expenditure and any other losses are prevented;". In the instance of a contract with Evergreen Consulting, management will continue to incur irregular expenditure until 2025, where the provisions of S33 have not been adhered to. Irregular expenditure may only be condoned by National Treasury.

Suspensions / Acting positions

- Suspended officials are often suspended for many months or years without resolution.
- The Audit Committee have continued to highlight their concern as to those situations where suspended officials are not dealt with timeously.
- The monthly cost to the Municipality of suspended officials is material.
- Bold action will be required to be taken to address suspended officials.

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Greg Billson

Chairperson : Audit Committee

10 January 2019