

Assessment of factors that relate to qualified audit reports in the two municipalities

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Mini-dissertation submitted in partial fulfilment of the requirements
for the degree *Master of Business Administration* at the North-West
University

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Graduation ceremony: July 2019

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ABSTRACT

This research examines the factors that contribute to qualified audit reports in municipalities in the Free State Province. Municipalities in South Africa are assigned the duty of providing services to the communities that reside within them. In this respect, they require financial resources to fulfil this constitutional mandate. To date, the municipalities in the country are not showing progress with regards to proper financial management systems to fulfil their mandate. Lack of accountability and mismanagement of finances are some of the challenges that affect municipalities in the country.

The Annual audit reports on public institutions, compiled by the Auditor-General of South Africa (AGSA, 2018) pointed to a high prevalence of poor audit outcomes within the local municipalities, and the results of these outcomes illustrate both poor financial management by municipalities and a persistent non-compliance to the provision in the Municipal Finance Management Act (MFMA). There are areas which have been indicated by the AGSA as areas of major concern at a local government level. The AGSA pointed out weaknesses in internal controls, leadership, and governance in municipalities. Considering that audits of municipalities are conducted on annual basis, it is important that municipalities are responsive to all the requirements pertaining to the achievement of a clean audit. This research therefore endeavoured to establish challenges relating to the qualified audit reports in two municipalities in the Free State province.

There are 23 municipalities in the Free State, according to the National municipal demarcation board. Two of the municipalities, namely Setsoto and Nketoana local municipalities in the Thabo Mofutsanyana district, were selected so that the study could be managed within the defined period. To achieve the objective of the study, the research applied a qualitative phenomenological approach to obtain objective and reliable information. A purposive sampling method was utilised in the selection of participants and data was collected through semi-structured interviews with the senior managers in the two municipalities based on their experience in strategic planning and knowledge of audit processes. This research design was used as the study sought to obtain from the research participants information pertaining to various kinds of practices in the two municipalities in relation to audits.

A summary of the responses of interviewees was provided in line with each of the study objectives. Data analysis and interpretation of the results were outlined using the framework matrix.

Findings of the study confirmed the statements that were made by the Auditor-General of South Africa on audited municipalities and that factors that contributed to the achievement of qualified audit reports were related to poor financial management practices in the municipalities.

Keywords:

Auditor-General of South Africa, Annual Financial Statement, District municipality, Internal control, Local municipality, Municipal Finance Management Act.

DEDICATION

I dedicate this thesis to my late father and mother, Mr. Masiko and Mrs. Matobi Kula for their love, provision, and support. They raised me to be the woman I am today. Rest in peace my dearest parents; I will always cherish the wonderful memories we shared together.

ACKNOWLEDGEMENTS

Firstly, I acknowledge the almighty God, who provided the grace, strength, and ability to complete this study.

To my dear husband, King Seitheisho, no words can express my gratitude for the love, support, and every word of encouragement you provided throughout this journey. Without you this would not have been possible. You are my pillar of strength. My children, Morafe and Lofentse Seitheisho, thank you for your understanding, you gave me a sense of purpose.

I would like to convey my sincere gratitude and appreciation to Professor. Ines Nel, my supervisor, for his valued knowledge, guidance and mentorship during the conduct of this study. Thank you for your incredible support, your time and patience.

A special thanks to my friends, Thato Dichabe, Gloria Mohlakoana and Goitsewang Palogangwe for their support during this journey.

Furthermore, I would like to thank my extended family, friends, colleagues and fellow students.

Lastly, I am grateful to the Municipal Managers of Setsoto and Nketoana local municipalities, and the managers working in these institutions for allowing me to conduct the interviews. You responded in a respectful and professional manner.

LIST OF ACRONYMS

AC	Audit Committee
AFS	Annual Financial Statement
AGSA	Auditor-General of South Africa
CEO	Chief Executive Officer
COGTA	Department of Cooperative Governance and Traditional Affairs
GRAP	Generally Recognised Accounting Practice
HOD	Head of Department
KPI	Key Performance Indicators
MFMA	Municipal Finance Management Act
MPAC	Municipal Public Accounts Committee
MSA	Municipal Structures Act
PAA	Public Audit Act
PFMA	Public Finance Management Act
SALGA	South African Local Government Association

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CHAPTER 1 INTRODUCTION TO THE STUDY

1.1 INTRODUCTION

South African local municipalities have a significant challenge relating to financial performance. They have recently come under significant scrutiny following the repeated failure of local governments to achieve clean “audit results”. Despite continued engagement to find a solution to this challenge, there is still no improvement in annual audit outcomes presented by the Auditor-General of South Africa (2018: 52) in the MFMA general report 2016/17. There is a need for effective, efficient and sound financial management, and achievable progress with regard to proper and clean audit outcomes by the municipalities (Mazibuko and Fourie, 2013: 132).

Public sector organisations in South Africa are audited by the Auditor-General, who has a Constitutional mandate to conduct audits and to report publicly on the accounts, financial statements, financial management, and performance of the public sector organisations (Motubatse, 2016: 42). In a period of three months subsequent to the end of every municipal financial year, municipalities submit their financial statements to the Auditor-General of South Africa (AGSA). In the ensuing reports, the AGSA expresses various audit opinions which relate mainly to financial affairs of the municipalities (Mathebula, 2016: 213).

Municipal audits provide information about financial reporting quality, internal control systems, and compliance with laws and regulatory requirements (Peterson, 2014: 2). One of the objectives of the audits is to enforce strong, transparent financial governance, which will ensure well-run public organisations that are able to fulfil their mandate and deliver services to the communities (Craig, 2017). The significant aspect of the auditing is centred on the overall audit outcomes. A “clean audit”, which refers to a particular type of audit opinion, is regarded as the highest outcome available from the audit process (Motubatse, 2016: 52).

The Annual audit reports on public institutions, compiled by the Auditor-General of South Africa pointed to a high prevalence of poor audit outcomes within the local municipalities, and the results of these outcomes illustrate poor financial management by municipalities and a persistent non-compliance to the provision in Municipal Finance Management Act (MFMA), 2003, (Act 56 of 2003).

There are areas which have been indicated by the AGSA as areas of major concern at a local government level. The Auditor-General (AG) pointed out weaknesses in internal controls, leadership and governance, and financial health of municipalities as the most prevalent in the audit findings (Auditor-General South Africa, 2018). In support of the statements presented in the AG report, Motubatse (2016: 78) also highlighted the fact that audit challenges faced by local governments globally are directly related to the quality of leadership, financial management and governance. The Auditor-General of South Africa (2013) report pointed out that weak leadership, Ineffective financial management, and poor governance structures have undermined the efforts of South African municipalities. This study therefore aims to establish factors contributing to the qualified audit reports in the two municipalities in the Free State province.

1.2 BACKGROUND

The promulgation of the Public Finance Management Act 1 of 1999 (PFMA) (RSA, 1999) and the Municipal Finance Management Act 56 of 2003 (MFMA) (RSA, 2003) led to certain developments in the public sector administration. These legislations were introduced in an effort to improve service delivery by ensuring effective financial management and accountability in the public sector (Motubatse 2014: 1). In South Africa, accountability is key at the provincial and municipal levels, since it is in these spheres that the major part of the national budget aimed at alleviating poverty through the provision of services (Jordaan, 2018: 4). It is therefore imperative that accountability and good financial management practises are prioritized for the municipality's sustainability.

Poor financial management and a lack of accountability have been cited as challenges affecting municipalities in South Africa (Maphalla, 2015). An article by Corruption Watch (2014) put emphasis on the impact of finances on a municipality's ability to deliver services effectively and efficiently. According to Corruption Watch (2014), if a municipality's financial management is disorganised, its resources can be misdirected and abused, which in turn results in poor service delivery and an increase in the risk of corruption.

The financial performance of the South African municipalities has also come under significant scrutiny in recent months. In 2018, the then Auditor-General, Kimi Makwetu, released the audit outcomes for municipalities for the 2016/17 financial year in Parliament. The outcomes illustrate poor financial management by municipalities, with

irregular, fruitless, and wasteful expenditure each surging more than 70% for the 2016/17 year (Auditor-General of South Africa, 2018: 3).

It has been reported that in the 2016/17 financial year, irregular expenditure of municipalities amounted to R16 billion, which was a 50% increase from the 2015/16 financial year. Results show that this year municipalities further increased that percentage to 75%, hence R28.376 billion in unnecessary expenditure (Auditor-General of South Africa, 2018: 2). The results give an indication that Accounting Officers in municipalities have not taken enough reasonable steps to prevent unauthorised, irregular, and/or fruitless and wasteful expenditure and have continued to act in non-compliance to the provision in Municipal Finance Management Act (MFMA), 2003, (Act 56 of 2003).

According to the AG, the continued lack of accountability and leadership failures were the main causes of governance failures, which led to a significant regression in audit outcomes from the previous year (AGSA, 2018). Every year the Auditor-General (AG) publishes an annual report on the outcomes of audits conducted in the country's 278 municipalities in the preceding financial year. The report examines the extent to which municipalities have complied with national standards for municipal financial management and other predetermined objectives for service delivery (Powell *et al.* 2014: 2). Some years ago, the Auditor-General of South Africa (2013) reported that the audit in the South African public sector is used to "assess the stewards of public funds, the implementation of government policies and compliance with key legislation in an objective manner". With these imperatives in mind, there is an urgent need for effective, efficient, and sound financial management and achievable progress with regard to proper, clean audit outcomes by all municipalities (Mazibuko and Fourie, 2013: 131).

The Auditor-General of South Africa has, as part of recommendations to municipalities, placed emphasis on the importance of accountability in the management of municipal affairs, starting with appropriate planning focused on the needs of citizens, and instituting appropriate internal controls and supervision that will ensure sound financial and performance management (Auditor-General of South Africa, 2018). The sound financial management and controls would result in better functioning of the municipalities and continued improvement in the intended audit outcomes.

A study conducted by Motubatse (2016: 199) entitled "An evaluation of factors affecting progression to clean audit outcome by South African municipalities", concluded that leadership, in conjunction with financial management and governance functions, played

a significant role in clean audit. In addition, Powell *et al.*, (2014: 2) asserted that achieving a “clean audit” was feasible with the improvement of public financial management in all municipalities in all nine provinces. Thus, it can be argued that proper financial management and governance can affect the audit outcome in municipalities.

Ngoepe and Ngulube (2014:148), however, are of the view that resolving the majority of audit outcomes is not a complex issue, but requires dedicated cadres, commitment of leadership, and realising that most of the challenges are basic, like the implementation of proper records management, which is one of the fundamental principles in Municipal Finance Management Act (MFMA), 2003, (Act 56 of 2003). One of the possible conclusions, could be that municipalities simply need to get the basics right and comply with the prescribed legislations. Considering that audits of municipalities are conducted on an annual basis, it is important that municipalities are responsive to all the requirements pertaining to the achievement of a clean audit. Hence, the objective of this study is to assess the factors that relate to qualified audit reports in two municipalities.

1.3 PROBLEM STATEMENT

The MFMA (2016/17) report reflects on the lack of progress made by municipalities in improving financial performance and continued accountability failures (Auditor-General of South Africa, 2018: 2). One of the recommendations made by the Auditor-General of South Africa (2018: 1) was for municipalities to improve on audit outcomes and accountability in the work of municipalities. Despite all the support and recommendations provided to municipalities, many municipalities in South Africa receive disclaimers of opinion every year due to a lack of accountability and non-compliance to the prescribed standards and legislation.

The persisting non-achievement of clean audits by municipalities requires attention and a detailed investigation to determine the dysfunctionalities in the municipalities that lead to an unfavourable audit outcome.

Therefore, the research question will be articulated as:

Why are municipalities continuously getting a qualified audit reports?

1.4 OBJECTIVES OF THE RESEARCH

Financial management and mismanagement in municipalities has been the source of concern in South Africa, discussions of municipal finance management and clean audit outcomes has been on the government's agenda for some time and requires adequate attention. With the backdrop of these challenges, it is therefore critical to investigate the factors that contribute to a qualified audit reports in the two municipalities.

1.4.1 Primary objective

- To establish the perceived challenges relating to qualified audit reports in the Nketoana and Setsoto local municipalities;

1.4.2 Secondary objectives

- To determine the extent of official capacity and competency in managing the challenges in municipalities in relation to audits;
- To investigate the level of compliance with Municipal Financial Management Act (MFMA) by officials in Nketoana and Setsoto local municipalities in relation to audits;
- To consider measures for improvement of the audit outcomes within Nketoana and Setsoto local municipalities.

1.5 RESEARCH METHODOLOGY

The research methodology section outlines the steps that will be taken during the research study in order to answer the research question. The current research adopted a qualitative research method, in which collection of data took place through the use of interviews. Conducting in-depth interviews is one of the most common methods of carrying out qualitative research. One of the main advantages of this method is that the interview becomes broad and open-ended, allowing the participants to raise issues that matter most to them (Choy 2014: 102).

1.5.1 Literature study

Data research incorporated analysis of reports pertaining to audit procedures and findings. The aim was to obtain information on the previous and current trends on the study that is done using primary source. The reports of previous financial years (2014/15 until 2016/17) by the Auditor-General of South Africa, the Integrated Development Plan (2016/17), Municipal annual financial reports and other related documents were studied.

Secondary sources, which include publications, articles, and books relevant to local government with specific reference to audits were reviewed to identify shortfalls in both theory and practice.

1.5.2 Research design

A research design is the plan specifying how the researcher will systematically collect and analyse the data needed to answer the research question (Bertram & Christiansen, 2014: 40). It can also be defined as a framework which has been created to get answers to the research question. This research adopted a phenomenological research design. According to Alase (2017: 10). Phenomenology, as a research study was first conceptualized and theorized by Husserl (1931) as a way to understand the context of the 'lived experiences' of people and the manner in which they experience a given phenomenon. In other words, the participants in phenomenology are those with lived experience with regard to the phenomenon under study and who will be able to share insight about the situation that is observed to exist (Phala, 2017: 72). Phenomenological studies generally try to set aside biases as well as preconceived assumptions regarding human feelings, experiences and responses to a given situation. This design was used as the researcher sought to get from the research participants their perceptions of the various kinds of factors that relate to qualified audit reports in the two municipalities. The research aimed to explore the experiences of those working in two local municipalities in the Free State province falling under Thabo Mofutsanyana district.

1.5.2.1 Qualitative approach

The qualitative research approach is a descriptive form of research and is subjective, in the sense that the researcher interprets the data. According to Edmonds & Kennedy (2013: 112), It is a method for examining phenomena using words for data, and its aim is to understand or interpret phenomena within the context of the meaning that people

express without attempting to generalise the results to other individuals or populations. Respondents in the study were requested to elaborate on specific answers. These comments and answers were analysed in a qualitative manner to build and add value to the research objectives. The aim was to arrive at a generally acceptable conclusion within the research study.

1.5.2.2 Population

Population is defined by Bryman *et al.*, (2014: 165) as “the universe of units from which the sample is to be selected, these would include, people, nations, cities, regions, firms, etc.,” The population of this study was the two local municipalities in the Free State province falling under Thabo Mofutsanyana district, namely Setsoto local municipality and Nketoana local municipality. Employees from the municipalities are capable of providing answers to the different kinds of questions that are addressed by the research.

1.5.2.3 Sample

A sample is required to be representative of the population selected, since the study was designed to make a qualitative analysis. Sampling is referred to as the process of selecting objects or phenomena when it is impossible to have knowledge of the entire collection (population) of the phenomena (Phago: 2010: 308).

The sample was made up of the following:

- Municipalities - 2,
- Individual participants – 8

The sampling technique which was adopted in the case of this research study is purposive sampling. Purposive sampling means that the researcher makes a specific choice about which individuals, groups or objects to include in the sample (Bertram & Christiansen, 2014: 60). There are 23 municipalities in the Free State, according to the National municipal demarcation board.

Two of the municipalities, namely Setsoto and Nketoana local municipalities in Thabo Mofutsanyana district, were selected so that the study could be managed within the defined period. Members of a sample were purposely chosen in relation to criterion which was considered important for this particular study. The officials selected for the study

were senior managers who have experience in strategic planning and audit processes in the municipalities.

1.5.2.4 Collection of data

This study made use of a data collection method that would ensure collection of data that are adequate and reliable from the selected municipalities. Data were collected through interviews with the officials in the two municipalities. According to Bryman *et al.*, (2016: 215) an interview is a prominent tool for data collection in both quantitative and qualitative research.

Meetings were arranged telephonically with the officials in the two municipalities. Semi-structured interviews were conducted with the senior managers working in the two municipalities. An interview guide was developed and used to conduct the semi-structured interviews to gather information pertaining to the research study. Bertram and Christiansen (2014: 82) describe an interview as a useful method of collecting data as it allows the researcher to ask probing and clarifying questions, and to discuss participants' understanding with them. This method is preferred because it allows the researcher to probe for details on what is contained in the municipal reports and other strategic documents (Mohale, 2013: 82).

1.5.2.5 Interviews

Interviews were semi-structured so as to allow the researcher to obtain specific information as well as to facilitate discussions for in depth answers which could provide a detailed picture of the participants and their perception of the research topic. Semi-structured interviews allow interaction between the researcher and the participants (Phago, 2010: 306). Face-to-face interviews were conducted with the officials from the selected municipalities in the province. According to DiCicco-Bloom and Crabtree (2006: 315), semi-structured in-depth interviews are the most widely used interviewing format for qualitative research and can occur either with an individual or in groups.

1.5.2.6 Analysis of data

Data analysis entails carrying out data inspection, making sure that the data collected for the research are properly cleaned, and ensuring that the given data are transformed and modelled with the sole aim of discovering useful information. Data analysis in

qualitative research is defined as the process of systematically searching and arranging the interview transcripts, observation notes, or other non-textual materials that the researcher accumulates to increase the understanding of the phenomenon (Wong, 2008: 14). Data were analysed using framework matrix.

According to Gale *et al.*, (2013: 2), the Framework falls within a broad family of analysis methods often termed thematic analysis or qualitative content analysis. It involves summarizing and analysing qualitative data in a table of rows and columns, which allows for both cross-case as well as sorting data by theme.

1.6 LIMITATIONS OF STUDY

The study was limited to the analysis of local municipalities in the Free State province, and issues at the provincial and national level were not analysed intensively. The literature review was limited to South African sources due to time constraints. There are 23 municipalities in the Free State province, and only two were selected for the purpose of the study. Although the findings are not representative of all the municipalities in the province, the current study could form the basis or foundation for the development of a research programme that would include all municipalities in South Africa.

1.7 CONCLUSION

The chapter started by outlining the background information relating to the study. It dealt with the principles and procedures pertaining to audits within the South African context. The reasons for clean audit were highlighted together with challenges of non-compliance by municipalities to recommendations made by the Auditor- General of South Africa. The discussions clearly show that work needs to be done to improve the outcome of audits by municipalities. This might include addressing the core challenges that municipalities experience in achieving clean audits.

In concluding, the chapter outlined the research methodology of the study. A qualitative approach was adopted in order to capture the responses and perceptions of the participants. The design of the study and the summary were also outlined.

2 CHAPTER TWO: LITERATURE REVIEW

2.1 INTRODUCTION

The previous chapter provided the background, problem statement, and purpose of the study. The chapter furthermore outlined the question that the study sought to answer and the objectives that the study aim to achieve. The purpose of this chapter is to review literature from previous related researches. This was achieved by gathering information on topics relating to audits and problems faced by municipalities in the country in achieving favourable audit opinions. A literature review mainly involves the use of secondary data sources. The literature review section surveys scholarly articles, books, and any other sources relevant to a given issue, research area, or theory. It offers a description, summary, and a critical assessment of the works in relation to the problems which are being investigated by this research study.

2.2 AUDIT

An audit aims to examine financial reports or financial statements. The International Auditing and Assurance Standard Board (2014) defines audit as an “engagement in which the practitioner expresses a conclusion aimed to increase the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of the subject matter against the criteria” . The auditors are charged with the role of carrying out these assessments. They also take personal responsibility for the audit results. An audit represents an objective review of the financial practises of an organization (Doyle, Ge & McVay, 2005: 197). One key requirement for an auditor is recognized expertise in the given area under audit. Auditors can be classified into two groups: internal auditors and external auditors (Wilken, 2016: 68). Internal auditors often report directly to the top management of the organisation. They are viewed as playing a critical role in providing independent assurance and consulting service on internal control, risk management, and governance processes (Ackerman, 2015: 239). External auditors are outside the organization’s management hierarchy. An external auditor can also be described as an independent third party responsible for examining an entity’s financial statements with the aim of ensuring that the financial information is in line with the applicable accounting standards and legal requirements and fairly represents the financial state of the entity (Wilken, 2016: 68). As a result, external auditors are also known as third party or independent auditors.

2.2.1 Auditing process

When considering an external or internal audit for an organization, it is essential to know the main steps which are involved. Although thorough auditing consumes a lot of time, the resulting peace of mind is always worth the time that is committed. Kritzinger (2016: 34) describes auditing as a systematic process that an auditor follows in order to give assurance on an organization's financial statements in the form of an audit. Auditing entails a number of phases, starting with pre-management activities and progressing to planning of the audit, collecting evidence, which entails scheduling the required meetings or onsite visits in order to ensure that the auditor can review the procedures, sometimes referred to as "fieldwork phase". Lastly, the audit involves conclusion, evaluation, and reporting (Kritzinger, 2016: 34). This last step entails the preparation of a report with audit findings, sometimes referred to as an audit outcome. An audit outcome is the auditor's published statement of his/her opinion of the state of the financial statements (Fahami *et al.*, 2016). The auditor presents the report to the relevant stakeholders and might also release the results publicly based on the kind and the scope of the given audit.

2.2.2 Reporting Audit Findings

External and internal audit findings are often reported in writing and are often delivered verbally to the stakeholders. A written audit report ought to be worded concisely and in a manner that can be understood easily by the readers. After writing the report, the auditor should present the findings to the stakeholders within the organization. In a large non-profit organization, for instance, the auditor would present the findings to the audit committee that oversees the auditing process. The committee can then discuss the given audit findings with the auditor. They can ask for clarification on any problem issues before presenting the given audit report to the board of directors (Lesolang, 2015: 24).

2.2.3 Types of audit reports

In any audit engagement, auditors always give their opinion concerning the financial information that was disclosed by the Organisation. According to Harvard Business Essentials (2000) (cited by Maclean, 2014: 89), an audit is designed to provide reasonable assurance that the financial statements are a fair representation of a company's financial transactions. Therefore, the auditor's report is considered to be an integral component of the audited financial statements of the business. At the conclusion of any audit engagement, auditors often express their opinions in the report of the auditors. An audit outcome is the last product in the auditing chain, and is the

independent auditor's expression of an opinion about the state of financial reporting, compliance with laws and regulations, and performance information (Motubatse, 2016: 48) The audit opinions issued by the auditor may be unqualified, a qualified disclaimer opinion, or an adverse opinion (Auditor-General of South Africa, 2017).

2.2.3.1 Unqualified Report

Unqualified opinion is regarded as the most common kind of auditor's report. It is the most desirable audit opinion in which the auditor communicates information about the quality of financial reporting (Czerney, Schmidt and Thompson, 2014: 2124). It points out that the financial statements of the organization conform to the generally accepted accounting principles and therefore have not hidden any significant facts. In most cases, it is issued when the auditor strongly believes that the financial statements contain no material misstatements and there are no findings raised on either the reporting on predetermined objectives or non-compliance with legislation aspects of government (Mathebula, 2016: 51). Maclean (2014: 95) assert that with an unqualified report the auditor often concludes that the given financial statements of the business present a true and fair view of the organization in all material aspects. It should, however, be pointed out that the unqualified report does not guarantee that there are no errors in the financial statements but merely provides a high degree of assurance in the integrity of the accounts (Maclean 2014: 95).

2.2.3.2 Qualified Report

A qualified opinion means that the auditees are unable to account adequately and accurately for all financial transactions and activities, meaning that their financial statements are unreliable in certain areas (Auditor-General of South Africa, 2016: 4). According to SAICA (2013/14), the audit opinion should be qualified when the auditor, having "obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive". An auditor's report can be referred to as qualified if there is either a limitation of scope in the work of the auditor, or if there is a disagreement with the management concerning the application, adequacy, or acceptability of the accounting policies.

2.2.3.3 Disclaimer Opinion report

In this kind of report, the auditors give a disclaimer when they are not able to express a definite opinion. A disclaimer indicates that the auditor could not get appropriate and sufficient financial statements to use for supporting his/her opinion (Auditor-General of South Africa, 2015: 5). This may be brought about by lack of properly maintained financial records or by the absence of or inadequate support from the top management of the given organization. With regard to seriousness, it should be noted that a disclaimer opinion is of a more serious nature than a qualified opinion.

2.2.3.4 Adverse Opinion report

According to Auditor-General of South Africa (2015) an 'adverse audit opinion' is to be given when auditors have obtained sufficient appropriate audit evidence that the financial statements are marred by significant mistakes, meaning that when the auditors issue an adverse opinion, it points out that there has been a gross misstatement and probably fraud during the preparation of the financial records of the company. It could indicate that the records of the organization have not been prepared according to the GAAP and given organization's financial statements are not reliable.

2.2.4 Management of the implementation of audit recommendations

The Auditor-General of South Africa (2018: 24) pointed out that there is a need for leaders to make sure that there is effective implementation of audit recommendations. They need to have in place the right strategy to help in ensuring that the implementation is carried out in a timely manner. It is also essential for the internal audit departments to make sure that they effectively follow up on the recommendations which have been given through making sure that their implementation is closely monitored (Ogneva, Subramanyam and Raghunandan, 2010).

2.3 LOCAL GOVERNMENT IN SOUTH AFRICA

The institutional framework for government in South Africa was established in 1996, when the country adopted its first democratic Constitution (DPME, 2014:17). The Constitution of South Africa (1996) was adopted as the supreme law of the country and it remains the base of all the law and government in the country (Chetty, 2015: 17). It allocated legislative and executive powers to three spheres of government, and

established local government as a separate sphere of government that is responsible for service delivery (Mazibuko, 2013: 6).

In addition, the broader responsibilities of the local government are contained in section 152(1) of the Constitution (1996) which states that municipalities are to provide democratic and accountable government for local communities, ensure the provision of services to communities in a sustainable manner, promote social and economic development, promote a safe and healthy environment, and encourage the involvement of communities and community organisations in the matters of local government (SALGA, 2015).

Local government is a sphere of government in its own right with executive and legislative powers to act and implement laws (DPME, 2014: 17). These powers are guided by a set of scheduled powers and functions in Part B of schedules 4 and 5 of the Constitution (Local government review, 2014: 17), which provided for the establishment of three categories of municipalities: namely, category A (single tier municipalities), category B (local municipalities) and category C (district municipalities which contain two or more local municipalities) (SALGA, 2015). This system of local government was finally established in December 2000 as the first term of fully democratic non-racial local government (SALGA, 2015).

2.4 FINANCIAL MANAGEMENT IN MUNICIPALITIES

Financial management is the identification, acquisition, allocation and utilization of assets and/or financial resources with the organizational goal in mind (Abale & Soni, 2017: 4). One of the objectives of financial management in an institution is to maximise wealth for the equity shareholders (Brigham & Houston, 2012: 5), but there is a different perspective when it comes to public financial management. The National Treasury (2003: 4), in their manual of normative formation for financial management guidelines, holds the view that the Government's main objective is to maximise service delivery to the communities, and define public financial management as *"all decisions and activities of management, as guided by a chief financial officer, that impact on the control and utilisation of limited financial resources entrusted to achieve specified and agreed strategic outputs"*. The core of public financial management is therefore taken to be budget planning and preparation, appropriation by the legislature, budget implementation, accounting and financial reporting, auditing and evaluation (Mahlaku, 2013: 2). Figure 1-1 provides a schematic representation of public financial management.



Figure 2.1: Pillars of Public financial management

Source: Farvacque-Vitkovic and Kopanyi (2014: 54)

Notsi (2012: 21) declared that in the public sector, the financial management focuses on prioritization and use of scarce resources, on ensuring effective “stewardship” over public money and assets, and on achieving value for money in meeting government objectives of service delivery. The same views are also applicable to municipalities in South Africa, the Constitution of South Africa (1996) requires that municipalities structure and manage their finances to give priority to service delivery within the communities.

2.5 FINANCIAL MANAGEMENT POLICIES AND REGULATIONS

In order to have a clear understanding of financial management in the context of government, it is important to know the policies and regulations that govern public financial management. At the municipal level of government financial management is governed by the Municipal Finance Management Act (MFMA), 2003, (Act 56 of 2003), which is aimed at ensuring sound and sustainable management of fiscal and financial affairs of municipalities (Mazibuko, 2013: 8).

The Municipal Finance management Act (MFMA) was introduced in line with the National Treasury’s strategy of establishing a modern customized financial management system for local government entities (Matolong, 2015: 29). Some of the provisions of the Municipal Financial management Act, 2003, (Act 56 of 2003), are to ensure

transparency, accountability, and appropriate lines of responsibility in financial affairs of the municipality and municipal entities.

Section 79 of the Municipal Financial management Act, 2003, (Act 56 of 2003), assigns responsibility to the municipality to establish the system of financial management and internal control and further requires that the financial and other resources of the municipality be utilised effectively, efficiently, economically, and transparently. This is key to local government as it puts emphasis on the element of financial management and control.

2.6 AUDITING IN SOUTH AFRICA

In the South African context, public sector organisations are audited by the Auditor-General, who has a Constitutional mandate to do so (Motubatse, 2016: 42). The AG reports publicly on the accounts, financial statements, financial management and performance of public sector organisations (Motubatse, 2016: 42). Audit of public sector organisations is broader than in the private sector, it includes auditing of financial statements, performance or predetermined objectives, and compliance (Independent Regulatory Board of Auditors, 2012: 15). The role of the Auditor-General in a municipal context is to audit and report on the accounts, financial statements, and financial management of the municipality (Lesolang, 2015: 9) and it involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements (Auditor-General of South Africa, 2016).

According to the Auditor-General of South Africa (2016), the procedures selected for the audits depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

2.6.1 Audit of financial statements

The Auditor-General of South Africa's mandate is prescribed in the Public Audit Act, 2004 (Act 25 of 2004). The Act requires the AGSA to "audit and report on the accounts, financial statements and financial management of all national and provincial state departments and administrations; all municipalities and all municipal entities" (Motubatse, 2014: 48). It is therefore a legislation requirement that the municipalities submit annual reports for the purpose of audit. According to Lesolang (2015: 19), the annual reports that are submitted by municipalities should be in line with Generally

Recognised Accounting Practices (GRAP). Section 14 (1) of the Public Audit Act , 2004 (Act 25 of 2004) further indicates that financial statements submitted to the AG by an auditee (municipality) must be submitted within two months subsequent to the end of every municipal financial year The report should be in the prescribed format and contain the information as required by legislation (Mathebula, 2016: 216). Given that the municipal financial year starts on the first of July, this means that all municipalities in South Africa have to submit their annual financial statements to Auditor-General not later than the last day of August each year (Lesolang 2015: 19). According to Lesolang (2015), this is also where municipalities disclose any unauthorised, irregular spending as well as the fruitless and wasteful expenditure incurred. Fourie *et al.*, (2011) stated that financial reports are used by municipalities as a means to communicate financial information to all relevant stakeholders including the AG. Consequently, these reports should be based on sound accounting standards. Municipalities must therefore submit reliable and accurate annual financial statements to reflect their financial activities.

According to the compliance framework (Independent Regulatory Board of Auditors, 2012: 15), a financial audit consists of an audit of financial statements, plus some or all of the following elements:

- Audit of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;
- Audit of financial systems and transactions, including an evaluation of compliance with applicable statutes and regulations, internal control and internal audit functions;
- Audit of performance against predetermined objectives;
- Reporting of any other matters arising from or relating to the audit that the supreme audit institutions considers should be disclosed compliance.

2.6.2 Audit of predetermined objectives

In terms of section 20(2) (c) of the Municipal Financial management Act, 2003, (Act 56 of 2003), and the Public Audit Act, 2004 (Act No. 25 of 2004) and related regulations, it is a legislated requirement for accounting officers or municipal authorities to report annually on the performance of the entity against predetermined objectives (Independent Regulatory Board of Auditors, 2012). This constitutes an audit of the policies, processes, systems and procedures for the management. The performance reports are used to

assess the success of service delivery and the use of funds appropriated by the legislatures (Independent Regulatory Board of Auditors, 2012: 16). According to KPMG (2016: 4), this performance information enables the auditor to conclude whether the reported performance against predetermined objectives is reliable, accurate and complete, in all material respects, based on predetermined criteria. In order to improve the efficiency and effectiveness of audits in the public sector, it is important that the audits performed by the AGSA include special focus on service delivery matters as well as human resource management, procurement, and contract management (Independent Regulatory Board of Auditors, 2012: 19).

2.6.3 Audit of compliance with laws and regulations

The scope of the Auditor-General is quite broad. The audit places emphasis on compliance to relevant laws and legislations. Sections 20(2) (b) and 28(1)(b) of the Public Audit Act, 2004 (Act No. 25 of 2004) state that the auditor's report must reflect an opinion or conclusion on the entity's compliance with any applicable legislation relating to financial matters, financial management and other related matters. Financial management in municipalities is regulated by the Municipal Finance Management Act (MFMA), 2003, (Act 56 of 2003). The act provides mechanisms for strengthening accountability and transparency in municipalities, and furthermore clarifies roles and responsibilities of various role players involved in municipal financial management for the purpose of good governance (National Treasury, 2011). Non-compliance to the provisions of the act can contribute to unfavourable finding by the AGSA.

2.7 LEGISLATIVE REQUIREMENTS RELEVANT TO THE AUDIT

2.7.1 The Constitution of South Africa, 1996 No. 108 of 1996

The Constitution of South Africa (1996) provides for the establishment of the Office of the Auditor-General to audit and report on the accounts, financial statements, and financial management of all institutions of government. The Constitution of South Africa (1996) recognises the significance and pledges the independence of the AGSA, stating that the institution must be impartial and must exercise its supremacies and execute its functions without fear, favour, or prejudice. All government departments, including municipalities, are obliged by law to comply with the requests of the AGSA to submit their financial statements and reports for the purposes of audit.

2.7.2 Public Audit Act, 2004 (Act No. 25 of 2004) (PAA)

- Sections 20(2) (c) and 28(1) (c) of the Public Audit Act, 2004 (Act No. 25 of 2004) requires that: ‘An audit report must reflect an opinion or conclusion relating to the performance of the auditee against predetermined objectives.’
- Section 4(1) of the Public Audit Act, 2004 (Act No. 25 of 2004) PAA outlines the following: ‘The Auditor-General must audit and report on the accounts, financial statements and financial management of –(a) all national and provincial state departments and administrations;(b) all constitutional institutions;(c) the administration of Parliament and of each provincial legislature;(d) all municipalities;(e) all municipal entities; and (f) any other institution or accounting entity required by other national or by provincial legislation to be audited by the Auditor-General.
- Section 4(3) of the Public Audit Act, 2004 (Act No. 25 of 2004), states that the Auditor-General may audit and report on the accounts, financial statements and financial management of (a) any public entity listed in the Public Finance Management Act; and (b) any other institution not mentioned in subsection (1) and which is funded from the National Revenue Fund or a Provincial Revenue Fund or by a municipality; or authorised in terms of any legislation to receive money for a public purpose.

2.7.3 Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) MSA instructs municipalities to prepare for each financial year a performance report reflecting the following:

- (i) The municipality’s and any service provider’s performance during that financial year, also in comparison with targets of and with performance in the previous financial year.
- (ii) The development and service delivery priorities and the performance targets set by the Municipality for the following financial year; and (iii) Measures that were or are to be taken to improve performance statements and the report on audit on the audit performed and the municipality must table this annual report within one month of receiving the audit report (Municipal Systems Act, 2000).

2.7.4 Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

In terms of section 92 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003), the Auditor-General must audit and report on the accounts, financial statement, and financial management of each municipal entity. It is on this basis that the AGSA will

act in accordance with those financial statements and supporting documentation to make a determination in the form of audit outcomes (Mathebula, 2016: 215). Furthermore, section 127(1) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) specifies that the annual report of the municipal entity must include an assessment by the entity's accounting officer of the entity's performance against any measurable performance objectives set in terms of the service delivery agreement (Independent Regulatory Board of Auditors, 2012).

Section 32 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) requires accounting officers to take effective and appropriate steps to ensure that unauthorised, irregular, fruitless and wasteful expenditure is prevented. This will ensure that the municipal funds are not misused but are directed for the purpose of service delivery.

2.8 INSTITUTIONAL ARRANGEMENTS IN MUNICIPALITIES

A municipality structure in South Africa has both political and administrative functions (Khanyile, 2016: 24), and each structure within the municipal governance system has its individual role to play. These government administrators, consisting of political leadership and municipal officials, must achieve their municipalities' objectives while acting in the public interest at all times (Auditor-General of South Africa, 2018: 12).

The following elected and appointed members play a role in relation to municipalities' objectives (Khanyile, 2016: 28):

- Municipal council;
- Executive mayor;
- Municipal manager;
- Chief financial officer;
- Other officials of the municipality.

Municipal council – In terms of Section 151(2) of the Constitution of South Africa, 1996, the executive and legislative authority of a municipality is vested in the municipal council (Van Niekerk & Dalton-Brits, 2016: 120). A municipal council must conduct its business in an open manner (Van Niekerk & Dalton-Brits, 2016: 120), since it is entrusted with the responsibility of ensuring that the resources of the municipality are protected and used effectively.

The members of the municipal council are elected representatives of the political parties (IoDSA, 2013). This position comes with enormous responsibilities. Khanyile (2016: 28) mentioned that the council has an overall responsibility for the approval of policy and budget related plans for the provision of basic services. It is in this context that the council is viewed as playing a critical role in rendering oversight functions to improve accountability and governance over the activities of municipalities.

Apart from the oversight and accountability functions of a municipal council, there are also committees and personnel who must fulfil the functions of accountability and oversight over municipal officials to ensure that municipalities meet their constitutional obligations such as the executive committees, mayoral committees, council portfolio committees, municipal public accounts committees, and audit committees (Van Niekerk & Dalton-Brits, 2016: 121).

Audit committee - Section 166 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) requires that each municipality and municipal entity must have an Audit Committee (MFMA, 2003). An audit committee of a municipality is a council's independent advisory committee which has oversight responsibilities on the effectiveness of financial statement preparation (Mbua, 2016: 27), and it is responsible to respond on matters raised by the Auditor-General in the audit report to the council (MFMA, 2003). As an oversight structure, an audit committee also provides a valuable benefit, as it results in a greater focus on controls and risk management, as well as financial reporting (Mbua, 2016: 30).

The committee also reviews the annual financial statements to provide the Council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality (PSACF, 2013: 3). It must comment on the effectiveness of the internal controls, provide its evaluation of the Auditor-General's annual financial statements and may communicate any concerns it may have to the Auditor-General (Ncgobo & Malefane, 2017: 81). Senior management in a municipality consists of the accounting officer, the CFO and all senior managers (Khanyile, 2016:31).

Accounting officer – the Municipal Manager (MM) or Accounting Officer (AO) is the head of a department or the chief executive officer of a constitutional institution (Independent Regulatory Board of Auditors, 2012). In terms of Section 51 of the Municipal Systems Act (MSA) 2000, the municipal manager is accountable for the overall performance of the administration of a specific municipality. This means that the municipal manager is responsible for the implementation of the agreed inputs and

policies, and is accountable to the council and community for the overall administration of the municipality (Mazibuko, 2014: 107).

The following general financial management responsibilities of the accounting officer are provided for in the MFMA: Section 62 (1) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) states that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure—

- That the resources of the municipality are used effectively, efficiently and economically and that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards;
- That the municipality has and maintains effective, efficient and transparent system of financial and risk management and internal control
- That unauthorised, irregular or fruitless and wasteful expenditure and other losses are prevented (MFMA, 2003)

Section 61 (1) the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) also stipulate the fiduciary responsibilities of accounting officers (MFMA, 2003). “The accounting officer of a municipality must—act with fidelity, honesty, integrity and in the best interests of the municipality in managing its financial affairs”, therefore as the head of the municipal domain, the accounting office must make ethical decisions when managing public funds.

Chief financial officer (CFO) - The CFO plays a special role in the achievement of the goals and functions of the municipal financial management. Section 81 (1) of the MFMA (2003) stipulates the role of the CFO as the official who oversees the budget and treasury office. His role is described as essential in assisting the accounting officer to carry out his or her financial management responsibilities, in areas ranging from budget preparation to financial reporting and the development and maintenance of internal control policies and procedures.

Executive Mayor (EM) – The EM is an executive authority of the municipality. He/she is responsible for providing leadership and political guidance to the municipality. The executive mayor or committee must provide political guidance regarding the policy implementation, budget, and financial affairs of the municipality and must ensure that the municipality complies with its legislative obligations (Mazibuko, 2014: 105). It is therefore

expected that the Mayor plays a strategic role in ensuring that plans are in place to comply with the requirements of the audits.

Other officials of the municipality - The officials must see to the effective administration of the budget and finances of the municipality. The MFMA (2003) states that any official who exercises financial control responsibilities must take all reasonable steps within that official's area of responsibility to ensure that:

- This responsibility is carried out diligently, effectively, economically and transparently;
- Internal control is carried out diligently;
- Assets and liabilities are managed effectively; and
- That losses are prevented (Booyesen 2012: 58) (Khanyile, 2016:33).

The audit gives practical meaning to the constitutional rights of citizens to expect clean, transparent, accountable local government by exposing practices of municipal management to scrutiny, oversight, and possible sanction (Powell *et al*, 2014: 2).

2.9 AUDIT PROCESSES IN MUNICIPALITIES

The MFMA (2003) establishes a detailed annual auditing process with which all municipalities must comply (Craig, 2017: 31). There are two main forms of auditing, namely, external auditing and internal auditing (Scholtz, 2014: 5), which are significant to the audit processes in municipalities.

In order to comply with all the prescribed regulatory requirements, every municipality or municipal entity has to institute an internal audit team. These internal audit teams play a significant role in the internal audit functions of the municipalities. An internal audit team has a responsibility to assist management to achieve their goals, and in doing so, internal audit performs assurance and consulting activities, which aim to evaluate and improve risk management, controls, and governance processes in the municipality (Sepuru, 2017: 18). In order to improve the overall governance of the municipality, management will have to take heed of internal audit's recommendations. The Institute of Internal Auditors (2013) defines internal auditing as "an independent and objective assurance and consulting activity designed to add value and improve an organisation's operations. This definition emphasises that internal auditing is an activity that contributes to the

effectiveness of internal control, risk management, and governance. It therefore assists an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes (IIA, 2009). With regard to the management of public sector funds, the Treasury regulations of South Africa states that IAFs in the public sector are also allowed to assess the effective utilisation of public service institutions' resources and provide accounting officers with independent assurance of whether the resources are being used effectively, efficiently and economically (Motubatse, 2016: 22). Janse van Rensburg (2014:43) argued that the scope of public sector internal audit is wide compared to the private internal auditor, because the public internal audit functions are service oriented and more concerned with the extent to which tax payer's money is spent by public institutions.

The current study, however, will focus on the external audit function as performed by the Auditor-General of South Africa. For the purpose of this study, an external audit will be defined as a review of the financial statements of an organization by independent legal authorized auditors, thus the main objective of the external audit is to provide an opinion on the financial statements (Jovanova and Josheski, 2012: 2).

2.9.1 Submission of municipal financial statements

Municipal financial reports are used by municipalities as a means to communicate financial information to all relevant stakeholders including the auditor general (Lesolang, 2015: 16). The reports are based on what is called Generally Accepted Municipal Accounting Practice (GAMAP) and Generally Recognised Accounting Practices (GRAP) (Maclean, 2014: 89). The annual report presents four basic financial statements, namely: the balance sheet, the income statement, the statement of retained earnings, and the statement of cash flows, all of which are made available for the purpose of auditing (Maclean, 2014:89).

These financial statements must be submitted to the Auditor-General for auditing within two months after the end of a financial year in question (Lesolang, 2015:19). The municipal financial year starts on the first of July; this means that all municipalities in South Africa have to submit their annual financial statements to Auditor-General not later than the last day of August (Lesolang, 2015: 19). Table 2-1 illustrates the dates for the submission of the municipal financial statements.

Table 2-1: Submission dates for financial statements

Date of financial year end	Date of the submission of the financial statement for auditing	Date of the auditor's report	Submission to the executive/authority council	Tabling of the annual report
30-Jun	31 August/30 September (Consolidated)	30 Nov/31 December (Consolidated)	31 January by the Mayor to the council	Within seven days after the council has adopted the relevant oversight reports in the provincial legislature

Source: Independent Regulatory Board of Auditors (2012: 20)

Whilst auditing the financial statements, the Auditor-General checks whether the financial statements adhere to the financial reporting framework (Ncgobo & Malefane, 2017: 71), thus a municipality must adequately plan and prepare for the submission of annual financial statements to ensure that the financial statements represent a true reflection of the financial position of a municipality (Lesolang, 2015: 19). It is imperative that the municipality provides information on their financial activities on regular basis. Khanyile (2016: 2) asserted that financial activities need to be reported daily, weekly, monthly and quarterly depending on their scale and frequency, as this allows for better preparation of audit by municipalities.

2.10 AUDITOR-GENERAL REPORTS

It is the Auditor-general's responsibility to express an opinion on the financial statements based on the performed audit (Auditor-General of South Africa, 2016). Section 126 of the MFMA (2003) requires the Auditor-General to submit an audit report on financial statements of a municipality to the accounting officer of the municipality within three months of receipt of the statements (Lesolang, 2015:25).

The opinion of the auditor plays a major role in stating whether the municipality fairly represented the reliable municipal financial accounts. The AG report findings are brought to the attention of auditee management, municipal councils, boards of municipal entities as well as oversight bodies and the public (Auditor-general South Africa, 2018: 8). Once the Auditor-General has submitted an audit report to the accounting officer, no person other than the Auditor-General may alter the audit report or the financial statement (Lesolang, 2015: 25).

2.10.1 Municipal audit outcomes

The office of the AGSA released a report in May 2018 on audit results of South African municipalities for the 2016/17 financial year. The report contained the consolidated results of the annual audits and the analysis of the root causes of non-compliance with legislation and mismanagement of financial resources in the public sector. According to the Auditor-General of South Africa (2018: 10), there were 257 municipalities and 21 municipal entities that were audited in the 2016/17 financial year. The information provided in the report indicated that the results of the 2016/17 financial year's municipal audit were concerning, according to the Auditor-General of South Africa. The summative analysis with regard to the overall audit displayed a dismal picture. The audit outcomes of 45 municipalities regressed (of which 17 were from a clean audit status) and those of only 16 municipalities improved (Auditor-General of South Africa, 2018: 2). Only 33 municipalities (13%) out of 257 municipalities received a clean audit, meaning that they managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit. (Auditor-General of South Africa, 2018: 2).

There is general concern about the overall progress in the audit outcome in the provinces. The Auditor-General South Africa (2018: 52) reported that the improvements in audit outcomes seen over the past few years seem to have stalled. He further mentioned that the overall outcomes in the 2016/17 financial year reflect a net regression of one audit outcome, six improved and seven regressed audit outcomes. Table 2-2 outlines the overall audit outcomes per province.

Table 2-2: Audit outcomes for financial year 2016/17

	Eastern Cape	Free State	Gauteng	Kwa-Zulu Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape	TOTAL
Clean audit	2	0	1	6	0	2	1	0	21	33
Unqualified with findings	22	10	10	33	9	11	11	2	4	112
Qualified	11	3	0	11	10	6	11	12	2	66
Adverse	0	1	0	2	1	0	0	0	0	4
Disclaimed	1	2	0	1	3	1	2	8	1	24
Outstanding audits	0	5	0	1	4	0	6	0	2	18

Source: Auditor-General of South Africa (2018)

The picture presented by the Auditor-General South Africa (2018), as outlined in Table 2-1, indicates that over 50% of the municipalities received a report with findings, and what is of great concern is that only six of the nine provinces had municipalities with clean audits. The provinces that received clean audits are; Eastern Cape (2 municipalities), Kwa-Zulu Natal (6 municipalities), Mpumalanga (2 municipalities), Northern Cape and Gauteng provinces, each having only (1 municipality) with a clean audit. The highest number of clean audit reports was achieved by Western Cape Province, with (21 municipalities) that received a clean audit.

The Free State, North-west and Limpopo provinces did not achieve a single clean audit in the 2016/17 financial year (Auditor-General of South Africa, 2018:1). The Auditor-General South Africa (2018) reported a regression in the unqualified audit opinions, and further stated that the unqualified opinions on the financial statements decreased from 68% in the 2015/16 financial year to 61% in the 2016/17 financial year. Moreover, he mentioned that the financial statements provided for auditing were worse than those submitted in the 2015/16 financial year, with only 22% of the

Discussion of municipal finance management and administration, and clean audit outcomes, has been on the government agenda for some time (Mazibuko & Fourie, 2013: 132). On yearly basis, the office of the Auditor-General releases the audit report to examine the extent to which municipalities have complied with national standards for municipal financial management and performed against predetermined objectives for service delivery (Powell *et al.*, 2014: 2). Based on the results, the performance of the audit are not improving, with municipalities showing little commitment to the recommendations made by the Auditor-General of South Africa.

The Department of Corporate Governance and Traditional Affairs (COGTA) launched “Operation Clean Audit 2014” on the 16th of July 2009, in order to address the financial management problems in municipalities (Powell *et al.*, 2014: 6). It was part of the government’s turn-around strategy to address the challenges faced by municipalities in achieving a clean audit (Powell *et al.*, 2014: 5). A number of objectives and targets were set by the Department and it was pronounced that progress would be monitored extensively.

With the results of audit outcome recorded over the years by the Auditor-general, the municipalities seemed to be failing in achieving the turn-around strategy targets. Mazibuko and Fourie (2013: 132) put it clearly that the performance on the audit is deteriorating, and therefore, the anticipated turn-around in the municipalities will not

materialize. This was proved to be true, as we observe a regression in the municipal audit outcome on yearly basis. The Auditor-General of South Africa (2018) pointed out that the repeated failures of leadership to ensure that the municipalities achieve clean audit opinions is greatly distressing. Over the years, the municipalities have increasingly failed to improve on audit quality.

The graph in Figure 2.2 shows the result of the audit opinions issued for the past three years.

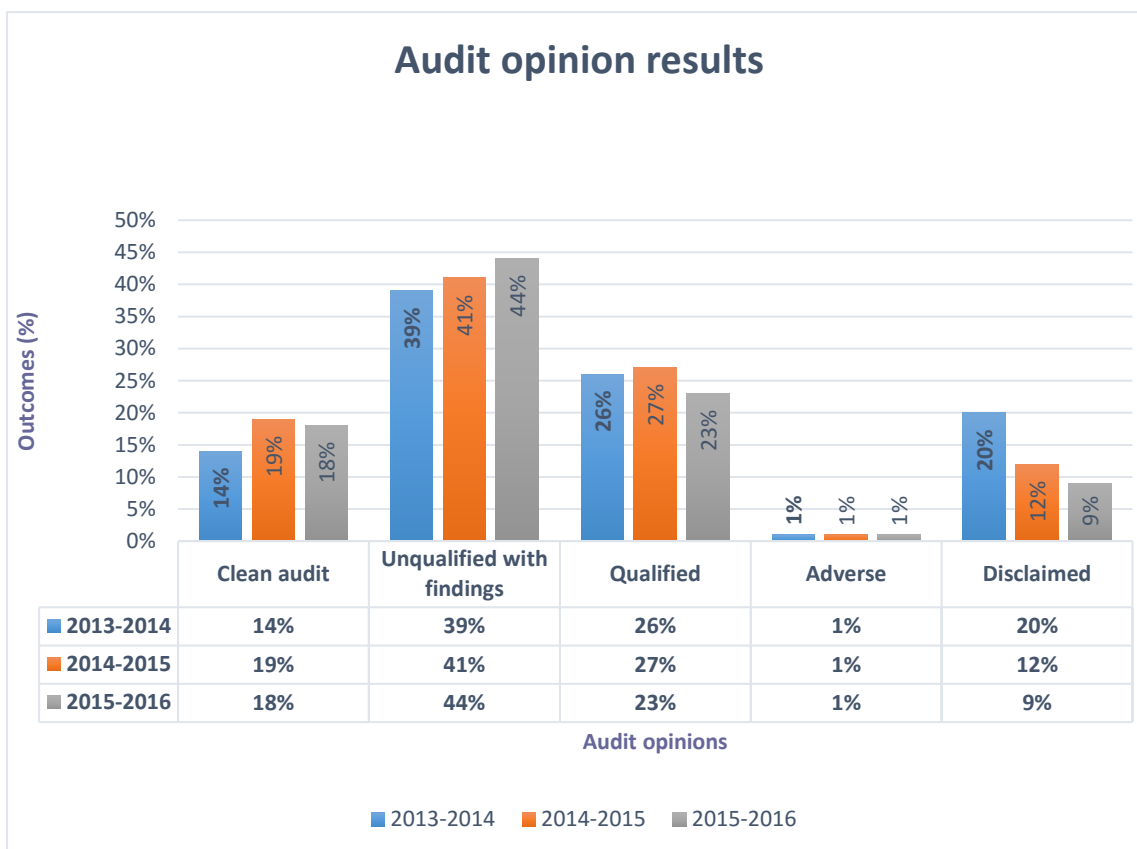


Figure 2.2: Audit outcomes from 2013/14 until 2015/16

Source: Auditor-General of South Africa (2017: 47)

2.10.2 Unauthorized, Irregular and fruitless and wasteful expenditure

The operating expenditure of a municipality is one of the crucial components which must be carefully overseen in order to achieve a clean audit and maintain sound financial management (Mazibuko & Fourie, 2013: 137). For the 2016-17 audits, the AG highlighted concerns regarding ineffective leadership and poor financial management which were exposed by the continuous increase in unauthorised, irregular, and fruitless and wasteful expenditure (Lesolang, 2015: 3). The following results were consolidated by the (AGSA, 2018: 2) in the MFMA 2016/17 report:

- **Material non-compliance** with key legislation is a major problem, as 86% of the municipalities did not comply, according to the Auditor- General South Africa (2018: 2). This is the highest percentage of non-compliance since 2012-13.
- **Irregular expenditure** increased from R16, 212 billion in the 2015-16 financial year to R28, 376 billion in the 2016/17 financial year (which is a 75% increase).
- The Auditor-General (2018: 2) reported that unauthorised, irregular and fruitless and wasteful expenditure occurred in about 61% of the municipalities that were audited in the 2016-17 financial year. This was an increase from 52% in the 2015/16 financial year. Moreover, the AG raised concerns regarding failure of the council to conduct the required investigation into all instances of unauthorised, irregular and fruitless and wasteful expenditure which were reported in the 2015-16 financial year (AGSA, 2018: 2);
- It was also reported that the fruitless and wasteful expenditure amounted to R1,5 billion, which is a 71% increase from the 2015-16 financial year (AGSA, 2018:2);
- Additionally, about 31% of the municipalities disclosed a deficit, and according to the Auditor-General of South Africa (2018: 2), the total deficit for these municipalities amounted to R5, 6 billion.

The main factors that contributed to these unfavourable outcomes, according to the Auditor-General of South Africa (2018), are the weaknesses in internal controls at municipal levels. The AG reported that the audit and general reports have over the years been highlighting the weaknesses in internal controls and the risks that needed attention in local government (Auditor-General South Africa, 2018). However, there seemed to be a slow response from the political leadership to respond to the AG's recommendations.

The Auditor-General of South Africa advised the municipal leadership to embrace their responsibility by promoting accountability and oversight, as well demonstrating effective leadership. Furthermore, a report by SALGA (2016) pointed out that improvement in audit outcomes requires committed efforts by Municipal Managers to address a number of persistent challenges, which include accountability, consequence management, internal controls, financial management discipline, financial health, institutional resilience, and capacity and governance oversight.

2.10.3 Accountability in municipalities

Accountability and the need for appropriate consequences for accountability failures featured as prominent elements of the AG messages in the MFMA 2016/17 report (Auditor-General South Africa, 2018). The problem of accountability has emerged repeatedly in the recommendations that were made by the AG over the years. The Twenty Year Review Report of Local Government 2004–2014 pointed out that accountability challenges persist in local government (DPME, 2014: 34). What appeared more concerning was the fact that the recommendations that were made in the previous year to improve audit outcomes and accountability did not receive the necessary attention (Auditor-General of South Africa, 2018).

According to the DPME (2014: 34), more than half of the auditees can attribute their poor audit outcomes to mayors and councillors that are not responsive to the problems identified by the audits and do not take their recommendations seriously. They are slow in taking up their responsibilities and do not take ownership of their role in implementing key controls (DPME, 2014: 34). The non-responsive approach by the leadership in municipalities hinders progress in the improvement of audit outcomes. Furthermore, if this widespread root cause is not addressed, it will continue to weaken the pillars of governance (DPME, 2014: 34). The Auditor-General of South Africa (2018: 3) warned that these concepts of public interest and accountability are entrenched in the country's constitution and the legislation that governs local government, therefore municipalities are compelled to be accountable to all citizens of the country.

The Auditor-General of South Africa (2018) highlighted the fundamental impact of accountability failures on municipal financial management. According to the AG, the negative impact is felt directly by the communities and businesses the municipalities serve, particularly when it comes to inadequate access to basic services (Auditor-General of South Africa, 2018: 20). Improving accountability in the public sector is important to the improvement of public services (Said *et al.*, 2015: 225). However, accountability in the public sector can be weakened by poor controls and corruption, which is exacerbated by public officials and political leaders not being held accountable for their behaviour (DPME, 2014). Thus, the implementation of accountability and proper control is urgent and is desperately needed to address the challenges of audit quality and basic service delivery in the South African local government environment (Mazibuko & Fourie, 2013: 131).

2.10.4 Internal control

Internal control is another aspect that has been identified as a good practice in Public financial management (National Treasury, 2010). Internal control refers to the policies, as well as the procedures, which are used by the management to attain various goals, which include safeguarding organizational assets, and to provide reasonable assurance that undesired events will be prevented, detected and corrected (Erasmus & Visser, 2011: 9). The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013) defines “internal control” as a process, effected by an entity’s board of directors, management and other personnel, designed to provide a reasonable assurance regarding the achievement of the objectives in the following categories, Effectiveness and efficiency of operations, Reliability of financial reporting, Compliance with applicable laws and regulations.

The National Treasury has developed a series of technical competency dictionaries, referred to as the “*Competency Framework*”, covering a number occupational groups in the field of public financial management. Internal control was one of the financial management discipline which was identified by Treasury as an integral part of financial management in government and should be implemented to mitigate and manage risks in government (National Treasury, 2010). Weakness in internal control in an organisation generally can have a negative impact in the outcome of the audit. The Auditor-General South Africa (2018: 23) has reported weakness in internal control in municipalities as a concern, According to the MFMA 2016-17 report, the poor quality of performance reports was as a result of failures by municipality to address internal control deficiencies (Auditor-General South Africa, 2018: 58). According to Ncqobo and Malefane (2017: 74), internal controls are vital in guiding managers and employees about how the tasks should be performed, procedures and methods that should be followed and how to adhere to the established legislation. It is also a legislative requirement according to section 105 of the MFMA (2003) that managers are held accountable for overseeing internal control activities in municipalities (Ncqobo and Malefane, 2017: 79).

The COSO (2013) has established an internal control framework, the framework captures important concepts that are fundamental to how organizations design, implement, and conduct internal control. The Framework provides for three categories of objectives, which allow organizations to focus on differing aspects of internal control (COSO, 2013):

- Operations Objectives—these pertain to effectiveness and efficiency of the entity’s operations, including operational and financial performance goals, and safeguarding assets against loss ;
- Reporting Objectives—these pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, recognized standard setters, or the entity’s policies;
- Compliance Objectives—these pertain to adherence to laws and regulations to which the entity is subject.

These objectives when collectively applied can ensure effective and efficient operations, reliability of financial reporting, compliance with regulations that govern the internal control and maintaining good governance practices (Ncqobo and Malefane, 2017: 75)

The Committee of Sponsoring Organisations (COSO, 1992), also highlighted the internal control’s characteristics as “maintaining an effective control environment, risk management, control activities, communication, and monitoring”, these functions can be applied in different areas in the organisation. Every entity faces a variety of risks, it could be internal or external (COSO, 2013), therefore risk management can be considered an important elements of internal control system, which must be implemented in organisations. The Municipal Finance Management Act, 2003 (Act No. 56 of 2003), also establish that Accounting Officers are responsible for implementing effective, efficient and transparent systems of risk management within the institutions under their control, as such, municipalities must endure that they have systems of risk management in place. Risk assessment can be defined as the action of identifying possible risks and assessing the possible impact of the occurrence of these risks (Wilken, 2016: 6). Risk asserted that risk assessment processes could also be undertaken in public institutions to detect and evaluate risks to ensure that public institutions achieve their objectives.

A municipality can also experience weaknesses in financial management internal controls because of insufficient risk management plans and backups/ disaster recovery plan. Reliable disaster recovery systems are highly important because they ensure that in case a disaster occurs, the business should still continue with its operations (Omar, Alijani & Mason, 2011: 127). Planning ahead and implementing risk assessment is significant for the survival of municipalities.

When the Auditor-General is auditing public organisations, one of the constraints it faces is that records are either not available or could not be retrieved (Ngoepe and Ngulube, 2014: 136). Record management are essential for the survival of the organisations as they are able to protect an organization from significant risks such as compliance issues, disaster recovery, public relations crises, confidentiality breaches and security threats (Beiri, 2012).

Proper records management is increasingly becoming the only weapon through which organisations fulfil the requirements of the auditors (Ngoepe and Ngulube, 2014: 136). An effective records management system is a critical element in the preparation of an institution's financial statements (Erima and Wamukoya, 2012: 28), which are submitted for the purpose of auditing. The Auditor-General of South Africa has broadly emphasised the importance proper recordkeeping by public bodies that are audited.

The primary function of records management is to facilitate the free flow of records through an organization, to ensure that information is available rapidly where and when it is needed (Tagbotor, Adzido, and Agbanu, 2015: 2). This is also applicable with Annual Financial Statements (AFS) that are submitted to the Auditors by municipalities. The auditor general has broadly emphasised the importance proper recordkeeping by public bodies that are audited, including the AFS reports. Phiri (2015: 5) asserts that if the records and documents were not effectively managed, an audit opinion would not be reliable because it would be based on untrustworthy information.

When the Auditor -General audits the report of the municipality, there is high expectation that the files are readily available for auditing. Bhana and Ngoepe (2009) An ideal audit environment is one where an auditor can walk into an organisation and be provided with an audit file that contains the financial statements, which are in turn cross-referenced, to all the relevant supporting records in the same. In fact record management support the entire audit process and as such, leaders in municipality must play an accountable role to ensure that there is proper record keeping, supporting financial and performance reporting, and that relevant and accurate information is kept safely and it is accessible (Ncgobo and Malefane, 2017: 80).

Record management is crucial to all organization, Tagbotor, Adzido and Agbanu (2015: 2) states that unless records are managed efficiently, it is not possible to conduct business, to account for what has happened in the past or to make decisions about the future. A study conducted by (Erima and Wamukoya, 2012: 24), revealed a direct relationship between records management and risk management, it is important to note

importance of keeping records as a key to mitigate against risk. Bhana (2008) asserted that risk assessment in public organisations should also review recordkeeping so that the organisations' recordkeeping practices do not pose any legislative or business risk to the organisation.

2.10.5 Compliance with key legislation

Non-compliance to legislations was also a distinct concern that was raised by the Auditor General of South Africa (2018: 58). In his report, the AGSA indicated that material non-compliance with key local government legislation by municipalities was at 86%, and was by far the highest percentage of non-compliance since 2012/13 financial year (Auditor-General South of Africa, 2018). The areas that consistently displayed the highest non-compliance were the prevention of irregular expenditure, procurement, and contract management (Auditor-General of South Africa, 2018). The non-compliance with laws was high, signalling the impact issues of compliance to legislation have on the achievement of clean audits. According to Auditor-General of South Africa (2014), the challenges in unfavourable audit outcomes are deep-rooted and are the result of a generally poor understanding of governance and pieces of legislation related to administrative systems. This limits the effectiveness of the act in bringing about improvements in local government finance control (Khanyile, 2016: 27). It is therefore critical that municipalities respond to the policies of government to ensure accountability.

2.10.6 Leadership and governance

Leadership and political leadership roles in municipalities have been a topic of interest in various studies and reviews. It has been reported in the Local government budget and expenditure review report that the success or failure of a municipality depends on the quality of its political leadership, sound governance of its finances, the strength of its institutions and the calibre of staff working for the municipality (National Treasury, 2011). Moreover, the Auditor-general has also repeatedly emphasized the importance of leadership in the country's municipalities.

Audit outcomes have become a concern for South African local governments, since local governments continue to fail to achieve clean audit opinions (Motubatse, 2016: 75). Continued lack of accountability and leadership failures were also highlighted as the main causes of a significant regression in audit outcomes from the prior year (Auditor-General South of Africa, 2018). This situation has raised concerns about the quality of

municipal leadership because there is a generally accepted positive correlation between audit quality and leadership quality (Motubatse, 2016: 75).

Leadership, according to Yukl, (2011: 26), can be defined as the process of influencing a group of individuals to understand what needs to be done and how to do it, and a process of facilitating the individual or group effort to achieve shared goals. According to Emmery (2016: 10), a leader's job is to create the desired future for the organization.

In the context of municipalities, leadership relates to the process through which those who are in positions of political and administrative authority, that is the Executive mayors and municipal managers, possess the ability to influence members of the structure for which they are responsible (Madumo, 2012: 83). It is worth noting that these individuals, who are elected to positions of authority and decision-making, are entrusted with the responsibility of managing and leading an organization as directed by a constitutional mandate. Be that as it may, the leadership remains a challenge in municipalities, as political leadership fail to demonstrate good governance and are seen as lacking consequence management.

Leaders cannot be referred to as leaders simply by virtue of the position they hold in organizations but have a crucial role to play in an organization. The Auditor-General South of Africa report (2018) demonstrates that leadership's lack of accountability for sound financial management had a negative impact on municipalities' audit outcomes. Clamp, Murirwa and Khubeka (2012:1) reported that the insufficiency of a culture of good governance, unethical practices, lack of skills, ineffective implementation and the inability by leaders to account, are some of the features that characterise the public sector. Some of these sentiments were echoed by the Auditor-General South Africa (2018: 3), who pointed out that the weakness in most municipalities is linked to political and administrative leadership. In the MFMA 2016/17 report, the Auditor-General South Africa (2018: 3) confirmed that inadequate skills led to a lack of oversight by councils (including the mayor) and insufficient implementation and maintenance of financial and performance management systems by the administration.

It has been revealed that a significant relationship exist between governance and the achievement of clean audit outcomes in South African municipalities. Motubatse (2017: 99), acknowledging the importance of governance in obtaining clean audit, emphasized a need for a paradigm shift in the leadership in the municipal sphere. According to Scholtz (2014: 45), leaders should rise to the challenges of modern governance which is characterised by the ethical values of responsibility, accountability, fairness, and

transparency, and based on moral duties that find expression in the concept of “Ubuntu”. This is critical at municipal level where political leadership is responsible for good service within the local communities.

2.11 FREE STATE PROVINCE

The Free State province comprises one Metropolitan Municipality, four districts, and nineteen local municipalities since the local government elections of 2011. The AG reported that no municipality in the Free State province received a clean audit in the 2016/17 audit (Auditor-General of South Africa, 2018). This is distressing as it points to the lack of leadership commitment to the audit process in the province. According to the Auditor-General of South Africa (2018: 19), the continued lack of accountability and leadership failures in the province were the main causes of breakdown in governance. He further pointed out that seven municipalities in the province regressed while no auditees (municipality) were able to improve. Letsemeng and Nketoana municipalities regressed from qualified audit opinions to disclaimed opinions (Auditor-General of South Africa, 2018: 55).

Municipalities relied on the audit process and consultants to identify shortcomings and to produce credible financial statements, despite most chief financial officers meeting the minimum competency requirements (Auditor-General of South Africa, 2018: 55). The Auditor-General South Africa further pointed out that, even with exorbitantly expensive consultants, the municipalities in the Free State province still received worsening audit reports. This illustrates the need for the province to go back and ensure that measures are in place to address the recommendations as highlighted in the AG report.

2.12 THABO MOFUTSANYANA DISTRICT DEMOGRAPHIC INFORMATION

The Free State province is divided into one metro (Mangaung Metro) and four districts namely Xhariep, Lejweleputswa, Thabo Mofutsanyane, and Fezile Dabi district municipalities. Thabo Mofutsanyana District is located in the north-eastern part of the Free State province, and borders on Lesotho and KwaZulu-Natal. The District is subdivided into six local municipality areas, namely Setsoto, Dihlabeng, Nketoana, Maluti- A-Phofung, Mantsopa, and Phumelela (Thabo Mofutsanyana District Municipality, 2015: 13).

Figure 2.3 illustrates the map of Thabo Mofutsanyana District



Figure 2.3: Map of Thabo Mofutsanyana district

Source: Thabo Mofutsanyana District Municipality (2015)

The purpose of this study is to assess the factors that contribute to the audit outcome in two municipalities. Currently there are 23 municipalities in the Free State, according to the National municipal demarcation board. Two of the municipalities, namely Setsoto and Nketoana local municipalities in Thabo Mofutsanyana district, were selected for the purpose of this study. The Auditor-General South Africa has disclaimed Nketoana local municipality and issued an unqualified audit opinion with findings for Setsoto local municipality in the 2016/17 financial year audit. According to the report of the Auditor-General of South Africa, the two municipalities have not obtained a clean/unqualified outcome in the past three years (Auditor-General of South Africa, 2018). Table 2-3 show the audit opinion issued for the two municipalities.

Table 2-3: Setsoto and Nketoana LM audit outcome

YEAR	Municipality	2017/18	2016/17	2015/16	2014/15	2013/14
AUDIT OUTCOME	Setsoto Local municipality	n/a	Unqualified audit with findings	Qualified audit	Qualified audit	Financially unqualified
	Nketoana Local Municipality	n/a	Disclaimer of opinion, no report available	Qualified audit	Qualified audit	Unqualified - Emphasis of matter items

Source: Auditor-General of South Africa (2018).

2.13 SETSOTO LOCAL MUNICIPALITY

2.13.1 Background

Setsoto Local Municipality (FS 191) is a category B municipality (local municipality) as determined by the Municipal Demarcation Board in terms of section 4 of the Municipal Structures Act, 117 of 1998. It consists of four towns, namely Ficksburg, Senekal, Marquard, and Clocolan, and other neighbourhood areas.

The political system type comprises a mayoral executive system combined with a ward participatory system. The council has its committees (Section 80 Committees) including Audit and Performance Audit Committee and Municipal Public Accounts Committee (Section 79 Committees). The administrative structure of the municipality consists of five departments and four administrative units with the Municipal Manager as the Accounting Officer and head of the administration situated in Ficksburg (Setsoto Local Municipality, 2018).

Decision making within the Setsoto Municipality is guided by its Delegated Powers and Legislation. Various structures comprising of Management Meeting, Section 80 Committee Meetings, Mayoral Committee Meetings, and Council Meetings consider recommendations and make decisions within the powers delegated to the specific structure (Setsoto Local Municipality, 2018: 28).

2.13.2 Setsoto audit findings

The Office of the Auditor-General of South Africa commenced with the regulatory audit from 01 September 2017 and completed on the 31 November 2017. The municipality submitted a set of the Annual Financial Statements and the draft Annual Report for the year under review within the required timeframe, which was on the 31st August 2017.

In terms of the audit strategy the municipality was adhering to the response timeframes as agreed with the Auditor-General of South Africa. The turnaround time was three days for the request for information and for the exceptions issued the turnaround time was five days. Table 2-4 provides an overview of the report of the auditor-general to the Free State legislature and the council on the audit of the financial statements Setsoto local municipality (Setsoto Local Municipality, 2018: 28).

Table 2-4: Setsoto summary report on the audit of financial statements

AUDIT ITEMS	OUTCOME
Material impairments	As disclosed in note 5 to the financial statements, a provision for the impairment of debtors amounting to R148 406 866 (2015: R127 785 657) was made with regard to consumer debts amounting to R291 591 158 (2015: R246 820 305).
Going concern	Note 55 to the financial statements indicates that the municipality incurred a deficit of R126 711 817 (2015: R104 623 089). Furthermore, debtors increased from R119 034 648 to R143 184 292 and payables from R52 922 872 to R71 819 017.
Irregular expenditure	The municipality incurred irregular expenditure of R2 188 129 (2015: R33 449 533) during the year under review, mainly due to non-compliance with supply chain management requirements.
Additional matters	
Unaudited supplementary information and disclosed noted	An opinion not expressed
Predetermined objectives	
Infrastructure and service delivery	No material findings on the usefulness and reliability of the reported performance information for the selected key performance area.
Additional matters	
Adjustment of material misstatements	As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.
Compliance audit	
Strategic planning and performance information	The key performance indicators set by the municipality did not include indicators on the percentage of households with access to basic levels of water, sanitation and electricity, as required by section 43(2) of 253 the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and municipal planning and performance management regulation 10(a).
Financial statements and annual report	The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1) (c) of the MSA.
Expenditure management	

AUDIT ITEMS	OUTCOME
	Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA (AGSA, 2018).
	Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA
Internal control	The significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.
Leadership	Inadequate review and monitoring by management during the preparation of the annual report on predetermined objectives resulted in material findings on predetermined objectives.
Financial and performance management	Formal processes to ensure compliance with key legislation did not prevent non-compliance with laws and regulations in certain cases. Consequences management was not adequate in these instances.

Source: Setsoto Local Municipality (2018)

2.14 NKETOANA LOCAL MUNICIPALITY

2.14.1 Background

Nketoana Local Municipality is named after the Leibenbergsvlei River, which is Nketoana in Sesotho (StatsSA, 2011). The Municipality is situated within the Thabo Mafutsanyana District Municipality in the Eastern Free State. It comprises of Reitz, Petsana, Mamafubedu, Lindley, Ntha, Arlington, and Leratswana, with the head office situated at Reitz (Nketoana Local Municipality, 2018). The Municipality has four administration departments viz. Corporate Services, Community Services, Technical Services, and Financial Services. The main economic activities in the area are agriculture and retail businesses. Nketoana is a fertile agricultural region and approximately 19% of the economically active population is employed in the agricultural sector (Nketoana Local Municipality, 2018).

2.14.2 Nketoana audit outcome

The municipality received a disclaimer, meaning that The Auditor-General does not have all of the underlying documentation needed to determine an opinion. For example, the lack of underlying documentation and the amounts in question may be so great that it is

impossible to give any opinion at all. These findings are a result of lack of commitment to the audit processes by the municipality. The situation could be reversed if leadership and other supporting functions in the municipality are directed towards implementing recommendations of the Auditor-General. The Department of Cooperative Governance and Traditional Affairs (COGTA, 2017) has pledged to work together with the Auditor General office, National Treasury, provincial Cooperative Governance and provincial Treasury departments, which have a dedicated capacity to assist and support municipalities to develop post-audit action plans. This will address the critical issues identified by the Auditor general.

2.15 CONCLUSION

The literature review revealed that there are a number of municipalities in the country that are experiencing challenges with unfavourable audit outcomes. The main aim of recommendations is to bring about improvements in the manner in which the municipalities are carrying out their businesses and to make sure that the municipalities are meeting their obligations and complying with government regulations and legislation. The key issues that contribute to unfavourable audit outcomes revolve around governance, weakness in internal controls, and non-compliance to the key local government legislations. Despite various recommendations made by the Auditor General, the municipalities still continue to regress in the number of unfavourable audit outcomes.

3 CHAPTER THREE: RESEARCH METHODOLOGY

3.1 INTRODUCTION

This section explains how data was collected and analysed. It spells out the research philosophy adopted while the research was being conducted, research design, target population, sampling strategy, data collection tools, data analysis tools, validity and reliability of the research instruments, and ethical issues that the researcher took into consideration while conducting the research.

3.2 RESEARCH PARADIGM

According to Collis and Hussey (2013), the term research paradigm is defined as “an integrated cluster of substantive problems, variables, and concepts attached with corresponding methodological approaches and tools”. The two major kinds of approaches include positivist and interpretative research paradigms.

3.2.1 Positivist paradigm

Positivism depends on quantifiable observations that lead to statistical analyses. Research findings are usually observable and quantifiable. The positivist paradigm is often described as a "scientific research method", to study and understand social reality (Bryman *et al.*, 2014: 12). Additionally, it generally reflects a deterministic viewpoint where causes determine outcomes or effects. It therefore makes researchers pursue the social world in an objective manner (Brannen and O’Connell, 2015). In most cases, this kind of paradigm is used for quantitative studies, and therefore, this research study being qualitative, it was not the most appropriate research paradigm.

3.2.2 Interpretive Paradigm

The interpretive paradigm is concerned with understanding the world from the personal experiences of individuals. This kind of research mainly highlights and investigates the manner in which the subjective interpretations of groups and individuals shape societal objective features. It uses methodologies such as interviewing or participant observation. The interpretivism assumes that any research approach needs to respect the difference between people and objects in the natural sciences (Bryman *et al.*, 2014: 14).

The interpretive paradigm is used for qualitative studies, and this being a qualitative research study, it was the most appropriate research philosophy.

3.3 RESEARCH DESIGN

Research design refers to the different procedures or methods that are applied by the researcher to collect and analyse data that is needed to answer the research question (Bertram, & Christiansen, 2014: 40). This research adopted a phenomenological research design. This is a qualitative research method, which is used for describing the manner in which human beings experience a given phenomenon (Pietkiewicz & Smith, 2014: 8). Phenomenological studies generally try to set aside biases as well as preconceived assumptions regarding human feelings, experiences, and responses to a given situation. Phenomenology takes into consideration the different kinds of experiences of people and lays emphasis on what all respondents have in common (Alase, 2017: 9). This design was used as the researcher sought to get the research participants' perspective on the various kinds of factors that relate to qualified audit reports in the two municipalities. The research aimed to explore the experiences of those working in the local municipalities.

3.4 RESEARCH METHOD

There are three key research methods: qualitative, quantitative, and mixed research methods (Bryman *et al.*, 2014: 31). Quantitative research is a mode of inquiry used often for deductive research, when the goal is to test theories or hypotheses, gather descriptive information, or examine relationships among variables (Creswell *et al.*, 2011: 4). These variables are measured and yield numeric data that can be analysed statistically. It focuses on objective measurements, mathematical, statistical, or numerical data analysis through the use of questionnaires, surveys or polls or through the manipulation of the pre-existing statistical data through the use of different kinds of computational techniques.

Mixed methods research refers to a methodology which entails carrying out research which involves collection, analysis and integration of both quantitative (e.g., surveys, experiments) and qualitative (e.g., interviews, focus groups) research, in other words, It involves the intentional collection of both quantitative and qualitative data and the combination of the strengths of each to answer research questions (Creswell *et al.*, 2011: 5).

Qualitative research is an inquiry process of understanding based on distinct methodological traditions of inquiry that explore a social or human problem (Phala, 2017: 58). There are different kinds of qualitative research methods such as focus groups, in-depth interview, content analysis, ethnographic, and case study (Creswell *et al.*, 2011: 4). In most cases, the results of qualitative research methods are descriptive. It is also simple to draw inferences from the data which have been collected.

The current research adopted a qualitative research method, in which collection of data took place through the use of one-on-one interviews. Conducting in-depth interviews is one of the most common methods of carrying out qualitative research. One-on-one interviews, conducted with a single respondent at a time, allow the researcher to get in-depth details from the respondents. One of the main advantages of this qualitative research is its focus on the contexts and meaning of human lives and experiences (Creswell *et al.*, 2011: 4).

3.5 SAMPLING TECHNIQUE AND SAMPLE SIZE

A sample refers to a subset of the population, which is chosen for the investigation (Bryman *et al.*, 2014: 170). All the units which are included in the sample give an observation or a record. The size of the sample is always affected by a number of factors which include the size of the population, confidence level, risk, and variability. In order to obtain the sample, researchers often use a sampling technique. In most cases, there are two major techniques that can be used in order to draw the research sample from the population.

Sampling methods normally belong to either one of the following categories: probability methods or non-probability methods (Bertram & Christiansen, 2014: 60). In probability sampling all members of the population have a known probability of being selected in order to form part of the sample. In non-probability sampling the chances of an individual forming part of a given sample is not known (Bertram & Christiansen, 2014: 60).

In the research in hand, the sampling technique which was adopted was the purposive sampling technique. According to Etikan, Musa and Alkasaam (2016: 2), purposive sampling is a type of non-probability sampling where the researcher deliberately select participants due to the qualities they possess, this is done mainly on the judgement of the researcher. The idea behind purposive sampling is to concentrate on people with particular characteristics who will better be able to answer the research question.

3.5.1 Target Population

The population is the “individuals, groups, organisations, human products and events, or conditions that the researcher is interested in studying” (Welman, Kruger & Mitchell, 2005: 52). There are 23 municipalities in the Free State, according to the National municipal demarcation board. Two of the municipalities, namely Setsoto and Nketoana local municipalities in the Thabo Mofutsanyana district, were selected so that the study could be managed within the defined period. The members of the population which is targeted by a researcher have certain common characteristics and experience. Moreover, the participants in phenomenology are those with lived experience with regard to the phenomenon under study and who will be able to share insight about the phenomenon (Phala, 2017: 72).

3.5.2 Sampling size

The study used a sample size of eight officials from the selected municipalities. The officials selected were senior managers with experience in strategic planning and audit processes in the two municipalities. Members of a sample were purposely chosen in relation to criterion which was considered important for this particular study. Creswell (2007: 125) describes that in purposive sampling the researcher selects individuals and sites of the study that can purposefully inform an understanding of the research problem and central phenomenon in the study. According to Gray (2013: 324), qualitative research often works with small samples of people, cases or phenomena nested in particular contexts, and hence, samples tend to be more purposive.

Phala (2017: 72), asserted that the size of the sample in qualitative research is small because a phenomenon only needs to appear once to be of value. Furthermore, Morse (2000: 4) recommended that when doing a phenomenological study and interviewing persons, one has a large amount of data for each participant and therefore needs fewer participants in the study (Between 6 and 10).

In conducting qualitative research, one should also choose the sample size that has the best opportunity for the researcher to reach data saturation (Fusch and Ness, 2015). Saunders (2017: 1897) points out that “data saturation” relates to the degree to which new data repeat what was expressed in previous data. As stated by Saunders (2017: 1896), in interviews, when the researcher begins to hear the same comments repeatedly, it means “data saturation” is being reached alarming the researcher to stop collecting information and to start analysing what has been collected.

3.5.3 Data Collection instrument

In this research, the instrument which was used for the purpose of data collection was interviews. According to Bryman *et al.*, (2016: 215) an interview is a prominent data collection in both quantitative and qualitative research. Data was collected through interviews with the officials in the two municipalities. The interviews took the form of a semi-structure qualitative interview. There are a number of reasons why interviews can be used for data collection in any research. Interviews are highly useful for investigating different kinds of issues in an in depth manner (Brannen and O'Connell, 2015). Through semi-structured interviews, researchers are capable of collecting information on highly sensitive topics which individuals might feel uncomfortable discussing in focus group.

Some of the main advantages associated with interviews include the fact that they are highly useful to obtain detailed information regarding personal opinions, feelings, and perceptions. In addition, they enable researchers to ask highly detailed questions.

3.5.4 Data collection procedure

Data collection can be defined as the process of gathering and measuring information regarding the variables of interest in a manner that is systematic (Bertram and Christiansen, 2014: 71). It mainly aims to answer the stated research questions, and enables researchers to test hypotheses and evaluate outcomes. As previously mentioned, interviews were used for the collection of data. An interview guide as a data collection tool, was developed and used to conduct the semi-structured interviews and to gather information pertaining to the research. Furthermore, the data collection tool was important to collect diversity of data, opinion and experiences from senior managers who are involved in audit activities in the two municipalities. Bertram and Christiansen (2014: 82) describe an interview as a useful method of collecting data as it allows the researcher to ask probing and clarifying questions, and to discuss participants' understanding with them. After the selection of the interviewees, the researcher scheduled a convenient time for the research participants to carry out the interviews. All the data and information was collected while the interview was taking place.

3.5.5 Data analysis

Data analysis entails processing of data in order to answer the research question which consists of segmenting and re-assembling of data with the aim of transforming the data into findings (Boeije, 2010:75). Data were analysed using framework matrix.

According to Gale *et al.*, (2013), the framework falls within a broad family of analysis methods often termed thematic analysis or qualitative content analysis. Smith and Firth (2011: 2) assert that the principles of the framework approach can be used to undertake qualitative data analysis systematically, this ensures that data analysis is explicitly described to enhance the credibility of the findings. Framework matrix involves summarizing and analysing qualitative data in a table of rows and columns, which allows for both cross-case as well as sorting data by theme.

3.5.6 Validity and reliability of the research instruments

Validity and reliability are highly significant aspects in qualitative research (Leung, 2017: 325). Reliability can be defined as the degree to which the given research instrument generates similar results over multiple trials. Achieving reliability for qualitative research generally depends on consistency. Achieving reliability can be highly challenging due to the fact that different interviews are unique in certain ways. The variation can be brought about by the differences between interviewees, the data that are collected and the manner in which the data are interpreted. However, the problems can be reduced by adopting a number of interventions which include carrying out one-on-one interviews using interview questions which are standardized and can generate the highest reliability.

3.5.7 Validity

Validity can be defined as the degree to which the research instrument measures exactly what it aimed to measure (Creswell, 2009). Validity also assesses whether the research instrument gives a truthful and correct answer to the research problems. Validity in qualitative research can also apply to the “appropriateness” of the research processes, tools, and data (Creswell, 2009). Validity points out how sound a given research is. Specifically, validity applies to the methods and to the design of the given research. Ramabitsa (2014: 51) states that “for some qualitative researchers, validity serves as the key evaluative criterion that refers to the correspondence between what is reported, and the social phenomena under study”.

3.5.8 Ethical considerations

Qualitative research involves human participants and therefore, there was the need to ensure that various ethical concerns were adequately addressed. When carrying out research on human subjects, it is essential to minimize risks and harm to the research

participants. Ethical considerations ensure respect for human dignity, privacy of the research participants, and autonomy.

In this research study, the researcher obtained informed consent from those who were interviewed. Informed consent is needed in all research which uses human participants. The consent to take part of the research clearly points out the research purpose and what the information collected will be used for. The researcher made sure that the interviewees were provided with comprehensive information regarding the aim of the research and why they were being interviewed. Participation was voluntarily and no one was forced to take part in the research. The researcher also ensured that confidentiality and anonymity would be maintained. The ethical duty of confidentiality encompasses obligations to protect information obtained from the interviewees from unauthorized use, access, disclosure, theft, modification or loss. With regard to confidentiality, the researcher ensured that the information which the interviewees provided was undisclosed and only restricted to the research study.

3.6 SUMMARY

In this chapter the research methodology adopted for this study was discussed, the population was identified, the sample was justified and the design was explained. The research design adopted for data collection is that of a qualitative method with the use of an interview guide as a data collection tool and the design for data analysis purposes. In the next chapter data as collected will be presented and analysed.

4 CHAPTER 4: PRESENTATION AND INTERPRETATION OF DATA

4.1 INTRODUCTION

Chapter 3 provided the research methodology which was used in the research study. The key aspects which were discussed were the research paradigm, the research design, research population, the sampling technique adopted, the sample size, and the methods used for the purpose of data collection.

In this research, a semi-structured interview was conducted in the two municipalities that were selected for this study. Phago (2010: 321) maintains that semi-structured interviews allow follow-up questions to be posed to respondents. This method was chosen as it supported the effort of the researcher to gain information regarding the experience of the participants in their environment of work. Semi-structured interview guides with a sequence of themes as well as a set of suggested questions were developed in advance to steer and guide the interview (Phala, 2017: 81).

Data were collected from eight participants in the selected municipalities and analysed using a framework matrix. According to Gale *et al.*, (2013: 2), the framework approach falls within a broad family of analysis methods often termed thematic analysis or qualitative content analysis. It involves summarizing and analysing qualitative data in a table of rows and columns, which allows for making connections within and between participant and categories as well as sorting data by theme. Smith and Firth (2011: 2) assert that the principles of the framework approach can be used to undertake qualitative data analysis systematically, this ensures that data analysis is explicitly described to enhance the credibility of the findings. The advantage of this procedure is that the outcomes are visualized to the analyst, thereby making it easier to maintain an overview of the outcomes (Groenland, 2014: 5).

This chapter presents and interprets the results based on the responses which were obtained from the research participants. Data analysis was conducted in accordance with the research objectives. A summary of the responses of interviewees is provided in line with themes as outlined in the interview guide (Appendix B). Table 4.1 presents the key staff complement interviewed from the selected municipalities.

Table 4-1: List of interview participants

Key staff complement-interview participants	
Setsoto local municipality	Nketoana local municipality
Accountant	Chief Financial Manager
Chief Internal auditor	Internal auditor
Manager: Corporate services	Manager: Local Economic development and Tourism
Manager: Planning and performance management	Manager: Expenditure

In order to present information in a clear and interpretable form that would address the research problem, data analysis in this research was conducted in accordance with the research objectives. According to *Gale et al.*, (2013), there are 7 stages of data analysis using the framework matrix:

- Transcription – According to *Gale et al.* (2013: 4), good quality audio recording and, ideally, a *verbatim* (word for word) transcription of the interview is needed. Phala (2017: 87) asserted that the researcher must read the transcripts in their entirety several times to acquaint her/himself with the concepts used by participants in the interviews
- Familiarization with the interview – It is important that the researcher become familiar with the text being analysed. Immersion in the data can ensure an accurate data analysis (*Gale et al.*, 2013: 4)
- Coding – After familiarizing her/himself with the data, the researcher can begin to code the data. This involves reading the transcript line by line and applying ‘codes’ to passages in the data. In a deductive approach, the researcher will seek data which corresponds with the pre-defined themes
- Developing a working analytical framework – *Gale et al.*, (2013: 4) specifies that a researcher must develop a framework for analysis based on the codes that have been identified
- The last step is applying the analytical framework (*Gale et al.*, 2013: 5).

4.2 RESEARCH THEMES AND SUB-THEMES

Information outlined in the literature study, as well as data gathered from the interviews were broken down into smaller meaningful units, the units were combined into themes that address the research question. Five themes and their corresponding sub-themes were identified and are presented in Table 4.2.

Table 4-2: Themes and sub-themes in the research

THEMES	SUB-THEMES
Theme 1: Accounting and reporting weaknesses	<input type="checkbox"/> Adequacy of the financial transactions and accounting reports <input type="checkbox"/> Adherence to financial reporting frameworks <input type="checkbox"/> Misstatements in the financial statements <input type="checkbox"/> Spending and budget allocation
Theme 2: Internal control	<input type="checkbox"/> Effective integrated internal control system <input type="checkbox"/> How internal control weaknesses are addressed <input type="checkbox"/> Contribution of internal audit functions to the quality of audit outcome <input type="checkbox"/> Management's duty to address findings and recommendations identified in previous audits and develop action plans. <input type="checkbox"/> Risk assessment
Theme 3: Financial accountability	<input type="checkbox"/> Prevention of unauthorized, irregular, fruitless and wasteful expenditure <input type="checkbox"/> Adherence to supply chain management policies and procedures <input type="checkbox"/> Record keeping procedures
Theme 4: Audit on predetermined objectives	<input type="checkbox"/> Level of effectiveness of M&E <input type="checkbox"/> Link between M&E systems and the audit processes <input type="checkbox"/> Governance system at the municipality
Theme 5: Compliance Audit	<input type="checkbox"/> Compliance with legislation and applicable laws <input type="checkbox"/> Compliance with MFMA requirements <input type="checkbox"/> Use of financial policies to avoid unauthorized and irregular expenditure <input type="checkbox"/> Recovery of unauthorized, irregular, fruitless and wasteful expenditure <input type="checkbox"/> Principles of transparency, accountability and good governance

The Framework Method is appropriate for thematic analysis of textual data, particularly interview transcripts, where it is important to be able to compare and contrast data by themes across many cases, while also situating each perspective in context by retaining

the connection to other aspects of each individual’s account (Gale *et al.*, 2013: 6). A summary of the responses of interviewees is provided in line with each of the study objectives and the themes are also outlined in the interview guide. Data analysis and interpretation of the results are outlined in the framework matrix below based on the objective of the research. For the purpose of anonymity, the names of the municipalities will be referred to as “A” and “B”.

Primary objective: To establish the perceived challenges relating to qualified audit reports in the two municipalities;

4.3 THEME 1: ACCOUNTING AND REPORTING WEAKNESSES

The first theme sought to explore the adequacy of the financial transactions and accounting reports, adherence to financial reporting frameworks, misstatements in the financial statements, challenges during report submissions, spending and budget allocation. Table: 4-3 illustrates responses from interviewees with regard to accounting and reporting weaknesses.

Table 4-3: Responses relating to accounting and reporting weaknesses

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY A	MUNICIPALITY B
Accounting and reporting weaknesses	The municipality has the capacity to compile Annual Financial Statement	AFS is prepared by external consultants	The municipality prepares the AFS
	The financial statement is prepared, in accordance with the financial reporting framework.	AFS is compiled using GRAP and mSCOA	AFS is compiled using GRAP and mSCOA
	The municipality provides assurance that the financial statements are free from misstatements prior to submission to the Auditor General	The municipality utilises the services of external consultants, the Audit committee, municipal council for quality assurance	The municipality utilises the services of external consultants, the Audit committee, municipal council for quality assurance
	The Annual Financial Statements are submitted to the Auditor-General two months after the start of a new financial year	The municipality did not submit the AFS according to the prescribed timelines	The municipality met the submission deadline

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY A	MUNICIPALITY B
	The municipality should ensure that expenditure is aligned with the allocated budget	Expenditure is aligned with the budget	Expenditure is aligned with the budget

4.3.1 Sub-theme: Adequacy of the financial transactions and accounting reports

When the research participants were asked whether they think that the municipalities have the capacity to submit adequate financial transactions and accounting reports, all of the respondents (4) from municipality A and one (1) from municipality B stated that they believe that the municipalities have the capacity to submit adequate financial transactions and accounting reports. Three (3) respondents from municipality B stated that the municipality does not have the capacity to submit adequate financial transactions and accounting reports.

The respondents agreed that Municipality A and Municipality B have the capacity to prepare the Annual Financial Statements (AFS). In municipality A, the services of compiling an AFS were outsourced to a consultant, while municipality B used the internal capacity to compile the AFS, with the service of the consultants only being accessed for quality assurance.

One aspect that was of concern was the late submission of the AFS. A respondent from municipality B reported that the municipality does not always comply with the deadline for submission of the financial report to the AG, as it is a requirement that it is submitted by the end of the second month after the beginning of the municipal financial year. She further mentioned that there were also instances when the Audit committee sat, and the annual report submitted to the Audit committee was incomplete, meaning that the documents could not be finalized by the due date. A respondent from municipality B further pointed out the challenge of absenteeism, wherein officials would take leave without assigning other people to act or handing over the work to someone to complete while they were away. There appears to be a lack of accountability.

A respondent from municipality A highlighted challenges with technicality issues and information which is complex for officials to comprehend when compiling the AFS, indicating a need for training pertaining to the compilation of the AFS.

4.3.2 Sub-theme: Adherence to financial reporting frameworks

When the respondents were asked whether the financial statements were prepared in accordance with the financial reporting framework, and requested to comment on the extent to which the municipality followed the prescribed guidelines for submission of financial reports, all eight (8) respondents agreed that the financial statements are prepared in accordance with the financial reporting framework. They also agreed that the municipalities follow the prescribed guidelines for the submission of the financial reports. Municipalities in South Africa prepare Financial statements in accordance with the Generally Recognised Accounting Practice (GRAP), which is a financial reporting framework designed to standardise the reports submitted the Auditor-General of South Africa (IRBA, 2012). Whilst auditing the financial statements, the Auditor-General checks whether the financial statements adhere to the financial reporting framework (Ncgobo & Malefane, 2017).

It was established that financial reporting in both municipality A and B is done using the Municipal Standard Chart of Accounts (mSCOA). The mSCOA is a digital system developed by the National Treasury with the aim of standardising financial reporting in municipalities. A respondent in municipality B reported that Setsoto local municipality was one of the municipalities that was used for piloting mSCOA. It seems, however, that the municipalities are still experiencing challenges in using the mSCOA. Based on the feedback from three (3) respondents in municipality A, the system was not completely understood by the users, as there were challenges experienced with administering certain components of the GRAP. In addition to capacity constraints experienced by the users of the system, the respondents were also aware that the Auditor could pick up these discrepancies in the AFS and issued an opinion based on the misstatements in the AFS.

4.3.3 Sub-theme: Misstatements in the financial statements

When the respondents were asked about the manner in which the municipalities provide assurance that the financial statements are free from misstatements, all the respondents indicated that external financial consultants are always hired in order to ensure that the statements are free from any kind of misstatement. In addition, most of the respondents indicated that there are also internal control systems headed by the audit committee who check the statements to ensure that they are free from any kind of misstatement. The responses from the research participants were as follows: Seven (7) out of eight (8) respondents reported that the structures are in place to provide due diligence and quality

assurance on the AFS prior to submitting to the Auditor -General. The quality assurers are the Chief Finance Officer (CFO), the Municipal Manager (MM), the Municipal Council (MC), and the Audit Committee (AC). According to the respondents, the appointed financial consultants assist in checking all the financial statements and advise where needed on matters of misinterpretation in order to give the necessary assurance before submission. A respondent from municipality B reported that there was an incident where the municipality could not provide the supporting documentation to substantiate the information that was reported in the AFS. The supporting documentation included the information from the bank. The reason provided by the municipality was that the documentation was lost during flooding in the premises of the municipality.

4.3.4 Sub-theme: Spending and budget allocation

When the respondents were asked whether the spending in the municipality is aligned to the budget allocation, six (6) of the respondents indicated that the spending at the municipality is always aligned to the budget allocation. Two (2) respondents stated that spending is not always in accordance with the budget that is available.

Respondents reported that procurement is done in accordance to the prescribed guidelines. A respondent from municipality B declared that spending on the target objectives is aligned to Service Delivery and Budget Implementation Plans (SDBIP) and further mentioned that if there are unplanned expenditures which seem to be irregular, unauthorized and fruitless, they are recorded in a report and that report is submitted to the municipal council after being investigated by the Municipal Public Account Committee (MPAC) structure.

According to the information related by the six (6) respondents who were requested to describe how spending is aligned with the budget allocation, “the officials in the municipalities are required to submit an approved request form to the supply chain management unit whenever they procure for good and services, the budget office determines whether there is budget available before approval is granted”. All eight (8) respondents agreed that supply chain management processes were being followed during procurement of goods and services. However, two (2) respondents from municipality B pointed out to instances where due processes were not applied, due to unforeseen and unexpended circumstances, and these were treated as “irregular expenditure”. One respondent in municipality A recommended that these incidents should be recorded and reported to the Accounting Officer, the municipal council, and subsequently to the Municipal Public Accounts Committee, to further investigate the

matter. Based on the merit of the case, the MPAC should then recommend action or condone the matter.

4.4 THEME 2: INTERNAL CONTROL

The second theme aimed to explore various aspects concerning internal control. The main sub-themes include the presence of an integrated internal control system, monitoring of inefficiencies at the municipality, how internal control weaknesses are addressed at the municipality, effectiveness of internal audit functions, the contribution of internal audit functions to the quality of audit outcome, and risk assessment at the municipalities. The responses obtained from the interviews are outlined in Table 4.4.

Table: 4-4: Responses relating to internal control

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY A	MUNICIPALITY B
Internal control	The municipality must develop an integrated internal control system.	The internal control system is in place	The internal control system is in place
	The Municipality must monitor the effectiveness of the internal control system.	Monitoring not effective	Systems are in place to monitor the implementation of internal control
	The internal audit function must be effective in contributing to the quality of the audit outcome.	Lack of capacity to carry out the functions effectively	Effective and efficient internal audit function
	Management must address findings and recommendations identified in previous audits and develop action plans.	Findings are discussed in management meetings and the municipality prepares a recovery plan	Findings are discussed in management meetings and the municipality prepares a recovery plan
	The internal audit function must conduct a risk assessment to mitigate risks.	Risk management system not effective because of vacant positions	The municipality carries out the risk assessment and has a risk management committee

4.4.1 Sub-theme: Effective integrated internal control system

When the respondents were asked whether the municipalities have an integrated internal control system, all eight (8) respondents acknowledged that the municipalities have integrated internal control systems. The responses were reported as follows:

The four (4) respondents in municipality B mentioned that for internal control to be effective there has to be segregation of duties. There should be a person doing the work and others who authorize and approve the work. The respondents mentioned that procedures to be followed must be guided by policies and guidelines adopted by the municipalities. Respondents in municipality A shared the same sentiments and municipality A was reported to be following the same procedures.

4.4.2 Sub-theme: How internal control weaknesses are addressed

When the respondents were asked how the municipality addresses internal control weaknesses, the responses received varied. The four (4) respondents from municipality B could not adequately confirm the processes to manage and address weaknesses in control measures, while two (2) respondents from municipality A pointed out that disciplinary actions are always taken against those who do not adhere to internal control systems. When the respondents were asked how the municipality monitors inefficiencies in internal control, two (2) respondents from municipality A pointed out that the internal audit office is charged with the responsibility of ensuring that inefficiencies in internal controls are monitored.

4.4.3 Sub-theme: Contribution of internal audit functions to the quality of audit outcome

When the respondents were asked whether they find the Internal Audit Functions (IAF) effective, seven (7) out of eight (8) respondents reported that the internal audit functions were effective in conducting the IAF duties. However, all eight respondents believed that increased capacity and more human capital are needed to enhance the efficiency of the internal audit units. It was observed that in municipality A, there was a noticeable gap in the office of the internal audit. The office was functioning with only one official and an intern. The absence of management positions in municipality A made it difficult for the official to manage the load of work in the unit. Three (3) respondents from municipality A

indicated that the municipality was experiencing a high rate of vacancy, as the majority of the key positions in the municipality were unoccupied. It was established that municipality A was in the process of filling up the vacant positions. According to a respondent from municipality A, the organogram of the municipality has been revised and the municipality was in the process of putting up advertisements for the positions that were vacant.

When the respondents were asked whether the internal audit functions contribute to the quality of the audit outcome, four (4) respondents from municipality B and two (2) from municipality A were of the opinion that they did, while two (2) respondents acknowledged that certain challenges are being experienced, which hinder the internal audit functions from enhancing the quality of the audit outcomes. A respondent from municipality B reported that the internal audit unit experiences challenges when information is requested from officials. It was established that officials were often reluctant to submit information due to fear. A respondent stated that there was a lack of knowledge about the existence of the internal audit function in the municipality, and further noticed fear among the officials in general that reports submitted to the internal audit unit might be used against them, or used to assess their performance. She recommended that the municipality increase awareness about the role of internal audit functions in the municipality.

4.4.4 Sub-theme: Management's duty to address findings and recommendations identified in previous audits and develop action plans.

The eight (8) respondents from both municipality A and municipality B reported that when the Auditor-general issues the findings from the audited report, the findings are noted and brought before the management for their attention. The units that are responsible are tasked with responding to the findings of the Auditor-general. A respondent from municipality A further indicated that the municipality prioritises the audits in the monthly management meetings. Furthermore, they have gone as far as incorporating "audit" as a standing item in the monthly meetings. It was also expected that heads of the departments provide progress regarding implementation of AG recommendations.

4.4.5 Sub-theme: Risk assessment

When the respondents were asked whether either the municipality or the internal audit conducted risk assessment, all eight (8) respondents agreed that risks assessments are always conducted. Municipality A is reported to have a risk management plan and

strategy, and their audits are often guided by the risk assessment results. There is a Risk Management Committee that consists of directors in the municipality. The directors are referred to as risk owners, but there is an outside person who is chairperson of the Risk Management Committee. Risk owners report the identified risks on a quarterly basis to the accounting officer. After the risk owners have identified the risks and reported them to the accounting officer, the internal audit unit registers them in the risk register. The internal auditors conduct the audit, and they prioritise their work on managing these risks. One respondent in municipality B reported that the risk component is in the organogram of the municipality and located under the office of the municipal manager. It is also aligned with the functions of the internal audit. The acting manager in the internal audit unit is currently acting as risk officer and assisting with the operations of that unit.

4.5 THEME 3: FINANCIAL ACCOUNTABILITY

The third theme explored different aspects concerning financial accountability. The main aspects include prevention of irregular, fruitless and wasteful expenditure, measures to alleviate fruitless and wasteful expenditure, causes of irregularities, management of irregularities, and the effectiveness of record keeping procedures at the municipality. The responses obtained from the interviews are outlined in Table 4.5.

Table 4-5: Responses regarding financial accounting

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY A	MUNICIPALITY B
Financial accountability	A municipality must prevent irregular, fruitless and wasteful expenditure	Systems in place are not effective in preventing irregular, fruitless and wasteful expenditure.	Systems in place are not effective in preventing irregular, fruitless and wasteful expenditure.
	Supply chain management policies and procedures should be adhered to	SCM policies are available and are used during the procurement of goods and services	SCM policies and procedures are not completely observed
	The municipality must put measures in place to alleviate unauthorised, irregular or fruitless and wasteful expenditure	The municipality does put measures in place to alleviate unauthorised, irregular or fruitless and wasteful expenditure	Measures are in place to alleviate unauthorised, irregular or fruitless and wasteful expenditure
	The municipality must have a good record management system	Poor record management	Good record management and archive system

4.5.1 Sub-theme: Prevention of unauthorised, irregular, fruitless and wasteful expenditure

The research sought to explore some of the measures which the municipality has put in place to ensure alleviation of fruitless and wasteful expenditure. Based on the responses, it can be noted that while there are measures in place which are aimed at alleviating fruitless and wasteful expenditure, When the respondents were asked how irregular, fruitless and wasteful expenditure is prevented, all eight (8) respondents pointed out that there are different kinds of procedures, plans, and standards which ensure prevention of irregular, fruitless and wasteful expenditure.

A respondent from municipality A mentioned that the municipality complies with the required standards to minimise irregular, fruitless and wasteful expenditure. Another respondent further mentioned that if there is unplanned outlay which results in irregular, unauthorized and fruitless expenditure, a report to the council is prepared after investigation by the MPAC structure. A respondent from municipality B, however, reported that the municipality incurred an irregular expenditure which was detected by the Auditor-General in the 2016/17 financial year audit. The irregular expenditure was caused by the municipality not adhering to the payment timelines as required by the MFMA. The Municipal Finance Management Act (MFMA), 2003 (Act No. 56 of 2003), section 65, requires that the Accounting Officer take all reasonable steps to ensure that all money owed by the municipality be paid within 30 days of receiving the relevant invoice or statement. Both Municipality A and B have not complied with this provision in MFMA. A respondent from municipality A explained the consequences of the failure of the municipality to fulfil its debt obligations. He made reference to the debt owed to Eskom, a South African electricity public utility. According to the respondent, these arrears resulted in an accumulation of debt interests and charges.

Municipality A also experienced a challenge of cash flow as explained by a respondent from municipality A. As the municipality is unable to generate sufficient funds from ratepayers, this problem affects their operations because it becomes extremely difficult to maintain its cash balance.

4.5.2 Sub-theme: Adherence to supply chain management policies and procedures

When the respondents were asked whether the supply chain management policies and procedures are used when procuring goods and services. Five (5) respondents agreed that the SCM procedures are adhered to all times. It was mentioned that procurement processes were followed as there were guidelines from the SCM unit which were

followed. A respondent from municipality B mentioned that all departments in the municipality are advised to spend the budget in line with the targets as outlined in Service Delivery and Budget Implementation Plan (SDBIP).

A respondent from municipality A mentioned that the municipality developed containment measures to curb wasteful expenditure. The council issued directives to guide spending by the municipality indicating priority areas for spending, focusing on sustainable service to communities, not on “nice to have stuff”. An irregular, fruitless and wasteful expenditure register exists, where procurement processes and those expenditures are recorded, and the Municipal Manager checks as to whether they followed necessary processes.

The respondents from municipality B had a different view of the measures that are put in place to curb irregular, fruitless and wasteful expenditure. Three (3) respondents mentioned that some of the officials in the SCM unit do not follow SCM processes when requesting proposals or quotations from service providers. There seems to be a tendency by the officials to utilize the companies that are known to them, and they do not explore the market for services.

A respondent from municipality B reported a lack of consequence management. She was concerned that some of the transgressions in the municipality are not addressed. The respondent recommended that the municipality should have the policy to manage actions of misconduct by officials in the municipality.

4.5.2.1 Causes of irregularities

The research also sought to explore the causes of irregularities. Based on the responses which were obtained from the research participants, it could be noted that irregularities caused discrepancies in the financial statements. Two (2) respondents reported that municipality B had difficulties in reconciling their financial statements. According to the respondents, the information in the asset register was not aligned with the records in the general ledger where all the financial transactions that took place in the financial year are recorded. These irregularities resulted in an audit outcome with misstatements findings in municipality B.

4.5.3 Sub-theme: Record keeping procedures

When the respondents were asked whether the current record keeping procedures are highly effective in assisting the municipalities in maintaining good records, the four (4) respondents from municipality A noted that while there are procedures in place, they are

not highly effective in ensuring that proper records are maintained. The other four (4) participants from municipality B were satisfied with the record keeping in the municipality. A respondent from municipality B mentioned that the municipality has a good record system. She said that the municipality has a division called “Administration and council support”, where all the documents are archived. Each department is required to have a copy of all the documents that will be archived. A respondent from municipality A reported an incident in the past where the municipality could not account for the information recorded in the financial statements because the supporting documents were lost during flooding.

4.6 THEME 4: AUDIT OF PREDETERMINED OBJECTIVES

The main sub-themes include the level of effectiveness of Monitoring & Evaluation (M&E), the link between M&E systems and the audit processes, the governance system at the municipalities, and the internal performance assessment at the municipalities. The responses which were obtained from the research participants are outlined in Table 4.6.

Table 4-6: Responses regarding the audit of predetermined objectives

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY (A)	MUNICIPALITY (B)
Audit of predetermined objectives	The municipality must have monitoring and evaluation systems that are effective	Monitoring and evaluation system available	Monitoring and evaluation system available
	Monitoring and evaluation systems in the municipality must be aligned with the audit requirements	The system is not aligned with audit requirements	The system is not aligned with audit requirements
	The municipality must have effective governance and management support	Political and administrative structures are available but not effective	The political structures are available, the composition needs to be reviewed
	There should be an effective performance management system in the municipality	The performance management system applies to directors only.	The performance management system applies to directors only

4.6.1 Sub-theme: Level of the effectiveness of M&E

When the research participants were asked about the level of effectiveness of the system of monitoring and evaluation in the municipalities, six (6) participants believed that the Monitoring and Evaluation (M & E) systems at the municipalities are not effective as they do not generally improve performance, while two (2) participants from municipality A were satisfied with the M & E system.

A respondent from municipality A mentioned that the Performance Management System (PMS) function is based under the office of the municipality manager. He pointed out that the PMS was effective; however, the performance assessment processes, which are part of M & E system, focus only on the overall performance of the departments and not individuals. A respondent further added that it was only directors of the departments who were assessed for performance and not subordinates who directly report to them. The respondent pointed out that it was a general practice in the province, and that the Department of Cooperative Governance and Traditional Affairs (COGTA) had instructed that only Directors be assessed. Regarding municipality B, a respondent mentioned that the performance management system had over the years been focusing on senior management. It was only recently that the municipality took a decision to cascade it down to the level of supervisors.

4.6.2 Sub-theme: The link between M&E systems and the audit processes

When the respondents were asked whether the M&E systems are linked to the audit processes, the two (2) respondents from municipality (B) stated that it was linked, while two (2) from the same municipality and four (4) respondents from municipality A stated that it was not linked.

Concerning municipality B, a respondent reported that the municipality introduced a performance indicator within performance agreements of managers, indicating a percentage reduction of the audit findings, meaning that the managers have to put measures in place to ensure a reduction in the number of findings issued by the AG.

4.6.3 Sub-theme: Governance system at the municipality

When the respondents were asked to briefly describe the governance system in the municipalities, three (3) respondents from municipality B considered the structures that are present in the municipality sufficient to address governance-related matters, while

four (4) respondents from municipality A and one (1) from municipality B do not believe that they are effective. One respondent from municipality A believes that there is a problem with governance especially when it comes to the skills in the municipality.

According to a respondent from municipality A, “Officials are appointed to certain positions, but do not have the necessary skills to perform duties related to those positions”. He further expressed his concern regarding the level of incompetency in the municipality. He mentioned that COGTA conducts skills auditing on a quarterly basis and provides a report and recommendations, but the municipality needs to follow up on those recommendations.

4.7 THEME 5: COMPLIANCE AUDIT

The last theme sought to explore various aspects regarding the compliance audit. The main sub-themes include compliance with MFMA requirements, monitoring of non-compliance, use of financial policies to avoid unauthorized and irregular expenditure, and the principles of transparency, accountability and good governance at the municipality. The responses are outlined in Table 4.7.

Table 4-7: Responses regarding compliance audits

AUDIT REQUIREMENT	MINIMUM REQUIREMENT	MUNICIPALITY A	MUNICIPALITY B
Compliance audit	Compliance with legislation and applicable laws	The municipality is complying with applicable laws and regulations	The municipality is complying with applicable laws and regulations
	The municipality must ensure compliance with the MFMA.	The municipality has an MFMA timetable and activities to ensure compliance	The municipality complies with the MFMA
	The municipality must recover unauthorised, irregular or fruitless and wasteful expenditure	The municipality is not putting effort to recover the unauthorized, irregular, fruitless and wasteful expenditure	The municipality is not exerting effort to recover the unauthorized, irregular, fruitless and wasteful expenditure
	The municipality subscribes to the principles of transparency, accountability, and good governance	The municipality follows prescribed processes to enhance transparency and accountability	The municipality is not exerting effort to recover the unauthorized, irregular, fruitless and wasteful expenditure

4.7.1 Sub-theme: Compliance with legislation and applicable laws

When the respondents were asked what legislation they consider in their line of work, the most common answer was the Municipal Finance Management Act. And all eight (8) respondents believed that the municipalities comply with legislation and applicable laws

4.7.2 Sub-theme: Compliance with MFMA requirements

The respondents were asked whether the municipalities comply with the requirements of the MFMA and how they would rate the municipalities in terms of this compliance on a scale of one to three (1 = low, 2 = medium, 3 = high). Six (6) of the respondents, two (2) from municipality A and four (4) from municipality B, noted that the municipalities comply and rated the compliance at 2. Two (2) respondents from municipality A rated a score of 3. The two (2) respondents from municipality A mentioned that the municipality placed a high priority on compliance with the MFMA. According to the respondents, the municipality has an MFMA timetable with activities which are identified and implemented on an annual basis

4.7.3 Sub-theme: Use of financial policies to avoid unauthorized, irregular, fruitless and wasteful expenditure

When the respondents were asked how the municipalities ensured that fiscal policies were utilized to avoid unauthorized, irregular, fruitless and irregular expenditures, they noted that there were various financial policies, which were often reviewed periodically.

The respondents from municipality A mentioned that review of relevant policies and amendments is done on the regular basis. They also mentioned that accountability reports are compiled and consequence management policy is applied to the sections and departments that have committed the expenditure. The report is sent to relevant structures mentioned previously.

4.7.4 Sub-theme: Recovery of unauthorized, irregular, fruitless and wasteful expenditure

When the respondents were asked how the municipalities recover unauthorized, irregular or fruitless expenditure from the person liable from the expenditure, the four (4) respondents from municipality A and one (1) respondent from municipality B indicated that there was a section 32 committee entrusted with the power to investigate these types of cases. Three (3) respondents from municipality B said the municipality did not make efforts to recover money from the officials. The two (2) respondents from municipality A

mentioned that the systems put in place to recover the unauthorized, irregular, fruitless and wasteful expenditure have not been effective. It was only recently that the recorded irregular expenditures were taken to council based on the recommendations from the action plans that were compiled during management meetings. All previous financial years' reports of unauthorized, irregular or fruitless expenditure were only assessed in this financial year.

4.7.5 Sub-theme: Principles of transparency, accountability, and good governance

When the respondents were asked whether they thought the municipalities were abiding by the principles of transparency, accountability, and good governance, the four (4) respondents from municipality A and three (3) respondents from municipality B stated that municipalities abide by the principles of transparency, accountability, and good governance and only one (1) respondent from municipality B was not certain that they were effective.

According to the respondents from municipality A the municipality abides by those principles. They mentioned that the municipality has a website where reports, notices, and contracts awarded are published. Annual reports also appear on the website and in local newspapers.

4.8 SUMMARY

Chapter 4 presented data collected through semi-structured interviews. Data was analysed using a framework matrix. A summary of the responses of interviewees was provided in line with themes as outlined in the interview guide. The study followed a phenomenological approach, whereby the respondents expressed views and experiences pertaining to a particular phenomenon, thereby providing a clear understanding of perceived challenges relating to audit reports in the municipalities.

5 CHAPTER 5: DISCUSSIONS AND FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 INTRODUCTION

Chapter 4 provided information which was gathered from a sample group of individuals through extensive interviews which were conducted in their professional space. This procedure provided a detailed presentation of valuable data, which ensured that the findings of the research could be comprehensive. A total of eight respondents were interviewed. The data was transcribed and the resulting information has been presented and thematically analysed.

This chapter provides an analysis of the findings from the data that was presented in the previous chapter, and it outlines how the findings have achieved an objective of the research study. The purpose of this study was to assess the factors that relate to the qualified audit reports in two municipalities. In this analysis of the findings, the purpose was to determine the main contributors to the unfavourable audit outcome.

5.2 FINDINGS AND DISCUSSION

The findings are outlined according to the objectives of the research.

Primary objective: To establish the perceived challenges relating to qualified audit reports in the two municipalities

In order to obtain information pertaining to objective of this research, the analysis of the findings will be based on the themes and sub-themes that were developed as part of data collection in the research. This approach was selected to facilitate analysis of the results. The municipalities will be referred to as municipality A and municipality B to maintain the anonymity of the participants.

5.3 THEME 1: ACCOUNTING AND REPORTING WEAKNESSES

5.3.1 Sub-theme: Adequacy of the financial transactions and accounting reports

The first theme mainly aimed to explore the accounting and reporting weaknesses in the municipalities. Various aspects of the weaknesses in the accounting and reporting were examined. The sub-themes aimed to look at the adequacy of the financial transactions and accounting reports, adherence to financial reporting frameworks, misstatements in the financial statements, and challenges during report submissions. Based on the interview responses, it can be stated that the municipalities do not have the capacity to submit adequate financial transactions and accounting reports.

Regarding municipality A, the respondents reported that one of the reasons the municipality obtained a “Disclaimer audit report” during the 2016/17 audit, was the non-submission of the Annual Financial Statement to the Auditor- General. This is viewed as a serious contravention of the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003),) as well as the Public Audit Act, 2004 (Act 25 of 2004), As discussed in the literature review, it is a legislative requirement that municipalities submit the audit report as stipulated in Section 14 (1) of the Public Audit Act, 2004 (Act 25 of 2004), which clearly states that financial statements submitted to the AG by an auditee (municipality) must be submitted within two months subsequent to the end of every municipal financial year. The Municipal Finance Management Act, 2003 (Act No. 56 of 2003), also stresses the obligation of the Auditor-General to audit and report on the accounts, financial statement, and financial management of each municipal entity.

The respondents pointed out to a certain circumstance that resulted in a disclaimed audit opinion. The municipality did not have the supporting documentation needed to substantiate the information that was recorded in the AFS. The respondents alluded to the fact that “The bank statements and other documents were lost when there was flooding in the municipal offices”. The municipality did not make any backup of the original documents. These findings confirm the challenges of poor record management in municipalities as spelled out in paragraph (2.10.5) of the literature review. Poor record management was seen as a contributor to the unfavourable audit outcome. When conducting audits, the auditor is expected to obtain appropriate evidence that supports the information presented by the auditee (municipality). Failure to submit such evidence resulted in a situation where the auditor was unable to provide the basis for an opinion

on the financial statement submitted by municipality A. The findings confirm an inadequacy in the financial transactions and accounting reports.

5.3.2 Sub-theme: Misstatements in the financial statements

The research also aimed to explore whether the municipalities prepare the financial statements in accordance with the financial reporting framework, and the extent to which the municipalities follow the prescribed guidelines for submission of financial reports. A question was also posed to the respondents concerning the manner in which the municipality provides assurance that the financial statements are free from misstatements. All the respondents indicated that external financial consultants are always hired in order to ensure that the statements are free from any kind of misstatement.

The findings indicate that the financial statements are prepared in accordance with the financial reporting framework. Respondents also agreed that the municipalities follow the prescribed guidelines for the submission of the financial reports. The findings also indicate that both municipality A and municipality B provide assurance that the financial statements are free from misstatements by having in place external financial consultants who check the statements. However, the quality of service provided by the consultants is questionable.

The study discovered that Municipality B received an “Unqualified audit opinion with financial misstatements” meaning that the auditors found omissions or misstatements in management’s presentation of the financial statements. Although it is not a qualified audit opinion, it does not meet the standard or fall under the category of a “clean audit”, which according to the Auditor-General of South Africa (2013) is the highest outcome available from the audit process. It is obtained when the auditor strongly believes that the financial statements contain no material misstatements and that there are no findings raised on either the reporting on predetermined objectives or non-compliance with legislation aspects of government (Auditor-General of South Africa, 2013: 28).

The lack of proper reconciliation of the financial report resulted in errors and misstatements, thereby confirming the inefficiency in financial statement and accounting reports as stated in paragraph (2.61) of the literature review. What raises concerns about this matter is that both municipality A and municipality B, outsourced the services to consultants to provide assurance on the Annual Financial Statements. It is then expected that these municipalities would obtain a clean audit opinion. One could, therefore,

speculate whether any value was derived from the services of the consultants. This finding is in line with the comment made by the Auditor-General of South Africa (2018) regarding the reliance of municipalities on consultants.

Secondary objective (a): To determine the extent of official capacity and competency in managing the challenges in the two municipalities in relation to audits;

5.4 THEME 2: INTERNAL CONTROL

5.4.1 Sub-theme: Effective integrated internal control system

Various aspects of internal control were explored in this section. The main sub-themes include the effective integrated internal control system, how internal control weaknesses are addressed in municipalities A and B, and the contribution of internal audit functions to the quality of audit outcome, and risk assessment in the municipalities. The findings of the research indicated that both municipality A and B have in place an integrated internal control system. However, the findings identified the weakness in internal controls.

The Committee of Sponsoring Organisations (COSO, 1992), detailed the internal control's characteristics as "maintaining an effective control environment, risk assessment, control activities, communication, and monitoring". The respondents indicated that the municipalities address internal control weaknesses through various kinds of disciplinary actions against those who do not adhere to internal control systems.

The internal control system must identify, mitigate, manage and control risks which may hamper the operation of the municipality. Managing risk is the responsibility of management. Once again weaknesses in internal controls were experienced in Municipality A with "missing bank files" due to flooding. Such incidences could generally be regarded as negligence or failure by management to mitigate risks.

5.4.2 Sub-theme: Contribution of internal audit functions to the quality of the audit outcome

With regard to the effectiveness of the internal audit functions, the findings of the research indicated that they are not as effective as they ought to be. Concerning the

contribution of internal audit functions to the quality of audit outcome, while the respondents indicated that the internal audit functions contribute to the quality of the audit outcome, there are certain challenges which inhibit the internal audit functions from enhancing the quality of the audit outcomes. The capacity and vacant positions in the municipality contribute to the effectiveness of the internal audit function. In Municipality A the internal audit unit is run by one official with the assistance of an intern. With limited manpower in the internal audit unit, the officials are unable to carry out their functions effectively.

The findings of the research confirm the discussion in paragraph 2.10.2 of the literature review, where the Auditor-General of South Africa (2018:87) pointed out the importance of effective monitoring and oversight by all assurance providers (Internal Auditors) in providing independent assurance on internal controls, financial information, risk management, performance management and compliance with legislation. Therefore the ineffectiveness of the internal audit function and the failure of the management to mitigate risks can be regarded as contributors to the unfavourable audit outcome. The same sentiments were echoed by Mamaile (2018: 60), indicating that assessments and reporting on the organisation's risk management process should be a high priority of every internal audit function in the municipalities.

5.5 THEME 3: FINANCIAL ACCOUNTABILITY

5.5.1 Sub-theme: Prevention of unauthorised, irregular, fruitless and wasteful expenditure

The third theme explored different kinds of aspects concerning financial accountability. The main aspects include prevention of unauthorised, irregular, fruitless and wasteful expenditure, measures to alleviate unauthorised, irregular, fruitless and wasteful expenditure, causes of irregularities, and the effectiveness of record keeping procedures at the municipality. The findings of the research indicate that the municipalities prevent irregular, fruitless and wasteful expenditure by having in place different kinds of procedures, plans, and standards. Their effectiveness can, however, be questioned based on the responses from the research participants. While the municipality has in place various kinds of measures aimed at alleviating fruitless and wasteful expenditure, they are not very effective due to factors like lack of consequence management.

The challenge of unauthorised, irregular and fruitless and wasteful expenditure was also highlighted in the 2016/17 audits of the Free State province. The Auditor-General of

South Africa (2018) reported the following concerning the audit finding in the Free State municipalities: “The main findings were related to material adjustments to the financial statements, the inadequate management of expenditure as well as unauthorised, irregular and fruitless and wasteful expenditure not being prevented” (Auditor-General South Africa, 2018: 55). This goes to show the impact of the occurrence of the unauthorised, irregular and fruitless and wasteful expenditure on the outcome of the audit.

In addition, three of the respondents raised their concerns regarding the lack of consequence management in the municipalities. Concerning municipality A, a participant stated that a lack of consequence management was the main catalyst to many transgressions in the municipality. All respondents agreed that the two municipalities have systems in place to address the violation of laws and regulations. Furthermore, structures and various committees have been established to manage the occurrence of such incidents, and these committees include the Municipal Public Account Committee (MPAC), the Municipal Council, and the Financial Disciplinary Board (FDB). However, it appears that disciplinary mechanisms that are put in place by these structures to deal with these challenges are not effective.

The AG raised concerns regarding the failure of the council to conduct the required investigation into all instances of unauthorised, irregular and fruitless and wasteful expenditure which were reported in the 2015/16 financial year (The Auditor-General of South Africa, 2018: 2). For that reason, the research findings agree with these observations that the management structures that are in place are not adequately executing an oversight role as discussed in Paragraph (2.10.2).

These findings were also confirmed by some of the studies where weaknesses in municipalities were attributed to a lack of accountability by political and administrative leadership in the municipalities (Madumo, 2012; Van Niekerk & Dalton-Brits, 2016; AGSA, 2018).

One of the contributors to the irregular expenditure, as revealed by the respondents from both municipality A and municipality B, was the inability of the municipality to maintain a cash flow. This was as a result of municipalities failing to collect sufficient revenue from the ratepayers to sustain their cash flows.

The Municipal Finance Management Act (MFMA), 2003 (Act No. 56 of 2003), section 65, stipulates that the Accounting Officer must take all reasonable steps to ensure that all money owing by the municipality be paid within 30 days of receiving the relevant invoice

or statement. Deloitte (2014: 5), in their report, advised that the financial health of local government is highly dependent on the ability of municipalities to earn and collect revenue in order to maximise capacity for consistent and sustainable service delivery to communities.

A second contributor to the irregular expenditure, as pointed out by a respondent, was the accumulated interest from the debt that is owed to Eskom for the provision of electricity. Due to bad management practices in the municipalities, the majority of the municipalities in the country have over the years not made payments to Eskom. This resulted in the accumulation of interests and charges relating to the debt.

To date municipalities are still struggling with their finances as a significant percentage of the budget is used to pay for interests and penalties acquired in the Eskom debt. Such irregularities and discrepancies are picked up by the Auditor General upon the submission of the municipalities' financial statement and such irregularities contribute to the inadequacy in the financial statements.

5.6 THEME 4: AUDIT ON PREDETERMINED OBJECTIVES

5.6.1 Sub-theme: Level of effectiveness of M&E

The main sub-themes include the level of effectiveness of M&E, the link between M&E systems and the audit processes, the governance system at the municipality. The research indicates that the monitoring and evaluation systems at the municipalities are generally not effective and the performance management systems are not linked to audit processes. The findings of the research reveal that the municipalities conduct internal performance assessment but only on directors of the departments. This leaves the remainder of the officials not being assessed for the work they perform in the municipalities. The findings furthermore indicated that poor performance was caused by a general lack of knowledge and skills. The findings of the research indicated that the officials in the municipalities generally have neither the relevant educational qualifications nor an adequate understanding of MFMA. This was validated by the respondent who revealed the challenges arising from lack skills in municipality A. According to the respondent, there have been instances where he had to perform tasks that were not in his field of expertise. As a financial manager in the municipality, he has in the past performed the duties of an engineer to make up for the lack of skills in that particular unit in the municipality.

These findings are in line with the findings of research by Khanyile (2016), which mainly aimed to evaluate financial control, accountability, and financial reporting at Umtshezi Municipality. The researcher recommended that the municipality avail funds to be used for training the employees. The need for the national treasury to carry out consistent monitoring and support of the municipalities was also emphasized. This need for support was also revealed in the current study when the respondents expressed their frustrations in the implementation of the municipal Standard Chart of Accounts (mSCOA), a digital system developed by the national treasury with the aim of standardising financial reporting in municipalities. Municipality A was reported to be still battling with the technicalities that come with the implementation of mSCOA. Initially, when the system was introduced, municipalities were provided with training on the system. However, as has been seen with many information technology systems, there is always a need for regular training and monitoring of the system.

Secondary objective (b): To investigate the level of compliance with MFMA by officials in the two municipalities in relation to audits

5.7 THEME 5: COMPLIANCE AUDIT

5.7.1 Sub-theme: Compliance with legislation and applicable laws

The last theme sought to explore various aspects regarding the compliance audit. The main sub-themes include compliance with MFMA requirements, monitoring of non-compliance, use of financial policies to avoid unauthorized and irregular expenditure, procurement based on supply chain regulations, recovery of unauthorised, irregular expenditure and the principles of transparency, accountability and good governance at the municipality. The legislation that plays a key role in the management of finances in the municipalities is the Municipal Finance Management Act (MFMA). The municipalities also use various policies to maintain consistency and guide the activities in the municipalities.

The relevant finding indicates that during the procurement of goods, services, and works, the municipalities utilise the supply chain regulations. It was noted that even though the municipalities follow SCM processes to procure goods and services, there were instances where they did not fully comply with the principles of SCM regulations. One of the flaws picked up in the municipality was the sourcing procedure

followed in the SCM process. It was revealed that the SCM officials do not always adhere to basic procedures when they solicit the services of a potential supplier or a contractor. One of the respondents went as far as condemning the manner in which the service providers are accessed by the municipality. Municipality B was found to favour certain companies or utilize the service providers that are known to them, contributing to a “conflict of interest”. The respondents recommended that the municipality make a concerted effort to pursue the market and attract other businesses to provide services in the municipality. This finding is in line with paragraph (2.10.7) of the literature review which stated that principles of transparency, accountability, and good governance must be adhered to at all times.

5.8 CONCLUSION

From these findings, it can be concluded that relatively poor financial management practices are the main factors that contributed to the qualified audit opinions in the municipalities. The two municipalities under investigation have not received a “clean audit” report for the past three years, and in summarising the main contributors to this audit outcome, the following challenges were identified;

- Misstatements in the financial statements which were caused by poor accounting and financial reporting;
- Inability of the municipalities to develop efficient and accurate financial statements;
- Non-submission of supporting documentation to the Auditor-General to substantiate the disclosed information in the financial statement;
- Ineffectiveness of the internal control system to detect and manage the risks that arise from daily operations;
- Poor record keeping;
- Lack of oversight responsibility by the audit committees and municipal council to ensure that financial statement submitted to the Auditor-General are free from errors and misstatements;
- Under- capacitated internal audit unit and function;
- Failure by political and administrative leadership to prevent the irregular, fruitless and wasteful expenditure;
- Inefficient systems of the performance management in the municipalities; and
- High level of non-compliance to the Municipal Finance Management Act.

5.9 RECOMMENDATIONS

The achievement of “clean audit” depends on the full commitment by the municipalities to the audit processes, meaning that municipalities need to implement recommendations made by the Auditor general in their strategies. Compliance with the audit requirements depends on the quality the financial statements, achievement of set targets by municipalities, and compliance with acts and legislative requirements. Based on the findings from this research study, the following recommendations are made to improve the outcome of the audit in municipalities:

The study recommends that the municipalities develop municipal audit strategies that will guide performance towards achieving a “clean audit”. The strategies must stipulate key objectives, plans, indicators, and activities that will be implemented to ensure compliance with the audit requirements. These strategies must be endorsed by the council and submitted to the provincial Treasury departments for monitoring purposes.

The study also recommends strategies to implement consequence management in municipalities. The consequence management processes will address all transgression of the legislation and weak internal controls, with the key focus on the unauthorised, irregular, fruitless and wasteful expenditure that municipalities incur in every financial year.

Municipalities seem to have good plans and policies as control measures, but having good plans does not translate to implementing those plans. Good financial management practices rely on the implementation of plans by competent individuals. Thus, the study recommends that the municipalities review their employment strategies to ensure that officials with relevant qualifications and skills are appointed in key positions to implement government plans and policies.

Based on these findings, it can be deduced that all the objectives that were outlined in Chapter 1 have been realised. Findings of the study confirmed the statements that were made by the Auditor-General of South Africa on audited municipalities and that factors that contributed to the achievement of qualified audit reports were related to poor financial management practices in the municipalities. Recommendations have been provided that can be used by municipalities towards improving on the performance of the audit.

5.10 LIMITATIONS OF THE STUDY

The fact that the study utilised information based on the experience of only two municipalities in South Africa, means that the results of the study are not reflective of what is happening in municipalities in other parts of the country or the world. Time constraint was a challenge that the researcher encountered in achieving a full assessment which would encompass many other municipalities.

5.11 RECOMMENDATIONS FOR FURTHER RESEARCH

Further studies can be conducted to determine the best practices by municipalities in other countries in achieving a “clean audit”, and the results can be compared to the perspective of South African municipalities. It would be beneficial if further studies could determine the feasibility of enacting new legislation to commit municipalities to audit requirements.

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APPENDICES

Appendix A: SOLEMN DECLARATION



Higher Degrees Administration

SOLEMN DECLARATION AND PERMISSION TO SUBMIT

1. Solemn declaration by student

I, **Julia Seitheisho**

declare herewith that the thesis/dissertation/mini-dissertation/article entitled (exactly as registered/approved title),

Assessment of factors that relate to qualified audit reports in the two municipalities

which I herewith submit to the North-West University is in compliance/partial compliance with the requirements set for the degree:

Master of Business Administration

is my own work, has been text-edited in accordance with the requirements and has not already been submitted to any other university.

LATE SUBMISSION: If a thesis/dissertation/mini-dissertation/article of a student is submitted after the deadline for submission, the period available for examination is limited. No guarantee can therefore be given that (should the examiner reports be positive) the degree will be conferred at the next applicable graduation ceremony. It may also imply that the student would have to re-register for the following academic year.

Signature of Student: **Julia Seitheisho** Digitally signed by Julia Seitheisho Date: 2018.12.20 14:24:19 +02'00' University Number: **29799678**

Signed on this **20th** day of **December** of 20**18**

2. Permission to submit and solemn declaration by supervisor/promoter

The undersigned declares that the thesis/dissertation/mini-dissertation complies with the specifications set out by the NWU and that:

- the student is hereby granted permission to submit his/her mini-dissertation/ dissertation/thesis:
 Yes No
- that the student's work has been checked by me for plagiarism (by making use of Turnitin software for example) and a satisfactory report has been obtained:
 Yes No

Signature of Supervisor/Promoter
[Redacted Signature]

Date
[Redacted Date]

APPENDIX B: INTERVIEW GUIDE

ASSESSMENT OF FACTORS THAT RELATE TO QUALIFIED AUDIT REPORTS IN THE TWO MUNICIPALITIES

Thank you for your willingness to participate in this interview. Your participation in this study is voluntary, all your feedback will be treated with the strictest confidence, your identity and dignity will be carefully protected and not be disclosed at any stage during the analysis.

The study is conducted by myself (with permission from the municipality) to do a mini-dissertation in partial fulfilment of the degree of Master in Business Administration with the North-West University. This is part of my academic study and summary of all the findings will be presented to the municipality upon completion of the study. I sincerely hope this study makes a positive difference to the life of each and every person who participate in this interview.

Date and Time	:	
Location	:	
Department/unit	:	

I. Opening and Introduction:

- Explain the study and purpose of interview
- Asking for permission for recording the interview
- Collecting the signed consent form
- Gathering the information pertaining to the topic

Participant details

• Age	
• Gender	
• Education	
• Number of Years working in the municipality	
• Current Position	

II. Interview questions

PART 1:

General questions as related to the audits and MFMA

1. Could you please describe briefly about your current role in the municipality?
2. What is your understanding about audit and audit requirements?
3. What obstacles do you think your organization face in achieving a clean audit?
4. Does the municipality provide feedback on the audit findings?
5. What does the Municipality consider as the main reasons for qualified audit?
6. In your view, how should the municipality manage the AG recommendations?

PART 2:

Financial management practices as per MFMA

Theme 1: Accounting and reporting weaknesses

1. Do you think the municipality has capacity to submit adequate financial transactions and accounting reports?
2. Are the financial statements prepared in accordance to the financial reporting framework?
3. To what extend does the municipality follow the prescribed guidelines for submission of financial reports?
4. How is the municipality providing assurance that the financial statements are free from misstatements?
5. In your view, what are the challenges experienced with regard to submission of the reports?
6. Would you explain the budget planning processes followed by the municipality?
7. Is the spending aligned to the budget allocation?

Theme 2: Internal control

1. Does the municipality have an integrated internal control system?
2. Do you have a standard operating procedure to address internal control?
3. How does the municipality address internal control weaknesses?
4. What is the contribution of the internal audit functions to the municipality?
5. Do they contribute to the quality of the audit outcome?
6. Do you find the internal audit functions effective?

7. How does management address findings and recommendations identified in the previous audit?
8. Does the municipality conduct risk assessment?

Theme 3: Financial accountability

1. How are the Irregular, fruitless and wasteful expenditure prevented?
2. Do you think that the municipality is putting enough measures in place to alleviated fruitless and wasteful expenditure?
3. What in your view are the causes of these irregularities?
4. How is the municipality managing these irregularities and their effect? Do you think it is effective?
5. How do you find current record keeping procedures assisting the municipality in maintaining good records?

Theme 4: Audit on predetermined objectives

1. How effective are the system of monitoring & Evaluation in the municipality?
2. Are they linked to the audit processes?
3. Can you briefly describe governance system in the municipality?
4. Does the municipality conduct internal performance assessment?
5. Do you think there should be rewards for good performance?

Theme 5: Compliance Audit

1. Which legislations do you consider in your line of work?
2. Does the municipality comply with legislation and applicable laws?
3. Does the Municipality comply with the requirements of the MFMA and how would the Municipality rate itself in terms of this compliance on a scale of one to three (1 = low, 2 = medium, 3 = high)?
4. How does the municipality identify and monitor non-compliance to regulations?
5. Does the municipality procure goods and services according to the supply chain regulations?
6. Do you think the municipality is abiding by the principles of transparency, accountability, and good governance