EXPLORING THE IMPORTANCE OF INTERNAL CONTROL MECHANISMS IN ATTAINING A CLEAN AUDIT: THE CASE OF SEDIBENG DISTRICT MUNICIPALITY

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Dissertation submitted in fulfillment of the requirements for the degree Master of Arts in Public Management and Governance at the Vaal Triangle Campus of the North-West University

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DECLARATION

I, BJ Scholtz, declare that the dissertation titled, Exploring the importance of internal control mechanisms in attaining a clean audit: the case of Sedibeng District Municipality, is my own work and that all the sources I have used or quoted have been indicated and acknowledged by means of complete references.

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12 June 2014

To whom it may concern

This is to confirm that I, the undersigned, have language edited the completed research of B.J. Scholtz for the Master of Arts in Public Management and Governance dissertation entitled: Exploring the importance of internal control mechanisms in attaining a clean audit: the case of Sedibeng District Municipality.

The responsibility of implementing the recommended language changes rests with the author of the thesis.

Yours truly,

Linda Scott

DEDICATION

I dedicate this document to my beautiful, patient and inspiring wife, Mrs Claudine Scholtz, who encouraged me to complete this research project. Thank you for understanding me and allowing us to postpone our honeymoon based on the fact that we only got married on the 3 May 2014. All your prayers, assistance and motivation are much appreciated. I love you with all my heart.

Most of all, I want to dedicate this document to our Lord Almighty for giving me the strength and wisdom to compile this insightful paper. It is through your creation that my blessed mother taught me:

Life is an opportunity, benefit from it.
Life is beauty, admire it.
Life is a dream, realise it.
Life is a challenge, meet it.
Life is a duty, complete it.
Life is a game, play it.
Life is a promise, fulfil it.
Life is sorrow, overcome it.
Life is a song, sing it.
Life is a struggle, accept it.
Life is a tragedy, confront it.
Life is an adventure, dare it.
Life is luck, make it.
Life is too precious, do not destroy it.
Life is life, fight for it.

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"And let us consider how we may spur one another on toward love and good deeds – Hebrews 10:24"

ABSTRACT

The South African local government environment has a number of cross-cutting legislation in place to govern its portfolio over municipalities. This field is a much specialised area of expertise as each function is customised to its environment based on the policies and procedures taken from the legislation as a guide to minimise risk in a municipality. The SA Constitution (1996), Chapter 7 on local government, governs the autonomy of each municipality. The main legislation encompassed to ensure that the municipal control environment is in place is found in the Municipal Financial Management Act (MFMA) (56 of 2003). Since its implementation, the focus was to ensure sound and sustainable management of the financial affairs of a municipality and its entities, as well as to establish treasury norms and standards for the local sphere of government, and to provide for matters connected therewith.

The matters connected therewith are not stated. It is for this reason that the research was undertaken to show the importance of the entire internal control environment that impacts on the clean audit opinion received from the Auditor-General of South Africa (AGSA). The analysis obtained, showed that more emphasis are placed on financial management when it is the area of leadership, compliance to laws and regulations and pre-determined objectives (performance management) that are also key and are weighted the same as financial management, to obtain a clean audit report.

In addition, this study was conducted to test the hypothesis, namely the weaknesses in the internal control environment within the municipality. Information was obtained from five groups by means of one-on-one interviews and hand delivered questionnaires. Group 1, 2 and 3 consisted of ten political office bearers in the political management team (executive mayor, speaker of council, chief-whip of council and mayoral committee members), councillors, and ten from the senior management (executive of the administration level 1-3). Group 4 and 5 (level 4-12 respectively) consisted of ten officials not in management positions. The questionnaire comprised of six sections of questions (governance controls, financial management controls, predetermined objectives/performance management,

leadership controls, cluster specific controls and general and other information on controls), that was aimed at determining the extent of experience, knowledge and attitude of the respondent towards planning, implementing, reviewing, monitoring, assessing, documenting and response towards their internal control environment within each specific department, and the legal responsibility on political office bearers oversight role.

The analysis of the results indicated clearly that the overall understanding of internal controls differed per group. The planning, implementing, reviewing, monitoring, assessing, documenting and response to internal controls for non-management officials were unclear, but their awareness towards a clean audit was understood. Respondents in the political executive and the administration were more aware of their responsibilities and accountabilities towards internal control and the important task of achieving a clean audit. However, they acknowledged that the questionnaire made them aware of more aspects from a compliance perspective to be performed by the administration. The executive of the administration acknowledged that limited emphasis is made on internal controls to detect weaknesses. The analysis also proved that more emphasis and priority must be placed on internal controls from the respondents. The results are supported by the AGSAs intervention with the implementation of the key control questionnaire within the municipality to ensure that weaknesses in the internal control can be identified and corrected at an earlier stage before the audit starts.

The importance of internal controls during the analysis has proven that process management is an important attribute and tool for internal controls in achieving a clean audit. Other municipalities might benefit from this study as it provides key points towards a clean audit that highlight the importance of leadership, performance management, planning and governance and embracing diversity as a strategic move towards financial sustainability and management towards the achievement of a clean audit.

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LIST OF ACRONYMS

AAT	Association for Accounting Technicians
AG	Auditor-General
AGSA	Auditor-General South Africa
AFS	Annual financial statements
ASBSA	Accounting Standard Board of South Africa
CEO	Chief executive officer
CFO	Chief financial officer
CLLR	Councillor
COGTA	Cooperative Governance and Traditional Affairs
COSO	Committee of Sponsoring Organisations
DORA	Division of Revenue Act
DPSA	Department Of Public Service and Administration
ERM	Enterprise risk management
FAR	Fixed asset register
GAAP	Generally accepted accounting principles
GRAP	Generally recognised accounting practice
IASB	International Accounting Standard Board
IDP	Integrated Development Plan
IIA	Institute of Internal Auditors
ISA	International Standard on Auditing
IT	Information technology
KPI	Key performance indicators
MFMA	Municipal Financial Management Act
MISS	Minimum information security standards
MM	Municipal manager
MPAC	Municipal public accounts
MSA	Municipal Systems Act
MTBPS	Medium-term budget policy statement
MTEF	Medium-term expenditure framework
NICF	National Internal Control Framework
PAA	Public Audit Act
PESTLE	Political, economic, social, technological, legal and environment

PFMA	Public Financial Management Act
POSDCORB	Planning, organising, staff, directorate, coordinating, report and budgeting
OAG	Office of Auditor-General
OP	Operational planning
OPCA	Operation Clean Audit
SAA	South African Auditing Standards
SAI	Supreme Audit Institution
SAS	Statements on auditing standards
SDBIP	Service delivery business implementation plan
SDM	SDM
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific

CHAPTER 1: GENERAL INTRODUCTION

1.1 INTRODUCTION

This research concentrates on the context of the internal control and municipal audits. This research explores the importance of internal control mechanisms in attaining a clean audit. The research is based on the local sphere of government and specifically analyses the practices of the SDM (SDM). The SDM operates in the southern part of Gauteng Province. The SDM is a regulated and legislated administrative entity assigned to perform an oversight role to its three local municipalities, namely Emfuleni, Lesedi and Midvaal local municipalities. This research only focuses on the practices of the internal control. This chapter provides the orientation and the background of the study undertaken and outlines the problem statement. The research questions posed are illustrated in order to manage data collection for this research. The research methodology is described for determining the data collection instruments that will be used for this research.

1.2 ORIENTATION AND BACKGROUND TO THE STUDY

The South African National Department of Public Service and Administration (DPSA, 2014) envisions good governance and sound administration in the public service. Public administration is regarded as a coherent system that involves a set of authorities working together with the aim to continuously satisfy the public interest in accordance with the social expectations (Rosenbloom, 2012). Rosenbloom (2012) informs that the authorities refer to the management of the municipality that consists of “municipal council members, the municipal manager, the chief financial officer and the departmental managers” of a municipality. The Institute of Internal Auditors (IIA, 2014) indicates that the management of an institution is empowered to “plan, organise, and direct the institutional performance in order to ensure that the set objectives and goals are achieved in an effective manner”.

For this research, The Independent Commission on Good Governance in Public Services (2004:1) explains good governance as “a manner in which the public sector acknowledges the principles of sound budgeting and financial management”. The United Nations Economic and Social Commission for Asia and Pacific (UNESCAP,

2013) identifies the eight major characteristics of good governance. The eight characteristics of good governance include “participation, consensus orientation, accountability, transparency, responsiveness, effectiveness and efficiency, equitability and inclusiveness followed by the rule of law” (UNESCAP, 2013). In order to satisfy the needs of the community the public sector is required to develop policies and frameworks that will serve as a guideline when providing services to the public. Such policies provide support towards policy implementation. Policies also enable the municipality to improve service delivery. In addition, institutions are required to develop mechanisms that will strengthen its monitoring and evaluation process. Through the process of title development, the researcher became interested in the topic of internal control and further embraced the perception of clean audit as the focus of the research. Rosenbloom (2012) regards the process of monitoring the internal controls as the evaluation criteria for effective public administration. Evaluation of the internal controls is regarded as one of the “primary responsibilities of the internal auditing unit” (Rosenbloom, 2012).

The Institute of Internal Auditors (IIA, 2014) defines the concept control as “any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved”. The concept control is undertaken through a framework and processes that are “designed to ensure that risks are contained within the risk tolerances established by the risk management process” (IIA, 2014). The Project Management Institute (2000:8) defines risk management as a process that is involved in identifying, analysing and avoiding a potential threat to the institutional activities.

Kolakowski (2014) regarded internal control as one of the primary vehicles utilised by risk management to “identify and reduce risks within the organisation”. A broadly accepted definition of internal control comes from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (IIA, 2014). The COSO is an organisation “providing thought leadership and guidance on internal control, enterprise risk management, and fraud deterrence” (COSO, 2014). The COSO (1992) further defines internal control as “a process designed to provide reasonable assurance regarding the achievement of objective in the effectiveness and efficiency

of operations, reliable financial reporting, and compliance with applicable laws and regulations".

Provision for the requirement for standardised and enforced internal controls within local government is captured in various pieces of legislation. The researcher observed the Constitution of South Africa Act of 1996, the Local Government Municipal Financial Management Act 56 of 2003 (hereinafter referred to as MFMA), and the Public Audit Act 25 of 2004 for analysing the importance of internal control.

In terms of the Constitution of South Africa 1996, the researcher acknowledges the prescripts of Chapter 7 and Chapter 13, which emphasises the "role of internal control". In terms of Section 153(a) of the Constitution of South Africa Act of 1996, municipalities are required to "structure and manage its administration, budgeting and planning processes to give priority to the basic needs of the community and to promote the social and economic development of the community". In Chapter 13, Section 215(1) of the Constitution Act of 1996 also compels the government, namely national, provincial and municipal government, to "develop budgets and budgetary processes in order to promote transparency, accountability and the effective financial management of the economy, debt and the public sector".

The MFMA expects a municipality to "secure sound and sustainable management of the financial affairs" and other institutions in the local sphere of government. The act further envisages the "establishment of treasury norms and standards" for the local sphere of government in managing the matters related to municipal financial management. The Public Audit Act 25 of 2004 announces the assignment of the functions related to the Auditor-General in accordance to the prescripts of the Constitution. The Public Audit Act 25 of 2004 also prescribes the mandate for establishment of the auditing of institutions in the public sector. The office of the Auditor-General plays an oversight role for ensuring that the funds are used in a meaningful manner in order to enhance sustainable financial management in the public sector. In terms of Sections 4(1) and (3) of the Public Audit Act of 2004, financial management must be audited and reported on. The auditing and reporting emphasises the "need for accountability arrangements", which is a function of the

office of the Auditor-General in order to manage the office with diligence (Public Audit Act 25 of 2004).

For this research, the internal control not only refers to internal checks that audit created to maintain sustainable financial control but to the controls for the functioning of the institution as a whole (Visser & Erasmus, 2009:279). The legislative framework stated above gives a diverse perspective that internal control has a wide scope when looking at what the environment entails.

The Institute of Internal Auditors (IIA, 2014) defines internal control as “all means devised to promote, govern and check upon various activities for the purpose of seeing that institutional objectives are met”. Van Esch (1998:162) indicates that “an internal control system” consists of “all the policies adopted by the management of an entity to achieve the set goals”. According to Visser and Erasmus (2009:277-279), such systems seeks to “ensure that the institutional objectives are undertaken appropriately in order to safeguard the assets, to prevent and detect fraud and to ensure that there is accurate completion of the accounting records”. Internal controls also encompass “timely preparation of reliable financial information” (Van Esch, 1998:162).

Internal control is an important element for establishing adequate control of the taxpayer’s money. Trenerry (1999:8) further recognised the framework of internal control, which allows directors and management to exercise judgment in designing, implementing and conducting internal controls that are appropriate for the company. The internal control principles are essential for strengthening internal controls within the institution. The first principle seeks to ensure that the institution has competent personnel that can enable the rotation of duties. The second principle requires just determining how it will assign the roles and the responsibilities of personnel. Assignment of the roles eliminates redundant employees and it seeks to empower the employees in a meaningful way. The third principle further requires just the institution required to ensure that the roles are segregated to instil accountability and ownership. A municipality provides different services to its respective communities. Therefore, the fourth principle concentrates on the separation of operations and

accounting. Each department has its respective budget allocated to render the services related to the core functions. Each department is liable to use the allocated budget with diligence and they must report all used expenditures. Furthermore, the fifth principle compels the institution to develop security measures that will enhance service delivery especially with the handling of public monies. The sixth principle talks about the proper accounting for transactions. Proper accounting for transactions refers to the procedures undertaken to ensure the review and monitoring of the institutional finances. The seventh principle requires the institution to develop adequate safeguarding of assets (Visser & Erasmus, 2009:279). An institution can safeguard the municipal assets by means of an audit.

The internal control system is built around five interrelated components. The five components are “control environment, risk assessment, control activities, information and communication, and monitoring” (COSO, 1992). The components of the internal control can be associated with the mission of the SDM, which seeks to:

- create a local government that is dedicated to the provision of quality services in an effective, efficient and financially sound manner by promoting the Batho Pele principle;
- ensure cost effective and affordable service delivery;
- monitor and develop staff to ensure consistently high work output adhering to good governance and sound management practices; and
- develop a culture of accountability and transparency (Sedibeng District Municipality (SDM), 2010).

Monitoring is undertaken by means of an audit process. Audits can be described in two forms, namely internal and external auditing. The Institute of Internal Auditors (IIA, 2014) defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. Based on the characteristics of good governance, internal auditing enables 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, 2014).

There are notable developments initiated to strengthen public financial management in South Africa. The National Treasury and the Department of Cooperative Governance and Traditional Affairs (CoGTA, 2009) launched the Operation Clean Audit Programme in 2009. At this event the former National Minister (Honourable Sicelo Shiceka) for Cooperative Governance and Traditional Affairs (CoGTA, 2009) bestowed the SDM with an award. This award entitled the SDM to act as an ambassador of Operation Clean Audit to assist other municipalities in the country to achieve this status as well (SDM, 2010). It is on this basis that this study aims to provide reason and motivation on how the SDM consistently achieved a trend of unqualified audits and sustained their clean audit status outcome.

The imperative for achieving a clean audit report was emphasised by the former National Minister for CoGTA, in a statement made in Parliament on the 22 September 2009 (CoGTA, 2009). The statement related to the launch of Operation Clean Audit 2014. Here the minister gave credence on the state of municipalities in South Africa and outlined the challenges experienced in the local government environment. Hereto are excerpts from the Minister's speech (quoted directly from the former National Minister for CoGTA (Shiceka, 2009), which illustrates the seriousness and commitment of government to clean municipalities state of affairs through the launch of Operation Clean Audit. The excerpts are presented in Box 1.

Box 1. Excerpts from the minister's speech

"...The Clean Audit 2014 is part of the four legged operation clean up which includes three other legs, which are clean cities/towns, debt collection, public mobilisation and revenue enhancement, as well as infrastructure backlogs and economic development..." (CoGTA, 2009)

"…local government is the face of government to all our communities-to the electorate…" (CoGTA, 2009)

"...The then department of provincial and local government did not support provincial departments (CoGTA, 2009). As a result, the link and support between municipalities and provinces was weak and not sustainable (CoGTA, 2009). Thus, service delivery, governance and financial management is poor due to lack of support, without a

doubt service delivery will be negatively affected (CoGTA, 2009). More importantly, in some provincial departments and municipalities, there is lack of both administrative and political leadership. Let me explain this aspect of a lack of leadership. When any leader fails to make a decision, to me that is simply a sign of poor leadership. The public has been complaining about poor financial management, corruption, abuse of public resources, but some leaders decided not to act. Yet, reports from the Auditor-General continue to report about poor asset management, double payments by officials, stolen goods and assets, and yet again, some leaders choose not to do anything. Let me tell you, this time around, "die poppe sal dans..."

Source: Shiceka, 2009

Emanating from this programme, several projects were streamlined to provinces and all municipalities to assess and evaluate the status of their Auditor-General report findings. In the case of Gauteng province, a chief financial officers' forum was held on 4 December 2013. The aim of the forum was to enhance the fiscal performance of the municipalities. The respective objectives were intended to strengthen the functions of the municipalities as it aimed for:

- Operation Clean Audit to be prioritised;
- Municipalities delay on capital expenditure;
- Debt owed to municipalities decreasing; and
- Municipalities advised on Public Private Partnerships (Gauteng Provincial Treasury, 2013).

The municipal chief financial officers' forum is a preparatory meeting whereby its recommendations are addressed and adopted at the municipal finance indaba (Gauteng Provincial Treasury, 2013). The chief financial officers' indaba also had its key objectives that aimed to move the municipal efforts collectively towards achieving clean audits.

Visser and Erasmus (2009:278) identified the four types of audits outcomes, namely: "unqualified opinion, qualified opinion, adverse opinion, and disclaimer of opinion". The ultimate goal for any chief financial officer in the public sector is to achieve a

clean audit opinion report from the Auditor-General of South Africa. A positive report provides comfort and an acknowledgement that the internal controls in place are effective and with accountability operating efficiently and effectively. In itself, this has a lot of meaning and illustrates confidence from an investor perspective for economic growth and job creation in any vibrant local government environment. The process is illustrated through stakeholder engagements with investors and public participation processes with ward committees where broader communities can voice their views around service delivery matters. The audit opinion report is considered an “essential tool when reporting financial information to users, particularly in business” (Fitchat, 2013). Like any financial reporting instrument users require this independent opinion from auditors as it would benefit them to “attract investors, obtain loans, and improve public appearance” (Fitchat, 2013). Visser and Erasmus (2009:278) indicate that the “financial information without an auditor report is essentially worthless for investment purposes (Visser & Erasmus, 2009:278).

Therefore, based on the above explanations, the emphasis is that management can attest that over and above its agreed strategies, risk management remains their responsibility in achieving the objectives of the institution. The conclusion would be that the role of management is to identify and evaluate the significant exposure to risk and to contribute to the improvement of risk management and internal control systems in their functional areas of responsibility.

This study will cover, but is not limited to, the following functional areas:

- General internal control overview of standard operating information and procedures;
- Detailed study of key internal controls; and
- Corporate governance compliance.

Depending on the results obtained, some of the above areas will be studied more carefully, if they are found to have an important influence on the progress of projects. The study will tend to illustrate that internal procedures are performed to examine and evaluate the adequacy and effectiveness of the system of internal control.

1.3 PROBLEM STATEMENT

The previous (1 December 2006- 30 November 2013) South African Auditor-General (Mr. Terence Nombembe) stated in numerous articles the concern about the state of municipalities in the country. However, he emphasised that there has been a marginal improvement since the 2004/05 financial period (Nombembe, 2010:1-3) and highlighted the following. Problems, which hindered the realisation of the internal control processes:

- Improper documents management;
- lack of management supervision of finance units;
- lack of discipline in preparing monthly financial statements with disclosure notes;
- lack of technical skills within finance departments; and
- the audit committee not taking responsibility for reviewing the financial statements submitted for audit, as some of the areas that need special attention (Nombembe, 2010:1-3).

The Auditor-General ’s report indicates that the local government audit outcomes found that 245 out of the 283 of the municipalities still lacked proper financial management in a quest to safeguard the municipal assets. The following figures were also identified, whereby:

- 35 percent of municipalities received disclaimed audit opinions;
- 4 percent obtained adverse opinions;
- 23 percent obtained qualified opinions ; and
- 37 percent received unqualified opinions that fairly reflected their financial operations, however, other matters of concern were noted (Nombembe, 2010:1-3).

For this study, a suitable site was required where there would be adequate facility to appraise, assess, benchmark and analyse the internal control environment, and how it improved the state of the audit opinions.

Table 1.1: Categories of audit opinion in SDM

Financial Period	SDM
2005/06	Unqualified audit
2006/07	Unqualified audit
2007/08	Unqualified audit
2008/09	Unqualified audit
2009/10	Unqualified audit
2010/11	Unqualified audit
2011/12	Unqualified audit
2012/13	Unqualified clean audit

The study reviewed the SDMs continual achievement of receiving unqualified audit opinions. A trend analysis was used to plot movement of improvement and performance annually. The SDM's case was identified as the site, which based on as its recent track record as displayed below, make it a prime candidate to establish the objectives of this study. The unique example of the SDM was also used to enable the researcher to determine a causal relationship between the internal control environment and regional performance. The question that rose was: why municipalities continuously get unqualified audit for seven consecutive years and not be able to convert to unqualified clean audit.

1.4 HYPOTHESIS

Based on the trend analysis of improvement in audit opinions in the municipality, the hypothesis for the study is formulated as follows:

SDM constantly achieved an unqualified audit opinion from the Auditor-General , and this may be linked to the implementation of effective internal control mechanisms in financial management and good corporate governance towards achieving a clean audit report.

Most formal hypotheses connect concepts by specifying the expected relationships between propositions. When a set of hypotheses are grouped together they become

a type of conceptual framework (questionnaire). The hypotheses whose constituent terms have been interpreted become capable of test by reference to observable phenomena. Frequently the interpreted hypothesis will be derivative hypotheses of the theory; but their confirmation or disconfirmation (yes/ no) by empirical data will then immediately strengthen or weaken also the primitive hypotheses from which they were derived.

1.5 IMPORTANCE OF THE STUDY

The study attempted to evaluate the success and example setting of the SDM in clean audit reporting on internal control mechanisms utilised. This study assessed the management functions performed and the management decisions made by the SDM. This research determined the level in which the SDM manages it internal control function. The researcher also aimed to prove the authenticity of the following accounting equation:

Effective Internal controls + good corporate governance = clean audit.

The outcomes of data collection enabled the researcher to provide guidelines on how municipalities can work best to achieve a clean audit and to sustain it as well. The researcher also summarised the challenges faced in the auditing process, the reasons for these challenges and suggested possible solutions. In order to attain the aim of this study the researcher developed the questions below for exploring the internal control practices of the SDM. This research further served to supplement the sub discipline of financial management and to entrench the importance of proper internal control environments within the foundations of public administration.

1.6 RESEARCH QUESTIONS

In order to attain the aim of this study the researcher developed the questions below for exploring the internal control practices of the SDM. Key questions asked by this study:

- What does internal control entail and what are the conceptual and theoretical variables influencing internal control in a municipal environment?

- What does municipal auditing entail and what are the conceptual, regulatory, legislative and theoretical variables influencing auditing in a municipal environment in order to obtain a clean audit?
- What are the conceptual, theoretical and institutional variables influencing internal control to promote fiscal accountability?
- Which processes and principles are applied by the SDM to achieve a clean audit and what are the main contributions by SDM in this regard?
- Which conclusions can be drawn in order to determine an ideal management model for SDM to manage internal controls in an effective and efficient manner to achieve clean audits?

1.7 RESEARCH OBJECTIVES

The research paper primarily serves to establish the importance of proper internal control environments within the foundations of public administration, with specific reference to local government, by demonstrating improved performance (as determined by audit opinions) directly proportionate to the extent of the internal control environment. The secondary objectives of the appraisal were to:

- To define and explain the concepts of internal control and risk management in particular and other related concepts impacting on internal control in general.;
- To define and explain the concepts related to internal control and external auditing and to provide an exposition of the regulatory, legislative and theoretical variables influencing auditing in a municipal environment in order to obtain a clean audit towards achieving a clean audit;
- To define and explain the concepts, theories, mechanisms and institutions that influences internal control to promote fiscal accountability;
- To discuss the processes and principles the SDM applied to achieve a clean audit and to highlight the contributions made by the SDM in this regards; and
- To provide a synthesis of the insights brought to light by the study, with a view reaching conclusions and identifying a potential management model for SDM to manage internal controls to achieve clean audit of

1.8 RESEARCH METHOD

The research method of the study involved the use of a conceptual and theoretical analysis by way of a literature and documentary study and the research methodology outlined in the following paragraphs:

1.8.1 Literature study

The literature study was based on the fundamental strategic and operational sources, which were undertaken to lay the foundation for the appraisal of internal controls in achieving a clean audit for the SDM. The researcher consulted the local government websites to solicit data. The website of the CoGTA was essential to understand the framework of municipal financial management. The website of the office of the Auditor-General was consulted to analyse the context of the auditing. The following databases have been consulted to ascertain the availability of secondary sources for the purpose of this study and to provide recommendations that can enable the municipalities to manage the internal controls in order to achieve a clean audit:

- Catalogue of theses and dissertations of South Africa universities (Nexus);
- Catalogue of books: library search of information;
- Internet-Google search engine; and
- Official documents, legislation, regulations, policies and procedures within the local government environment.

The research also consulted and analysed the contemporary academic models and theories relating to the context of the unique nature of local government. The legislative frameworks consulted enabled the researcher to recognise the importance of the legislations governing the context of local government. The literature search and review also empowered the researcher to be familiar with the work already written by scholars in the field of public financial management.

1.8.2 Research approach

The research approach encompassed the following methods:

- Official documents, legislation, regulations, policies and procedures within the local government environment.

- Preliminary and documented meetings with political office bearers and senior management to discuss the various areas of internal control.
- Completion of a process and compliance checklist according to the activities identified (update from King III and other legislative amendments).
- Study of supporting documentation (where necessary).
- Benchmarking.
- Gap analysis.
- Final meeting with the district municipality executive mayor, municipal manager and chief operating officer to confirm the results, and
- Compilation and issue a formal report with chapters as articulated below after the finalisation of the study.

1.8.3 Research instruments

The emphasis throughout the study concentrated on the internal control practices of the SDM.

1.8.3.1 Data collection

Data were collected by using different methods in order to attain the set objectives. Employee selection was done by using random sampling in such a way that the main operational and corporate functions as listed are covered. The review approach involved the use of a semi-structured questionnaire. This was conducted by taking a combined approach of quantitative and qualitative research. Questionnaires were sent to all the selected politicians and employees that were willing to assist in the research, to ensure a high response rate.

1.8.3.2 Sampling

Sampling is concerned with the selection of a subset of individuals from within a statistical population(SDM officials) to estimate characteristics and the level of knowledge as to what internal controls are.

Each observation measures one or more properties (governance controls, financial management controls, predetermined objectives controls etc) of observable bodies

distinguished as independent individuals. In survey sampling, weights can be applied to the data to adjust for the sample design, particularly stratified sampling 0in this case the focus in on the SDM officials. Results from probability theory and statistical theory are employed to guide practice.

The sampling process comprises several stages:

- Defining the population of concern; which are the SDM officials from level1 - 10.
- Specifying a sampling frame, a set of items or events possible to measure-the categories that are used in structuring the questionnaire.
- Determining the sample size.
- Implementing the sampling plan.
- Sampling and data collecting.

1.8.3.3 Interviews

Interviews were conducted with political office bearers and management from within all the municipalities in the region. Although the questions posed to the participants inquired the operational nature of internal control. The responses obtained were documented and summarised to illustrate the views of the interviewers. It is envisaged that the population of the random sample will cover a combined total of 30 councillors and officials from SDM. Table 1.2 illustrates the interviews conducted across the region; these include Sedibeng and its broader constituency as follows:

Table 1.2 Random sample description

RANDOM SAMPLE DESCRIPTION	NO.
Mayoral committee members of SDM	5
Ordinary councillors of SDM	5
Level 1,2 and 3 management officials of SDM	5
Level 4,5,6 and 7 middle management officials of SDM	10
Level 8,9,10,11 and 12 lower officials of SDM	5
TOTAL	**30**

As the research method is combined, the population size is sufficient to draw a conclusion from, as it covers the political governance, and all management grading levels based on the hierarchy of SDM to draw information from the research tools to be used. The questionnaires were sent out, and the interviews were arranged and conducted with the selected employees to discuss the questionnaire. The interviews were conducted through telephone and face-face processes.

1.8.3.4 Data Interpretation

Data collected were interpreted to find any similarities between design methods and the municipality that use them. Data acquired was evaluated in conjunction with all other information acquired via resources such as the Internet and the literature available, followed by suggestions. In addition, the internal control environment process was classified to determine the extent of the methods used for strengthening the internal control purposes.

1.8.3.5 Research ethics considerations

The internal control and the achievement of clean audits form part of the public information. The discussions of the municipal financial management are on public domain. The Auditor-General also reports issues of the audit outcomes on a yearly basis. Once all the necessary data had been obtained and evaluated, the results were interpreted and written up, and possible guidelines formulated. The researcher

received approval from the SDM. The researcher also obtained consents from the participants who comprised the employees of the SDM.

Discussions with the SDM on the evaluation relating to confidential matters and documents were confined to the interviewees that were directly involved in this study. Professional standards prevent the disclosure to any persons of any information relating to the study subjects' business acquired in the course of the study. The names of the participants will not be communicated outside the organisation without prior approval of the accounting officer of the SDM. Exceptions to this policy may occur if instructed by a court of law to disclose certain information. Due professional care was considered when exercising the planning, execution and reporting of the research in order to proceed with the study from SDM.

1.9 CHAPTER OUTLINE

This research is divided into six chapters outlined below.

Chapter 1 defines the orientation and background to the study. The research problem, research objectives, the research questions and the research methodology are described as well as the central theoretical statement.

Chapter 2 conceptual and theoretical exploration of internal control.

Chapter 3 conceptual, theoretical, regulatory and legislative milieu of municipal auditing.

Chapter 4 conceptual, theoretical and institutional variables influencing internal control to promote fiscal accountability

Chapter 5 methodological orientation and results: processes and principles of SDM's fiscal accountability to promote a clean audit.

Chapter 6 summary, conclusion, findings and the recommendations.

CHAPTER 2: CONCEPTUAL AND THEORETICAL EXPLORATION OF INTERNAL CONTROL

2.1 INTRODUCTION

This chapter defines the concepts and theoretical exploration of internal control. The chapter further outlines the importance of internal control and its effectiveness when effectively implemented. The pervasive control environment in which internal control operates that affects the organisations operations in reaching the desired goals.

2.2 THE DEFINITION AND IMPORTANCE OF INTERNAL CONTROL

The COSO report presented a common definition of internal control and identified five key elements of a successful internal control framework. The COSO (1992) report defined internal control as "a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations" (COSO, 2014). Arwinge (2013:22) further defines internal controls as methods put in place by an institution to ensure the integrity of financial and accounting information, he emphasised that internal controls enable institutions to meet operational and profitability targets and transmit management policies throughout the organization. It is designed to provide reasonable assurance regarding the achievements of objectives in the following categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with laws and regulations (Arwinge, 2013: 22-30).

The researcher concurs with the definition of internal control, as stated by Coopers and Lybrand (1985:78), who regards internal control as "a comprehensive system that is used to carry out all activities of a public institution in an orderly manner". The authors also acknowledged the internal control for its role as it enables the manager to look after the institutional assets and allows for accurate and reliable reports.

2.3 AN INTERNAL CONTROL FRAMEWORK

The control environment is pervasive, as it affects (either positively or negatively) the entire organisation and all other elements in the framework. It is the medium that spreads the organisations commitment to “ethical and honest behaviour, effective internal controls and proper financial reporting” (COSO, 2014). DiNapoli (2010:5) enlightens that the information and communication is another element that flows through the entire internal control framework, that Information is the vehicle by which control policies and procedures are “introduced and reinforced” (DiNapoli, 2010:5). Communication is an instrument by which employees become aware of management’s commitment to internal controls (COSO, 2014). All elements of the framework are connected by the control environment and information, and communication. DiNapoli (2010:5) further indicates that the risk assessment, control procedures and monitoring are the “building blocks that create, implement and review the policies and procedures that constitute a system of internal controls”. Internal controls are systematic measures instituted by an organisation (Arwinge, 2013). They are used for different reasons that enable the institution to manage its resources effectively. The measures may include the reviews, checks and balances, methods and procedures (Arwinge, 2013). Internal controls are used to:

- conduct its business in an orderly and efficient manner;
- safeguard its assets and resources;
- deter and detect errors, fraud, and theft;
- ensure accuracy and completeness of its accounting data;
- produce reliable and timely financial and management information; and
- ensure adherence to its policies and plans (Arwinge, 2013).

2.4 COMPONENTS OF INTERNAL CONTROLS

There are five components of internal controls (COSO, 1992). The five interrelated elements of an internal control framework, as identified by the COSO report, are:

- fostering a favourable control environment ;
- conducting risk assessment;
- designing and implementing control activities in the form of policies and procedures;
- providing for effective communication throughout the organisation; and

- conducting on-going monitoring of the effectiveness of control-related policiesand procedures (COSO, 1992).

Control environment refers to a “set of standards, processes and structures that provide the basis for carrying out internal control across the organization” (COSO, 1992). “Risk assessment is the identification of factors or conditions that threaten the achievement of an organisation’s objectives and goals” (DiNapoli, 2010:5). It involves identifying risks to the effectiveness and efficiency of financial and service operations, to the reliability of financial reporting, and to compliance with laws and regulations (COSO, 1992). Institutions are required to develop control activities that will complement the internal process. DiNapoli (2010:5) describes control activities as “policies and procedures designed by management to help ensure that the organization’s objectives and goals are not negatively impacted by internal or external risks”.

Information and communication is the fourth essential element of the internal control framework (COSO, 1992). According to DiNapoli (2010:5), information and communication has “a global, interconnecting effect on the internal control framework”. In order for risks to be controlled, it is imperative that there be, “a sound communication process that captures information and then provides information to all who have need of it” (DiNapoli, 2010:5). The fifth essential element of an integrated internal control framework is monitoring (COSO, 1992). Monitoring is used to “determine whether the implemented programmes were successful” (DiNapoli, 2010:5). Monitoring also helps to “ensure that significant control deficiencies are identified timely and rectified” (DiNapoli, 2010:5).

2.5 BACKGROUND ON INTERNAL CONTROL

To fully understand the changes in internal control over the last twenty years, the researcher outlines the timeline for the internal control as adapted from the Office of the Comptroller): Quality Assurance Bureau of the Common Wealth of Massachusetts (OOC: QAB, 2007) in Table 2.1.

Table 2.1: The timeline for the internal control

1992	The Committee of Sponsoring Organizations of the Tread way Commission (COSO) released its Internal Control – Integrated Framework (the original framework) which is widely used around the world. It is recognised as a leading framework for designing, implementing and conducting internal control and assessing the risk of internal control (OOC: QAB, 2007).
2002	The Sarbanes-Oxley Act of 2002 (often shortened to SOX) was passed by Congress in the United States of America to protect investors from the possibility of fraudulent accounting activities by corporations (such as the Enron and WorldCom financial scandals). It sets new or enhanced standards for all United States public company boards, management and public accounting firms. The act also covers issues such as auditor independence, corporate governance, internal control assessment and financial disclosure (OOC: QAB, 2007).
2010	COSO announced a project to review and update the 1992 Internal Control – Integrated Framework. The project's goal is to increase the framework's relevance in the increasingly complex and global business environment. Its three main objectives are determining what information is essential to investors, getting preparers to think about relevance, and organising financial statements in a common sense way (OOC: QAB, 2007).
2011	COSO issued an exposure draft of the proposed Internal Control – Integrated Framework with a public comment period that closed in March of this 2011. More than 21,000 individuals downloaded the exposure draft and more than 200 organisations and professionals provided comments during this period (OOC: QAB, 2007).
2012	COSO has released for public comment an exposure draft of its Internal Control over External Financial Reporting: Compendium of Approaches and Examples (Compendium). This compendium – part of COSO's overall project initiated in 2010 – illustrates how the principles set forth in the proposed updated framework can be applied in designing, implementing and conducting internal control over financial reporting. COSO believes the

	compendium will be useful to management responsible for the preparation of external financial statements and particularly relevant to those who report on the effectiveness of internal control over financial reporting (OOC: QAB, 2007).

2.6 OBJECTIVES AND AIMS OF INTERNAL CONTROL

Internal controls are regarded as important because they ensure the orderly and efficient conduct of business in respect of systems being in place and fully implemented (Graham, 2008:1-7). Controls mean that business processes and transactions take place without disruption and with less risk or disturbance, and this, in turn, adds value and creates stakeholder value (Graham, 2008:1-7).

Managers are also required to allocate their resources in a meaningful manner. Safeguarding of assets is also important for sustainable development and for the institutional core functions (Graham, 2008:1-7). Institutions may have vehicles (fleet), buildings, and capital assets. There may be tangible and intangible assets, which must be secured; the internal control will ensure that such assets are protected from misuse, fraud, and theft (Graham, 2008:1-7).

Internal controls are also used to prevent and detect fraud. This can be realised by means of robust procedures and accountability frameworks. It also ensures the “completeness and accuracy of accounting records” and allows the managers to “manage the accounting transactions and have accurate record keeping” (Graham, 2008:1-7). It also helps the managers to “ensure the timely preparation of financial information” (Graham, 2008:1-7).

2.7. THE INTERNAL CONTROL AND PRINCIPLES

The framework includes “enhancements and clarifications” that are intended to “ease use and application” (COSO, 1992). COSO has formalised the fundamental concepts introduced in the original framework as principles (COSO, 1992). These principles, associated with the five components (mentioned previously) provide clarity for the user in designing and implementing systems of internal control and for understanding the requirements for effective internal control (COSO, 1992). The

framework has been enhanced by expanding the categories of financial reporting to include non-financial and internal reporting (COSO, 1992). The update of the framework sets out 17 principles across the five components of internal control that were described in COSOs original framework (COSO, 1992). Table 2.2 presents the COSO framework 17 principles of effective internal control.

Table 2.2: The revised COSO framework's 17 principles of effective internal control are as follows

Internal control components	Internal control principles
Control environment	1. Demonstrate commitment to integrity and ethical values 2. Ensure that board exercises oversight responsibility 3. Establish structures, reporting lines, authorities and responsibilities 4. Demonstrate commitment to a competent workforce 5. Hold people accountable
Risk assessment	6. Specify appropriate objectives 7. Identify and analyse risks 8. Evaluate fraud risks 9. Identify and analyse changes that could significantly affect internal controls
Control activities	10. Select and develop control activities that mitigate risks 11. Select and develop technology controls 12. Deploy control activities through policies and procedures
Information and communication	13. Use relevant, quality information to support the internal control function 14. Communicate internal control information internally 15. Communicate internal control information externally
Monitoring	16. Perform ongoing or periodic evaluations of internal controls (or a combination of the two) 17. Communicate internal control deficiencies

Source: COSO (1992)

A system of internal control refers to the process by which organisations maintain environments that encourage incorruptibility and deter fraudulent activities by management and employees (COSO, 1992). An organisation's components of internal control are evaluated during the planning phase of an independent financial

statement audit (COSO, 1992). The results of the evaluation directly influence the auditor's level of detailed testing. To reduce detailed testing, and perhaps the audit fee, organisations implement common features of a proper internal control system. Among the 17 principles, James (2001) highlights five common features that play an important role in the internal control system, namely: "management integrity, competent personnel, segregation of duties, records maintenance, and safeguards".

Management integrity according to James (2001) refers to "the moral character of persons of authority sets the overall tone for the organization". Management integrity is communicated to employees through employee handbooks and procedural manuals (James, 2001). The management is required to enforce policies that will direct the conformance to the policies implemented. For instance, the MFMA (2003) may be implemented and all employees would be required to comply with the policy.

An organisation's ability to "recruit and retain competent personnel indicates management's intent to properly record accounting transactions" (James, 2001). Whilst the manager is required to retain competent employees, such employees must also have defined roles. The defined roles will reduce duplication, boredom and redundant officials. An effective system of internal control "separates authoritative, accounting and custodial functions" (James, 2001). Graham (2008:15) further outlines that the managers must consider the following as managing their internal control system; managers can use the internal control system to**:**

- consider external factors: political and environmental influence.
- evaluate how management assesses its controls.
- review management's self-assessment.
- use questionnaires to evaluate internal controls.
- design institutional tests of controls.
- talk with the stakeholders.
- look at departments' documents.
- observe the activities.
- conduct walkthroughs.
- do re-performance.

2.8 THE IMPORTANCE OF RISK MANAGEMENT AND PERFORMANCE IN THE PLANNING AND CONTROL ENVIRONMENT

This section deals with the importance of risk management in the planning and control environment. It places interest on the effectiveness of management towards adverse events or opportunities that impact on institutional and objectives and the ability to make informed decisions regarding management of potential negative unsound effects of risk and take advantage of potential opportunities. Improved planning and performance management processes enables us to focus on core business, service delivery and implement business improvements, also it has the ability to direct resources to risks of greatest significance or impact and greater organisational efficiencies through avoiding 'surprises' and most importantly creating a positive organisational culture in which people understand their role contributes to the achievement of objectives.

2.8.1 Risk management

According to Risk Management Handbook (US Department of Transportation Federal Aviation Administration Flight Standards Service, 2009), risk management is "the identification, assessment, and prioritisation of risks". This is defined as the "effect of uncertainty on objectives, whether positive or negative, followed by coordinated and economical application of resources to minimise, monitor, and control the probability and/or impact of unfortunate events, or to maximise the realisation of opportunities" (US Department of Transportation Federal Aviation Administration Flight Standards Service, 2009). The concept of risk is not foreign to the public sector, and the existing framework borrowed heavily from the propositions of King II and other government policies such as the Batho Pele principles. Municipalities are required to "develop risk management policies, which are supposed to identify all the risks, and determine the level to which the municipality has tolerance to which type of risk" (MSA, 2000).

The process of risk management serves to:

- understand organisational objectives.
- identify the risks associated with achieving or not achieving them and assessing the likelihood and potential impact of particular risks.

- develop programmes to address the identified risks.
- monitor and evaluate the risks and the arrangements in place to address them (Frigo & Anderson, 2011).

According to Bessis (2002: 10-12), risk management is essential for reducing the probability that corporate objectives will be jeopardised by unforeseen event. The board must determine the type and extent of risks that are acceptable to the company, and strive to maintain risk within these levels (Bessis, 2002:14). Internal control is one of the principal means by which risk is managed. Risk may affect many areas of activity such as strategy, operations, finance, technology and environment. In terms of specifics, it may include, for example, loss of key staff, substantial reductions in financial and other resources, severe disruptions to the flow of information and communications, fires or other physical disasters, leading to interruptions of business and/or loss of records. More generally, risk also encompasses issues such as fraud, waste, abuse and mismanagement (Bessis, 2002:22).

Reviewing the effectiveness of internal control is an essential part of the board's responsibilities. Management is also accountable to the board for designing, operating and monitoring the system of internal control and for providing assurance to the board that it has done so (Bessis, 2002:30). The board will need to form its own view on effectiveness after due and careful enquiry based on the information and assurances provided to it.

2.8.2 Link between internal control and risk management

Internal controls provide "reasonable assurance that risks to the achievement of organisational objectives are at acceptable levels" (Correia *et al*., 2003). The organisational objectives, when approaching financial reporting, are to provide financial statements that are free of material omission or error. Risks needs to be identified, understood, and assessed (against levels defined as acceptable) prior to you knowing which controls to utilise. At the same time, controls are needed to manage those risks and to ensure they are and remain at acceptable levels (Correia *et al*., 2003).

2.8.3 Performance management

Performance management is a holistic practice of people management in which the prime objective is the founding of a culture in which individuals and groups take responsibility for the achievement of high levels of organisational performance through enhancement and full utilisation of their own skills, behaviour and contributions (Axon, 2010). Performance management is a "process for establishing a shared understanding about what is to be achieved and how it is to be achieved" (Axon, 2010). An approach to managing people that increases the probability of achieving success, it is "a process of motivating employees through setting goals, measuring progress, giving feedback, coaching for improved performance, and rewarding achievements" (US Department of Transportation Federal Aviation Administration Flight Standards Service, 2009). The objectives of performance management are to:

- increase two-way communication between supervisors and employees.
- clarify mission, goals, responsibilities, priorities and expectations.
- identify and resolve performance problems.
- recognise quality performance.
- provide a basis for administrative decisions such as promotions and succession plans.
- strategic planning, and pay for performance.

The development of a performance management plan should be consistent with the following principles in order to achieve a clean audit (Paladino, 2007):

- Performance management is considered a process, not an event. It follows good management practice in which continual coaching, feedback and communication are integral to success.
- The performance management plan is primarily a communication tool to ensure mutual understanding of work responsibilities, priorities and performance expectations.
- Elements for discussion and evaluation should be job specific – not generalised personality traits. The major duties and responsibilities of the specific job should be defined and communicated as the first step in the process.

- Performance standards for each major duty/ responsibility should be defined and communicated.
- Employee involvement is encouraged in identifying major duties and defining performance standards.
- Professional development should be an important component of the plan.
- The formal evaluation period should be long enough to allow for full performance and to establish a history such that evaluations are fair and meaningful. One year is a common evaluation period.
- Documentation of performance will occur as often as needed to record the continuum of dialogue between supervisor and employee.
- If formal ratings are included, they should reflect the incumbent's actual performance in relation to the performance standard for that major duty.
- The supervisor should be evaluated on the successful administration of the plan and on-going performance management responsibilities (Paladino, 2007).

A well-designed performance management system may include the following five attributes. The first looks at establishing guiding principles and program architecture that will provide a solid foundation. The second aims to develop clear success criteria that are used for identifying excellent performance. The third focuses on the alignment of expectations for producing a clear line of sight. The fourth attribute focuses on defining clearly articulated roles and coaching capabilities that will support a fair contract for performance. The fifth attribute concentrates on a specified process that will serve as a reliable roadmap for institutional performance (Bhattacharyya, 2011).

Bhattacharyya (2011) views performance management as the most recent stage in the evolution of public-sector management. Performance management is also seen as a merit-based system instituted to eliminate financial improprieties and nepotism and promote fair access to government contracts (Bhattacharyya, 2011).

Performance management, while continuing to assure appropriate controls through effective processes, has expanded the meaning of accountability and protecting the

public interest to encompass achieving results that benefit the public (Bhattacharyya, 2011). While bureaucratic processes focus on preventing bad things from happening, performance management adds a focus on assuring that government actually produces positive results (Bhattacharyya, 2011). Performance management is becoming the new standard for public-sector management. Underlying this transition is the recognition that it:

- allows public managers at all levels are able to make better decisions when the process is informed by relevant data.
- allows officials, managers, and employees at all levels to be accountable for producing the results that the public needs.
- enables the managers to provide accurate, timely, and unbiased information for high-level decision-making as well as for day-to-day management.
- promotes ethical conduct for all employees.

Paladino (2007) indicates that an effective performance management system helps organisations, managers, and employees succeed. Performance management is a shared commitment to high performance. Performance management also balances autonomy and accountability at the individual and organisational levels. Managers are required to provide continuous learning in order to align the employee skills with the core values throughout all departments (Paladino, 2007). It should be based on clearly identified core competencies for support staff and supervisors/managers (Paladino, 2007).

2.9 INTEGRATION OF PLANNING AND INTERNAL CONTROL

Planning implies developing a general strategy and a detailed approach for the expected character, duration and scope of the audit (Moeller, 2009:35). An objective of the planning phase is the projection of resources and capacities for the audit (auditors' days) based on tasks (Moeller, 2009:35). This activity focuses on the expected level of assurance of audits, that is, on the management of audit risks. Operational planning is a process carried out to determine priorities based on the assessed level of risk and materiality, audit objectives and targets, scope of the audit, and audit procedures. Planning is a continual process, which means that plans should be occasionally reviewed and amended if there are any changes in

presumptions or external circumstances on the basis of which it was formulated. The institution of audit and its departments have yearly operative audit plans along with a comprehensive strategic plan that covers three or more years.

Internal control and planning consists of five interrelated components (Moeller, 2009). These are derived from the way management runs a business, and are integrated with the management process. Although the components apply to all entities, small and mid-size companies may implement them differently than large ones. Its controls may be less formal and less structured, yet a small company can still have effective internal control (Moeller, 2009:46).

2.10 OTHER FACTORS IMPACTING ON PLANNING AND INTERNAL CONTROL

There are many things that are impacting on planning and internal control whether it negative or positive. This section highlights on those impacting municipalities in receiving clean audits. Therefore the following are factors that impact on planning and internal control:

2.10.1 Accounting standards

Accounting policy is regarded as an on-going concern by which the International Accounting Standard Board (IASB) and Accounting Standard Board of South Africa (ASBSA) amendment and revise standards to provide new guidance of accounting treatments of transactions. This relates to business combinations, consolidated, and separate financial statements, which normally affect the control environment on compliance reporting.

2.10.2 Emotional intelligence

Management has many dealings with people in the organisation, especially if the strategy of the organisation changes within the planning and control environment. It is here that emotional intelligence counts to improve performance. Emotional intelligence is based on honing emotional elements, self-regulation, motivation, empathy and social skill. Its goal is to find positive ways to move the organisation forward. Emotional intelligence is using the wisdom of emotion as a source of

information to motivate staff and connect them to other people (Puth, 2007:17). The importance of strategic intelligence relates to how organisations can use information and the processing thereof that indicates how everything is binds together; information to knowledge.

2.10.3 Productivity

In any control environment, the prime lever for improving performance is not through improving productivity of resources, but through the power to set and control prices. More and more, the value of the service derives fundamentally from productivity as it affects the control environment. Good management is perhaps the essential ingredient for higher productivity

2.10.4 Loyalty

Based on personal experience the planning environment, loyalty from staff must be counted upon to ensure that the control environment is sustainable and viable. In this process, rewards and special treatment through excellent performance can be recognised. In addition, loyalty is based mainly on business relationships that are built on mutual respect and trust. In both ways, the building of this trust requires that managers and staff must continue to nurture it in the spirit of business cohesion and team work based on performance expectations, even when in crisis, to ensure the efficiency of the control environment.

2.10.5 Skills development

South Africa does not have a capacity challenge but rather a challenge to generate additional accounting skill in South Africa (Gallagher, 2013). As the South African economy grows, the skills shortage poses a serious threat. Gallagher (2013) indicated that there is a particular need and demand for skilled accounting staff in all sectors and in all sizes and types of organisations. A new professional body for accounting technicians was launched in 2010 to empower the accounting skill shortages in South Africa (Gallagher, 2013). A partnership between the South African Institute of Charted Accountants (SAICA) and the London-based Association of Accounting Technicians facilitated the launch. The Association of Accounting Technicians South Africa provides a new career path in accountancy to enhance the

employees' competency in order to enable them to be effective and productive in their work environment (Gallagher, 2013).

2.10.6 Compliance

Institutions are required to ensure that their overall governance structure is capacitated for practicing good corporate governance. This can only be possible if the internal audit unit is functional. In addition, a risk management strategy must be developed to ensure compliance in the work environment. Bessis (2002:25) pointed that the starting point for setting a corporate governance culture in an organisation is to have an enterprise risk management framework (ERM). The ERM framework facilitates the determination of the risk appetite and risk tolerance of the organisation (Bessis, 2002:25). Where ERM is practiced, the compliance risk framework should be a sub-framework of the ERM framework. One of the key elements of the relationship between ERM and internal audit is that the ERM process assists with focusing both internal and external audits efforts on high-risk control areas. It is in this light that organisations are encouraged to implement a dashboard, or a compliance checklist (Bessis, 2002:26).

2.10.7 Brand

The reputation of an organisation must be captured in an image associated with the service. A good reputation enjoys public trust and strong equivalence between appearance and reality. Developing a reputation within the control environment demands the confidence to take risks, put ideas and beliefs into practice, and the humility to learn as one grows; to listen to the public and respect the impact of notions on others (Batey, 2012). It is not about perfection, and a reputation is strengthened by admitting and learning from mistakes and recognising and dealing with consequences to improve and enhance the control environment.

2.11 CONCLUSION

The concept of planning and its importance cannot be separated from internal control in any organisation. The two aspects are intertwined and are critical to any control environment and the establishment of its origin. The theory analysis provides

content as interpreted from a practical perspective and its relevance towards achieving a clean audit.

CHAPTER 3: CONCEPTUAL, THEORETICAL, REGULATORY AND LEGISLATIVE MILIEU OF MUNICIPAL AUDITING.

3.1 INTRODUCTION

This chapter begins with an overview of municipal auditing. Internal and external audits are explained and the nature of an audit is defined. It also addresses the functions and legal framework of internal audit, audit committees and the external audit (AGSA) by providing guidance and advice on how the municipality must implement and manage the systems of internal control from an accountability and governance point of view. Furthermore it describes the categories of the audit results; the description makes a distinction between the external audit and internal auditing.

3.2 DEFINITION OF CONCEPT AUDIT

Auditing is a discipline where things have to add up, it is known for its checks and balances. Loughran (2010:8) defines a financial audit as an audit of financial statements and the verification of the financial statements of a legal entity, with a view to express an audit opinion. The audit opinion intends to provide reasonable assurance that the financial statements are presented fairly, in all material respects, and/or give a true and fair view in accordance with the financial reporting framework (Loughran, 2010:8). The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements (Loughran, 2010:8). The accepted definition of an auditor is “the one who satisfies himself as to the truth of the accounting of another” (Loughran, 2010:8). An audit may be internal or external (National Treasury, 2012).

3.2.1 Internal audit

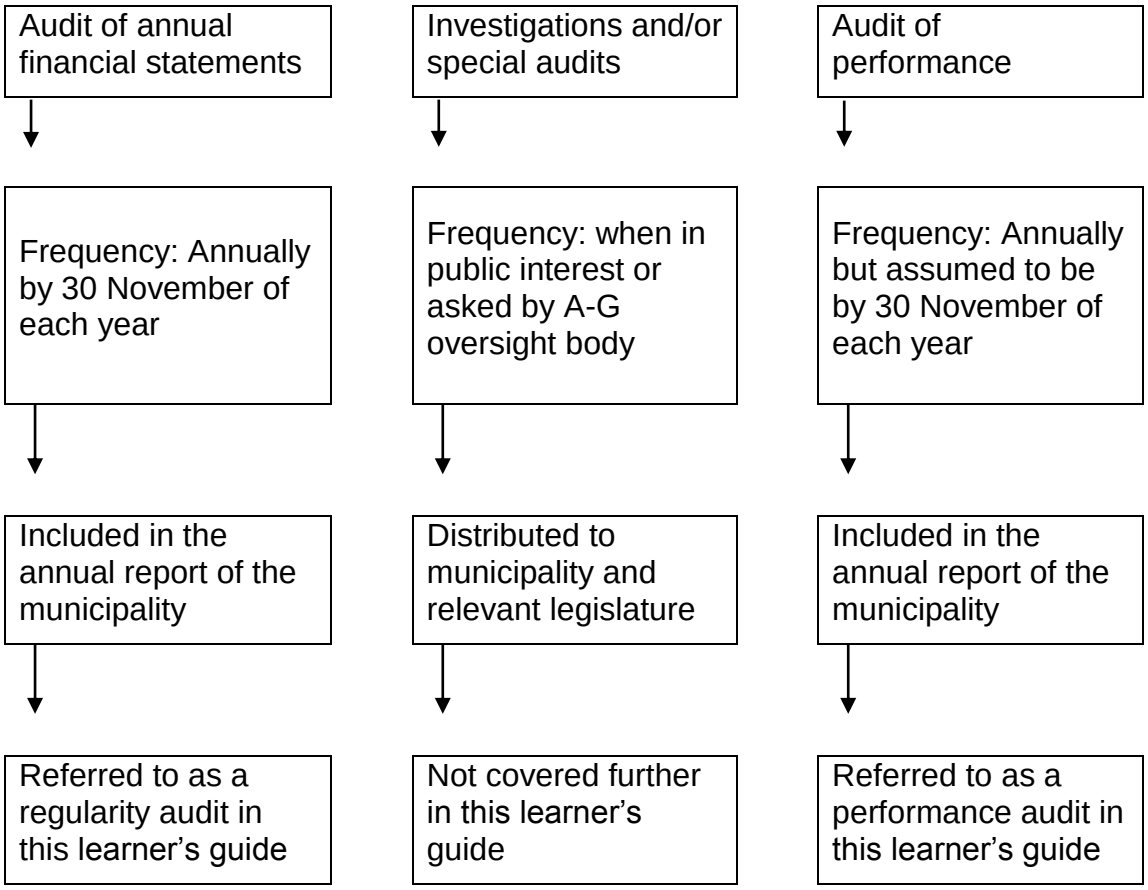
The Institute of Internal Auditors (IIA, 2014) defines internal auditing as “an independent objective assurance and consulting activity designed to add value and improve an organization’s operations”. Russell (2007) states that it helps an organisation “accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes”. Internal auditing is designed to assist an organisation

through focusing on how the organisation manages its risks, the assessing and evaluation of the implementation of controls to manage identified risks and to enhance governance processes through reporting to the accounting officer and a committee of the governing body. The reporting of internal audit findings is usually to management and the governing board. External stakeholders are seldom, if ever, issued with internal audit reports (Russell, 2007).

3.2.2 External auditing

External audit is defined in the Audit Professional Act 2005 as, the independent examination of, in accordance with prescribed or applicable auditing standards. The key purpose of an external adult is to express an opinion on the fairness of financial statements or other information that is prepared and presented by management or the appropriate governing body (Spencer Pickett, 2010).

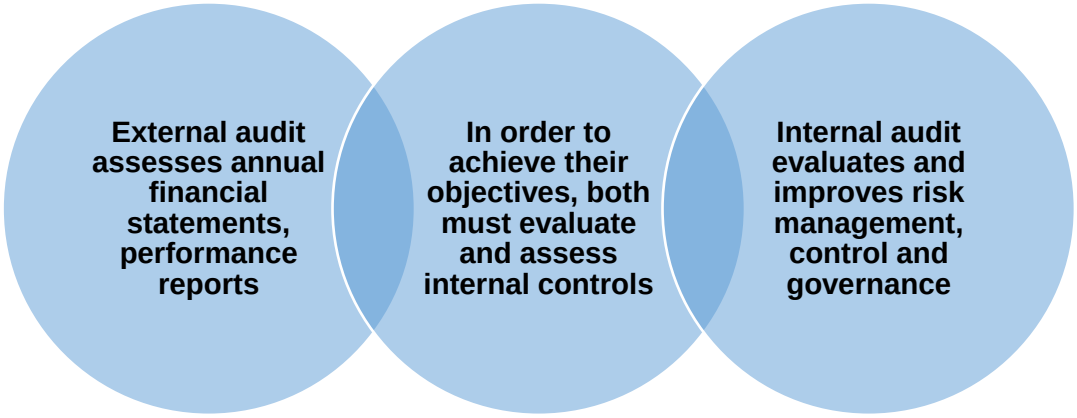
Figure 3.1: The different types of external audits



Source: National Treasury (2012)

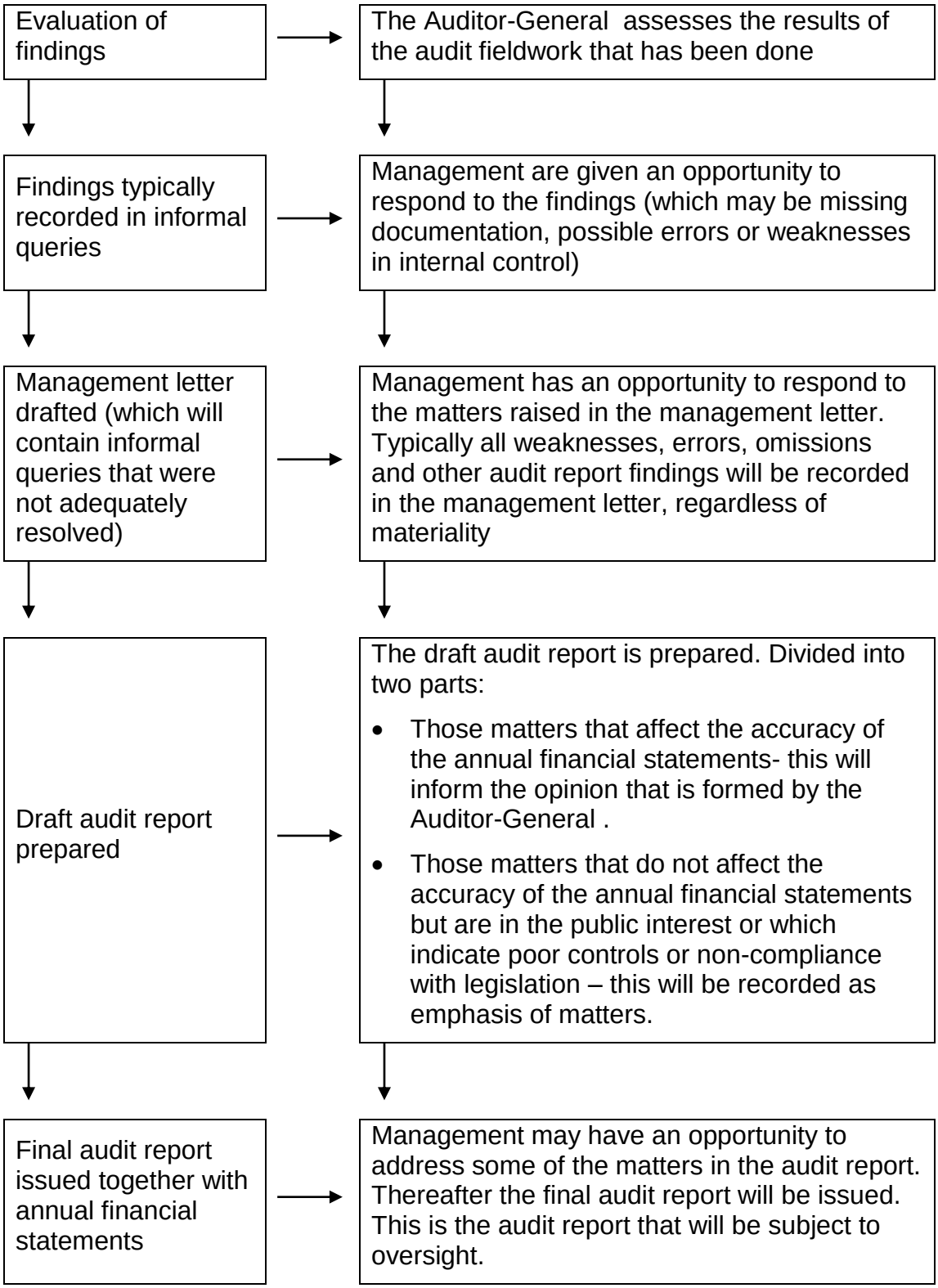
A key aspect of external auditing is that external audit reports are available for use by interested stakeholders that are predominantly external to the organisation and for whom the financial and other information is prepared for investment and other decision-making purposes (Spencer Pickett, 2010).

Figure 3.2: The relationship between internal and external auditing



Source: National Treasury (2012)

Figure 3.3: The external audit reporting process



Source: National Treasury (2012)

3.3 GENERAL PRINCIPLES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

The financial statements audited under international standards are the balance sheets (statement of financial position), income statements (statement of financial performance), and cash flow statements and the notes thereto. The first International Standard on Auditing (ISA 1, subject matter number 200) discusses the principles governing an audit of financial statements.

- ISA 200 (1) states that an auditor could comply with the code of ethics for professional accountants issued by International Federation of Accountants. This code emphasises a specified behaviour guided by principles such as integrity, objectivity, professional competence, confidentiality, professional behaviour and technical standards.
- ISA further states that the auditor should conduct an audit in accordance with International Standards on Auditing.
- The term scope of an audit refers to the audit procedures deemed necessary in the circumstances to achieve the objective of the audit.
- An audit in accordance with ISA is designed to provide reasonable assurance.
- There are certain inherent limitations in an audit that affect the auditor's ability to detect material misstatements.
- The audit of the financial statements does not relieve management of its responsibilities.

3.4 PROBLEMS EXPERIENCED

Institutions often perform audits and wonder why and when they are to be completed, and reasons why they did not go very well. This study will offer insight on how to better anticipate and solve the common problems that all auditors face. There is a multitude of issues and problems auditors will encounter during auditing that must be addressed individually. Every organisation faces a variety of potential risks, such as:

- Loss of key staff.
- Loss of funding or reduction of revenue sources.
- Regulatory non-compliance.
- Conflicts of interest.

- Fraudulent activities resulting from weaknesses in internal controls (Gauthier, 2006).

Below are some ways to help encourage executive managers to support the audit programme for eliminating the problems identified above (Loughran, 2010):

- Communicate the cost of audit observations
- Explain the regulatory effects of nonconforming processes
- Educate by stating or restating management's role in the audit program
- Distribute audit reports to management
- Have a member of management participate in an audit

Municipalities must encourage employees to work as a team not as groups also works shop must be conducted to make sure both parties (auditors and employee) understand their relationship and boundaries.

3.5 LEGAL FRAMEWORK AND MUNICIPAL AUDIT

In terms of Section 216(1) (c) of the Constitution of the Republic of South Africa of 1996, national legislation must prescribe measures to ensure both transparency and expenditure control in all spheres of government by introducing uniform treasury norms and standards in the respective control environment. Good governance involves management of an organisation, its organisational culture, policies, strategies and the way it deals with its stakeholders. The internal auditor and audit committee provide objective, independent advice to improve oversight, governance and help to mitigate risks. Working with the internal auditor, the audit committee brings different skills and expertise to assist in improving the performance of an institution. The internal auditor and audit committee does not assume any management functions nor should management exert any undue influence over the work of the internal auditor and audit committee.

Section 165 of the MFMA requires that each municipality and each municipal entity must have an internal audit unit. The internal audit unit of a municipality or municipal entity must prepare a risk-based audit plan and an internal audit program for each financial year. The internal audit unit advice the accounting officer, and report to the

audit committee on the implementation of the internal audit plan. The internal audit unit may report about the following matters relating to the internal control:

- Internal audit
- Internal controls
- Accounting procedures and practices
- Risk and risk management
- Performance management
- Loss control
- Compliance with this act, the annual Division of Revenue Act and any other applicable legislation
- Perform any such other duties as may be assigned to it by the accounting officer.

It also makes provision for outsourcing of the internal audit function if the municipality or municipal entity requires assistance to develop its internal capacity and the council of the municipality or board of directors of the entity has determined that this is feasible or cost effective. Section 166 of the MFMA requires that each municipality and municipal entity must have an audit committee. The audit committee must advise the municipal council, the political office bearers, the accounting officer and the management of the municipality or municipal entity on matters relating to:

- Internal financial control and internal audits
- Risk management
- Accounting policies
- The adequacy, reliability and accuracy of financial reporting and information
- Performance management
- Effective governance
- Compliance with the annual Division of Revenue Act (annually) and any other applicable legislation
- Performance evaluation
- Any other issues referred to it by the municipality or municipal entity.

3.6 KING III (2009) CORPORATE GOVERNANCE IN GOVERNMENT

The King report on corporate governance is a groundbreaking code of corporate governance in South Africa (King III report, 2009). Issued by the King Committee on Corporate Governance, it has been cited as the most effective summary of the best international practices in corporate governance (King III report, 2009). The third report on corporate governance in South Africa became necessary because of the new Companies Act 71 of 2008, and changes in international governance trends. This report, referred to as King III, was compiled by the King committee with the help of the King subcommittees (King III report, 2009). The King III report (2009) recommends that organisations produce an integrated report in place of an annual financial report, and a separate sustainability report. Those companies should create sustainability reports according to the Global Reporting Initiative's Sustainability Reporting Guidelines. King III is applicable to all entities – public, private and non-profit. It encourages all entities to adopt its principles and explain how these have been applied or are not applicable (King III report, 2009). The code of governance was applicable from March 2010. Eleven subcommittees were established for the King III process and some are discussed in the following sections.

3.6.1 Boards and directors, accounting and auditing

Section 166 of the MFMA enjoins every municipality to have an audit committee. According to the aforementioned section, Subsection 4(b), the audit committee must meet as often as required, but not less than four times a year. The King III requires the audit committee to oversee integrated reporting (King III report, 2009). However, the MFMA does not make any specific requirements for summarised sustainability reporting. The MFMA makes risk management the responsibility of the audit committee to advice council on all matters of risk management. However, it must be emphasised that external audits are conducted by the Auditor-General, consistent with the requirements of Section 188 (1) (b) of the Constitution of the Republic of South Africa (1996) and the Public Audit Act 25 of 2004.

Section 165 of the MFMA enjoins municipalities to set up audit committees and resource them appropriately to ensure that they have requisite independent assurance.

3.6.2 Risk management

The concept of risk is not foreign to the public sector, and the existing framework borrowed heavily from the propositions of King II and other government policies, such as Batho Pele principles (King III report, 2009). Municipalities are required to develop risk management policies, which are supposed to identify all the risks and determine the level to which the municipality has tolerance to what type of risk. The MFMA enjoins municipalities to “do risk-based internal auditing”. The Audit Committees are then required to “ensure that management implements outcomes of this risk-based auditing and where there are departures, these are reported to the municipal council”.

3.6.3 Integrated sustainability reporting and disclosure

Municipalities are required to dedicate time and resources to the preparation of the annual report (PricewaterhouseCoopers, 2009:1). King III requires that a formal process of assurance with regard to sustainability reporting should be established. In order to comply with the recommendations of the code, it is expected that reporting should be “integrated across all areas of performance”. Integrated reporting entails more than a mere ‘add-on’ economic, social and environmental information in the annual report – sustainability reporting should be embedded in the organisation.

According to Section 45 of the Municipal Systems Act 32 of 2000 (hereinafter referred to as MSA), municipalities are supposed “to have a performance management system in place”. According to the King lll, there are a number of areas where organisations need to show more initiatives, and these are “ethical leadership and corporate citizenship, councils and councillors, audit committees, the governance of risk, the governance of information technology, compliance with laws, rules, codes and standards, internal audit, public participation, annual reporting, and remuneration of councillors and senior managers” (King III report, 2009). These will be dealt with in more detail later.

There are a number of initiatives that to this date have been undertaken by the g ognised accounting practice (GRAP). However, the introduction of the MFMA is the biggest, and by far the most effective step to have been taken in the sphere of local

government. The legislation helped a great deal in bringing about the best practices in the financial management of municipalities. Among other things, the MFMA outlawed the car loans, which were given to municipal officials and which were one of the biggest financial burdens to be carried by municipalities. In terms of the old employment conditions, vehicles purchased by the municipality for the municipal manager, and managers directly accountable to him, were supposed to be worth sixty percent of each incumbents total cost to employer package. This dispensation was, through the agreement in the bargaining council, extended to include up to level four employees. This proved to be too expensive and unsustainable for municipalities and was abolished with the introduction of the MFMA. At the same time, the practice of giving salary advances and loans to employees was also abolished.

3.6.4 Compliance and stakeholder relationships

The King III places special emphasis on governing stakeholder relationships; the boards must appreciate that stakeholder's perceptions affect a company's reputation (King III report, 2009). Section 55(1) (0) of the MSA assigns the municipal manager with the responsibility of developing and maintaining a system that assesses community satisfaction with municipal services. To this effect, it is required that development priorities, objectives, key performance indicators and targets should be monitored (MSA Section 41(1) (c)). These should be included in the council's IDP. Section 16 of the MSA requires that the IDP is prepared through format-interactive process with the community, stakeholders and council. Furthermore, Section 20 of the MSA requires council meetings to "be open to the public, except if not desirable to any business being deliberated upon". In the public sector, the MFMA in municipalities and the Public Finance Management Act 1 of 1999, in the provincial and national spheres of government, are comprehensive in the manner in which they propose measures to engender good governance principles in the public service.

3.6.5 IT governance

The King III requires the IT to be aligned with the performance and sustainable objectives of the council. It further implores the board and council to monitor and evaluate significant IT investment and expenditure. To this effect the municipal

manager is required by Section 63(1) (a) of the MFMA to prepare a budget and present it to council for approval. It also forms an integral part of the municipality's risk management. Again, this responsibility is placed squarely on the shoulders of the municipal manager in terms of Section 62(1) (c) (i) of the MFMA. The municipality is required to establish an IT governance framework in order to support effective and efficient management and decision-making around the utilisation of IT resources to facilitate the achievement of the municipality's objectives, and most importantly, the management of IT-related risk. The National Treasury endorsed the King II and the King III has now superseded this. It included a charter, policies, IT governance structures, IT reporting and an internal control framework.

3.6.6 Relation between governance doctrines and law

There is always a link between good governance and compliance with law. Good governance is not something that exists separately from the law and it is entirely inappropriate to unhinge governance from the law (King III report, 2009). The starting point of any analysis on this topic is the duty of directors and officers to discharge their legal duties (King III report, 2009). These duties are grouped into two categories, namely the duty of care, skill and diligence, and the fiduciary duties (King III report, 2009). As far as the body of legislation that applies to a company is concerned, corporate governance mainly involves the "establishment of structures and processes, with appropriate checks and balances that enable directors to discharge their legal responsibilities, and oversee compliance with legislation" (King III report, 2009).

In addition to compliance with legislation, the criteria of good governance, governance codes and guidelines will be relevant to determine what is regarded as an appropriate standard of conduct for directors (King III report, 2009). The more established certain governance practices become, the more likely a court would regard conduct that conforms with these practices as meeting the required standard of care (King III report, 2009). Corporate governance practices, codes and guidelines, therefore, lift the bar of what are regarded as appropriate standards of conduct. Consequently, any failure to meet a recognised standard of governance, albeit not legislated, may render a board or individual director liable by law. Around the world, hybrid systems are developing; some of the principles of good governance

are being legislated in addition to a voluntary code of good governance practice (King III report, 2009).

The philosophy of the report revolves around leadership, sustainability and corporate citizenship. To facilitate an understanding of the thought process, the following key aspects are highlighted (King III report, 2009):

- "Good governance is essentially about effective leadership. Leaders should rise to the challenges of modern governance. Such leadership 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. Responsible leaders direct company strategies and operations with a view to achieving sustainable economic, social and environmental performance" (King III report, 2009).
- "Sustainability is the primary moral and economic imperative of the 21st century. It is one of the most important sources of both opportunities and risks for businesses. Nature, society, and business are interconnected in complex ways that should be understood by decision-makers. Most importantly, current incremental changes towards sustainability are not sufficient – a fundamental shift in the way companies and directors act and organise themselves is needed" (King III report, 2009).
- "The concept of corporate citizenship flows from the fact that the company is a person, and should operate in a sustainable manner. Sustainability considerations are rooted in the South African Constitution (1996), which is the basic social contract that South Africans have entered into. The Constitution imposes responsibilities upon individuals and juristic persons for the realisation of the most fundamental rights" (King III report, 2009).

3.7. MEDIUM TERM BUDGET POLICY STATEMENT / REGULATION

The South African Medium Term Budget Policy Statement (MTBPS) sets out a framework for sustainable public finances, while managing vulnerability to economic and fiscal risks. It outlines key steps in South Africa's transition to faster, more inclusive growth (Gordhan, 2011).

Governments in pursuit of accountability, transparency, efficiency and effectiveness generally adopt a National Internal Control Framework (NICF). The government has placed the highest importance on enhancing good governance based on the principles of transparency, accountability, efficiency and effectiveness. A strong internal control system is one of the essential requirements towards achieving this goal.

As per the MFMA the MTBPS outlines government's intent to:

- Pursue a fiscal path that balances the requirements of counter- cyclicality with a commitment to medium term consolidation
- Keep government debt on a sustainable long-term path
- Implement the national development plan
- Direct public spending to reignite inclusive growth and complement increased private-sector investment
- Support job creation and skills training, particularly for the unemployed youth
- Create a climate for investment
- Manage the risks emerging from the current and potential global economic turbulence
- Cut waste and extravagance in government
- Support black entrepreneurs as investors and partners in our industrialisation and broadening of economic participation (Gordhan, 2011).

The specific objectives MTBPS are three-fold. Firstly, it provides an overall framework for implementing and maintaining effective internal controls (Gordhan, 2011). Secondly, it describes internal control related measures for heads of all agencies in government, and government owned or administered agencies to implement (Gordhan, 2011). Thirdly, it describes appropriate internal control practices for major functional area (Gordhan, 2011).

3.8 AUDIT SCOPE, OBJECTIVES AND TOOLS

The organisation's audit department unit will follow the code of ethics of the Institute of Internal Auditors and all municipal policies. The audit scope and objectives of the

AGSA are described in Section 118 of the Constitution of 1996, and further delegate in Public Audit Act of 2004 The scope and objectives for every audit are determined through discussion with the department's management and a department specific risk assessment. While each audit is unique, there are some general or common objectives applied to most audits. Some of the common objectives are (Public Audit Act 25 of 2004):

- Review activity for the most recent twelve-month period;
- Review discretionary, self-supporting, restricted and agency account expenditures and determine if they are valid, reasonable and in compliance with university policies and donor restrictions;
- Determine if gifts are deposited into appropriate accounts, properly restricted and forwarded to the office of institutional advancement;
- Review sponsored project account expenditures and determine if they are compliant with university policies, grant agreements and federal regulations, if applicable;
- Assess travel and business expense reports for compliance with university policies and procedures;
- Evaluate cash controls to determine if deposits are reasonable and timely and determine if revenues are reasonable and are properly controlled and appropriately recorded;
- Review procurement card transactions for compliance with university policies and review monitoring and reconciling procedures;
- Review conflict of interest forms for disclosures and ensure effective controls that properly monitor any disclosed outside interests;
- Review controls over IT environment, such as software licensing compliance, physical security and policies and procedures; and
- Review procedures used for the use of and control over Panther Fund cards.

3.9 ORGANISATIONAL ARRANGEMENTS/ ROLE PLAYERS FOR MUNICIPAL AUDIT

The sections below discuss the role players of the municipal audit.

3.9.1 Auditor-General

The Auditor-General's role is to audit the finances and activities of the South African public sector. In undertaking this task, the Auditor-General will scrutinise the public sector for potential instances of wastage, inefficiency or ineffectiveness, and report his findings to parliament. Reporting directly to the parliament, the Auditor-General is an ally of the people and parliament (Russell, 2007). He/ she must act independently in carrying out all his/her powers and duties. Independence is the cornerstone of public sector audit. The Auditor-General must be free from pressure, influence or interference from any source that may erode that independence. The Auditor-General is responsible for (Russell, 2007):

- auditing the annual report on state finances
- conducting financial statement, KPI and control audits and issuing audit opinions for over 200 public sector agencies
- undertaking wide-ranging performance examinations to ensure there are adequate controls within agencies, compliance with the relevant legislation, and most importantly efficiency, effectiveness and economy of agency operations or programs
- reporting the results of audits to parliament in an objective, competent, insightful and timely manner

3.9.2 Internal auditors

Management is responsible for establishing and maintaining an adequate system of internal controls. According to Benison (2007:30), an internal audit office is charged by management with, "assessing the effectiveness of the design and execution of the system of internal controls and risk management processes". Internal auditors continuously evaluate risk exposures:

- Effectiveness and efficiency of operations.
- Reliability and integrity of financial and operational information.
- Safeguarding of assets.
- Compliance with laws, regulations and contracts.
- Accomplishment of established operational goals and objectives (Benison, 2007:30).

Internal auditors are responsible for making recommendations for improvement in internal controls to top management and, if applicable, a governing board of directors. To maintain independence, and to perform in an objective capacity, internal auditors should not engage in any operational or programmatic responsibilities (Benison, 2007:30). Internal auditing performed in diverse environments and within organizations that vary in purpose, size, and structure. In addition, the laws and regulations within various countries differ from one another. Particularly, public sector auditors operate in organizational structures that are as complex and varied as the many forms of government that exist throughout the world today. There are various models for resourcing an internal audit activity as described below (INTOSAI, 2012:3).

In-house

In-house employees of the organisation provide internal audit services exclusively or predominantly. An employee of the organisation manages the internal audit activity in-house (INTOSAI, 2012:3).

Co-sourced

Internal audit services are provided by a combination of in-house employees and service providers. An employee of the organisation manages the internal audit activity in-house (INTOSAI, 2012:3).

Outsourced with in-house management

Service providers contracted to the organisation provide all internal audit services. The internal audit activity is managed in-house by an employee of the organisation (INTOSAI, 2012:3).

Fully outsourced

Service providers contracted to the organisation provide all internal audit services. The service provider also manages the internal audit activity. An employee of the organisation does the project management of the service provider contract in-house.

The International Standards of Supreme Audit Institutions (INTOSAI, 2012) examine and contribute to the on-going effectiveness of the internal control system through

their evaluations and recommendations, but they do not have primary responsibility for designing, implementing maintaining and documenting it.

3.9.3 External auditors

Table 3.1 distinguishes between the internal and external auditors. The audit committee must in relation to external audit:

- Take cognisance of the scope of work undertaken by the external auditor and the extent of co-ordination with the internal audit unit.
- Review annual external audit plans, audit fees and other compensation.
- Review reports and monitor management's implementation of audit recommendations and municipal council resolutions in the new financial year.
- Review the report on the financial statements and matters rose therein for reasonability and accuracy (Spencer Pickett, 2010).

Table 3.1: Differences between internal and external auditing

External audit	Internal audit
External audit is independent from the municipality in that it does not participate in the management or governing of the municipality or assist it to achieve its objectives.	Internal audit focuses primarily on assisting a municipality to be more effective and achieve its objectives through mitigating risks, strengthening controls and improving governance.
External audit has to issue a report on its findings and express an opinion on the annual financial statements based on the work that it has undertaken.	Internal audit reports are internal documents issued to management.
There should be no restriction on the scope of work needed to express an opinion on the annual financial statements.	The scope of work that internal audit can do will depend on its role, the budget allocated to the internal audit function and the personnel and/or skills of the staff employed as internal auditors.

External audit	Internal audit
External audit is accountable to the oversight body and parliament.	Internal audit is accountable to management and the audit committee of the municipality.

Source: National Treasury (2012)

3.9.4 Audit committee

Audit committees are an increasingly important component of effective accountability and governance. An audit committee must have three important qualities in order to fulfil its duties; independence, communication, and accountability. An audit committee should have a charter that states its mission, objectives, authority, organisation, and methodology. In addition, the charter should establish voting requirements, the liability of members, and their method of appointment (Nashwa, 2009).

Within the public sector, an audit committee is an extension of the governing body. Committees are formed to fulfill the governing body's responsibilities, not expand them. Officials are able to increase their oversight of specific issues by assigning various matters to committees (Benison, 2007:29). In this light, the audit committee is an integral element of public accountability and governance. It plays a key role for the governing body in carrying out its legal and fiduciary responsibilities, especially with respect to the integrity of the government's financial information, system of internal control, and legal and ethical conduct of management and employees (Benison, 2007:29). The roles of the audit committee may vary from entity to entity depending on the complexity and size, as well as the requirement of the governing body. However, the one common responsibility for all audit committees, among all their potential roles, is risk management oversight (Benison, 2007:29).

An audit committee has three fundamental goals. Firstly, it must satisfy itself that management is maintaining a comprehensive framework of internal control. Secondly, the audit committee must ensure that management's financial reporting practices are assessed objectively. Thirdly, the committee needs to determine, to its own satisfaction, that the financial statements are audited properly and that any

problems disclosed in the course of the audit are satisfactorily resolved (Benison, 2007:29). Audit committees are an increasingly important component of effective accountability and governance.

The combination of independent oversight and the technical expertise of audit committee members enhance accountability. Erasmus (2009:3) identifies the legislative duties of the audit committee as it seeks to:

- nominate an auditor that the audit committee regards as independent
- determine the audit fee.
- ensuring that the appointment of the auditor complies with the Companies Act and other relevant legislation.
- determining the nature and extent of non-audit services.
- pre-approving any proposed agreement with the auditor for the provision of non-audit services.
- preparing a report to be included in the annual financial statements describing how the committee carried out its functions, stating whether the auditor was independent, and commenting on the financial statements, accounting practices and internal financial control measures of the company.
- receiving and dealing with relevant complaints.
- making submissions to the board regarding the company's accounting policies, financial controls, records and reporting.
- any other function designated by the board.

In addition to the legislative duties set out in the act, King III proposes a number of additional functions, including:

- overseeing the external audit process.
- financial risks and reporting.
- internal financial controls.
- fraud and IT risks as they relate to financial reporting.
- overseeing integrated reporting (both financial and sustainability reporting).
- satisfying itself with regard to the expertise, resources and experience of the finance function.

- overseeing the internal audit function.
- playing a key role in the risk management process.
- overseeing external audit process (Erasmus, 2009:1).

The audit committee also requires the managers to ensure the application of a combined assurance model to provide a coordinated approach to all assurance activities.

3.10 TYPES OF AUDITS

The University of Las Vegas Auditing (2006) identifies six services and types of reviews performed by the audit department. These are operational reviews, financial reviews, compliance reviews, internal controls reviews, information system reviews, and special audits (University of Las Vegas Auditing, 2006).

3.10.1 Operational reviews

Operational reviews examine “the use of resources to determine of the resources are being used in the most effective and efficient manner to fulfil the University’s mission and objectives”; an operational review includes elements of the other review types listed below (University of Las Vegas Auditing, 2006).

3.10.2 Financial review

The financial review is, “used to review the accounting and financial transactions to determine if commitments, authorisations, and receipt and disbursement of funds are properly and accurately recorded and reported” (University of Las Vegas Auditing, 2006). This type of review also determines if there are sufficient controls over cash and other assets and that adequate process controls exist over the acquisition and use of resources. Unlike external financial audits, internal financial reviews do not prepare or express professional opinions on the financial statements’ fairness.

3.10.3 Compliance reviews

Compliance reviews are “used to determine if departments are complying with applicable laws, regulations, policies and procedures” (University of Las Vegas Auditing, 2006). Recommendations from these reviews usually require

improvements in processes and controls used to ensure compliance with regulations.

3.10.4 Internal control reviews

The internal control reviews focuses on, “the components of the university’s major business activities such as pay and benefits, cash handling, inventory and equipment, physical security, and grants and contracts” (University of Las Vegas Auditing, 2006).

3.10.5 Information systems reviews

The information systems review the “internal control environment of automated information processing systems and how people use these systems” (University of Las Vegas Auditing, 2006). The audit usually evaluates systems inputs and outputs; processing controls, backup and recovery plans, system security, and computer facilities. These reviews may review existing, as well as, developing systems.

3.10.6 Special audits

There are three types of special audits. The special audits include management audits, programme (cost-benefit) audits, and investigative audits.

A management audit assesses “the quality of the decision-making process and the information environment” (Fitchat, 2013). The programme (cost-benefit) audit evaluates the “economy, efficiency and effectiveness of a program; the auditor will concentrate on the inputs and outputs for a specific program” (Fitchat, 2013). The purpose overlaps with operational and management audits and the process review. Investigative audits “may result from findings during a routine audit or from information received from personnel” (Fitchat, 2013). The audit should be conducted immediately, collecting as much evidence as possible. It is essential that the records in question be removed from the department/employee under investigation or otherwise safeguarded (Fitchat, 2013).

3.11 AUDIT OUTCOMES AND AUDIT OPINIONS

The objective of an audit of financial statements is to express an opinion on whether the financial statements fairly represent the financial position of the auditee at financial year-end and the results of its operations for the financial year. The National Department of Cooperative Governance and Traditional Affairs (COGTA) launched the Operation Clean Audit in 2009. Audit opinions on the affairs of government departments are expressed in terms that are often not understood by the public. Provided below are simplified definitions of the audit outcomes as they can be expressed by the Auditor-General audit opinions.

3.11.1 Clean audit outcome

An institution receives a clean audit outcome when the financial statements are “free from material misstatements (in other words, a financially unqualified audit opinion) and there are no material findings on reporting on performance objectives or non-compliance with legislation” (Yes Media, 2012).

3.11.2 Financially unqualified with findings

An unqualified opinion is a “favourable outcome that has no reservations concerning the financial statements” (Fitchat, 2013). It is also known as a positive opinion meaning that the financial statements appear to be presented fairly. The financial statements “contain no material misstatements” (Yes Media, 2012).

3.11.3 Qualified audit opinion

A qualified opinion means that the auditor has taken exception to certain current-period accounting applications or is unable to establish the potential outcome of a material uncertainty (Fitchat, 2013). The financial statements contain material misstatements in specific amounts. In some cases, the Auditor-General may find that there is insufficient evidence from the reports submitted. Lack of information may discredit the state of the institution and may lead to the institution to be under administration (Yes Media, 2012).

3.11.4 Adverse audit opinion

The worst opinion is an adverse opinion, which states that the “financial statements do not fairly present the financial position, results of operations, and changes in financial position, in conformity with generally accepted accounting principles” (Fitchat, 2013). The financial statements contain “material misstatements that are not confined to specific amounts or the misstatements represent a substantial portion of the financial statements” (Yes Media, 2012).

3.11.5 Disclaimer of audit opinion

A disclaimer is a special type of audit report issued when the auditor cannot form, and consequently refuses to present an opinion, on the financial statements (Fitchat, 2013). This may happen when the auditee “provided insufficient evidence in the form of documentation on which to base an audit opinion”. The lack of sufficient evidence is not confined to specific amounts, or it represents a substantial portion of the information contained in the financial statements (Yes Media, 2012).

3.12 AUDIT OUTCOMES OF THE 2011/12 FINANCIAL YEAR

Berkowitz (2012) outlined that the results of the 2012/13 financial year’s municipal audit were not good in the eyes of the Auditor-General. The aggregate figures make for dismal reading: 155 of the 283 municipalities (over half) received a qualified audit, disclaimer, adverse opinion, or simply did not submit their financial statements in time. Of the remaining 128 municipalities, 115 received unqualified audits, but even among these, “the majority…achieved [an unqualified audit] by correcting the mistakes identified through the audit process” (Berkowitz, 2012). It is also indicated that there were no fewer than 64 municipalities (23% of the total) with adverse opinions or disclaimers, and a further 37 just did not submit in time. Table 3.2 presents the summary of the audit outcomes of the 2011/12 financial year.

Table 3.2: Audit outcomes of the 2011/12 financial year

	EC	FS	GT	KN	LP	MP	NC	NW	WC
Clean audit	0	0	0	5	2	4	0	0	2
Financially unqualified with findings	13	6	9	47	3	7	8	2	20
Qualified	13	3	6	7	12	3	5	2	3
Adverse / Disclaimer	18	13	0	2	10	6	10	5	0
Audits outstanding	1	3	0	0	3	1	9	15	5

Source: Berkowitz (2012)

The strong performances from KwaZulu-Natal and the Western Cape further skew the overall picture: 67 of the 115 unqualified audits and seven of the 13 clean audits come from just these two provinces, or more than half of the total good news. In the Eastern Cape, Free State, Limpopo, Northern Cape and the North-West more than half of the municipalities are bad-news stories. In the Free State, for example, a municipality is more likely to have an adverse opinion or disclaimer than not. In the North-West, over 60 percent of all municipalities did not submit their financial documents to the Auditor-General's office on time.

3.13 CONCLUSION

The illustration in this chapter provides important content for management to take note of in respect of the audit process and the importance of understanding their control environment. It provides the reader the assurance aspects on effective and efficient control to be put in place by management. The understanding of the audit process is in the hands of management to ensure that a good audit opinion is reported to the governance structures. Note should also be taken in this chapter around the additional input towards the audit process, which relates to the oversight role within the governance structures.

CHAPTER 4: CONCEPTUAL, THEORETICAL AND INSTITUTIONAL VARIABLES INFLUENCING INTERNAL CONTROL TO PROMOTE FISCAL ACCOUNTABILITY

4.1 INTRODUCTION

This chapter discusses the application of the internal control in the municipality. In this chapter, the researcher provides the overview of municipal auditing and the reputational promise, which spells out findings of the Auditor-General of South Africa (AGSA). It also addresses the functions and legal framework of internal control by providing guidance and advice on how the municipality must implement and manage the systems of internal control from an accountability and governance point of view. It further continues to provide the challenges in the profession, the type of audit outcomes and the importance of the oversight responsibility of good governance. The chapter would further also emphasise that effective internal control systems are paramount to improving and enhancing the audit outcomes. Both external auditing and internal auditing are important components of financial management practices in South Africa, and the requirement that a municipality is subject to an annual external audit and to establish its own internal audit function as legislated. The discussion of this chapter begins with the role of planning in the municipal financial management.

4.2 DEFINING THE CONCEPTS OF PLANNING

Rendering of public services take place in a resource-restrained environment. Whilst allocating the limited resource base the municipality is also required to respond to political, social and economic events. In order to respond to the political, social and economic events a municipality is required to be in a capable environment for achieving the organisational mandate. One of the concerns is the quest for satisfying the needs of the community. In order to attain the basic internal control function the municipality is required to develop a plan that will guide the resource allocation and its finances. Planning is essential for successful generation, safekeeping and use of funds to achieve programme objectives.

The planning is usually done in advance so to plan and decide about what, how, when and who will be involved in the planning process. Planning bridges the gap from the current state of an institution to the future aspirations. It makes it possible for things to occur which would not otherwise happen. Planning is the control of development by a local authority, human resource through regulation and licensing. The planning process is a continual process rather than compiling documents that once finished remain on the shelf untouched. According to Bebarta (2002), planning is “a function that determines in advance what should be done”. It further consists of selecting the enterprise objectives, policies, programmes, procedures and other means of achieving these objectives. Planning is a mental work for thinking ahead and preparing for the future, it bridges the gap between institutional desires and dreams by calling the managers to respond to the action thus no plan is worth the paper it is printed on, unless it being implemented (Bebarta 2002).

A concrete plan supplies an institution with tangible steps to take in the direction of their dreams. In this case, it is to achieve a clean audit.

4.2.1 Objectives and aims of planning

In making planning decisions the council aims to ensure that new development fits in with the council’s plans and policies and that a balance is maintained between the need for new development such as housing, employment, leisure and shopping facilities with a need to protect the built and natural environment and quality of life in the city. Planning has the following objectives (Bebarta, 2002):

- To improve quality of life for residents by ensuring that land use requirements of the community for housing, employment, retail, leisure, community facilities, waste, minerals and transport are met in a sustainable way.
- To conserve and enhance the best features of the natural and built environment.
- Caring for customers.
- Delivering high quality developments/ services.
- Promoting sustainable development
- Caring for the staff and developing their potential.

The above objectives emphasise the importance of planning, as it is the first and most important function of management (Bebarta, 2002). It is needed at every level of management. Planning can be undertaken through different forms to allow the managers to carry out their mandate in an effective manner. Planning can also be understood by its principles, which strive to maintain accountability and work ethics for the service delivery mandate. There is also a planning system that is considered when planning for the organisation. Table 4.1 presents the types of planning, the principles and the planning system.

Table 4.1 Types of planning, principles of planning and planning system

Types of planning	Principles of planning	Planning system
-Operational planning -Intermediate planning -Contingency planning -Strategic planning	-Principle of passion -Principle of creativity -Principle of influence -Principle of priorities -Principle of flexibility -Principle of timing -Principle of teamwork	-Survival -Competition -Opportunities -Vulnerabilities

Source: Bebarta (2002)

Types of planning

An operational plan is an annual work plan. It describes short-term business strategies; it explains how a strategic plan will be put into operation during a given operational period (fiscal year). An operational plan is the basis for and justification of an annual operating budget request. Each department (or budget unit) prepares and submits an operational plan as part of its total budget request document (Bebarta, 2002). Intermediate planning is seen generally as plans that fall under the next one to five years. These plans help business owners and managers assess certain aspects of their company and make decision to increase production output or operational profits. Intermediate plans also allow owners and managers to forecast

future changes in the economic market. It covers six months to a year and is the big picture approach to planning (Bebarta, 2002).

A contingency plan is a process that prepares an organisation to respond coherently to an unplanned event. The contingency plan can be also used as an alternative for action if expected results fail to materialise. A contingency plan is sometimes referred to as Plan B. It is a course of action to be followed if a preferred plan fails or an existing situation changes (Bebarta, 2002). Strategic planning is a review and planning process that is undertaken to make thoughtful decisions about an organisation's future in order to ensure its success. Strategic planning involves clearly defining the organisation's mission and an assessment of its current state and competitive landscape. Strategic planning also requires a well-thought out plan for how to allocate time properly, human capital and financial resources.

Principles of planning

It is hard to achieve anything consequential without a written plan. Regardless how the human resource thought, concrete or indigenous a plan may be, it won't happen unless additional ingredients are injected into the planning process, therefore, the following principles are critical for a successful planning (Bebarta, 2002):

Planning system

A planning system addresses the four basic purposes to help an organisation. The survival planning system allows an organisation to plan for tactical moves for quick reaction to the political, economic, social, technological, legal and environment to plan accordingly, unlike the private sector, government departments are established to provide public services to the community. With the public service mandate, the public sector will strive to survive in order to ensure that the services are rendered in a sustainable manner. Planning is also undertaken by means of benchmarking with other municipalities for ensuring customer satisfaction. Achieving a clean audit may be seen as a completion of accurate planning process among the institutions throughout the world.

Institutions are required to develop a checklist that will evaluate the progress and customer needs satisfaction. The planning checklist serves as an action template by which plans and the contractual conditions were realising this plans are put to work (Suchman, 1994;180-184). It also serves as a workflow system that addresses each activity in the process plan. It provides a model that represents work procedures that control the order in which the sequences of task are to be performed. This checklist system for the co-ordination of activities has drawn much attention, but has been subject to much controversy and criticism for the rigid representation of work in process models (Suchman, 1994;180-184). The checklist can be either manually implemented or automated.

4.3 BASIC INTERNAL CONTROLS

Institutions may use the following basic internal controls to manage their internal control functions. The basic internal controls include the following:

- Proper record keeping
- Processing and reconciling controls
- Regular and accurate reporting
- Compliance with the legislative framework
- Proper IT system controls
- Effective audit committees
- Effective internal audit function
- Sound risk management framework
- Effective leadership culture
- Oversight responsibility
- Sound HR management
- Effective and updated policies and procedures
- Clear action plans to address any deficiencies and
- Sound IT governance (Van Coller & Oberholzer, 2012).

Controls are restraining and directive influences over the activities of a system, therefore, general principles of control are applied in business organisations, accounting systems to assist management in controlling operations. Internal controls

assure the authorisation of all transactions; all transactions are recorded, access to assets is allowed only for authorised purposes, and accounting records describe only real assets. Effectiveness and efficiency of operations in governance, reliability of financial reporting, reliability of performance reporting, and compliance with applicable laws and regulations are a proper scope of how basic controls can be categorised. Internal control is an integral part of any organisation's financial and business policies and procedures. Internal controls consist of all the measures taken by the organisation for protecting its resources against waste, fraud, and inefficiency; ensuring accuracy and reliability in accounting and operating data; securing compliance with the policies of the organisation; and evaluating the level of performance in all organisational units of the organisation. Internal controls are simply good business practices. Internal control systems operate at different levels of effectiveness and they determine whether a particular internal control system is effective. It also ensures that the five components of internal control are applied. Effective controls provide reasonable assurance regarding the accomplishment of established objectives.

4.4 PROPER RECORDING

The audit committee (AC) is required to issue a report that informs about the financial health of the institution. The AC annual report should include the membership of the AC, with details of the number of meetings held by the AC and the number of meetings attended by the AC members. The effectiveness of the internal control systems depend on:

- proper record keeping
- the risk areas of the entity’s operations covered in the scope of internal and external audits
- the adequacy, reliability and accuracy of financial information provided by management
- accounting and auditing concerns identified as a result of internal and external audits
- the entity’s compliance with legal and regulatory provisions
- the effectiveness of IIA

- the activities of IIA, including its annual work programme, coordination with the external auditors, the results of significant investigations and response of management to specific recommendations (National Treasury, 2009:24).

Recording is the process of capturing data or translating information to a recording format stored on some storage medium, which is referred to often as a record. Recording of information may be stored in an audio or visual medium. Records tell the managers what, where and when something was done and why a decision was made. It informs about who was involved and under what authority. They provide evidence of government and individual activity and promote accountability and transparency. Electronic records are created, managed and preserved within information systems, and methods to support this must be developed (Borglund & Öberg, 2014:1). A record has several criteria, which makes the record unique in relation to other types of information. Thomassen (2001:374) highlights that records:

- are evidence of actions and transactions.
- should support accountability, which is tightly connected to evidence but which allows accountability to be traced.
- are related to processes, *inter alia* information that is generated by, and linked to, work processes.
- must be preserved, some for very short time and some permanently.

These four characteristics of records make them different from other types of information. In an organisation, records are part of the organisational memory and are used to support organisational management. It is stated that the evidential value of a record can only exist if the content, structure and context are preserved. The context is the link between different records that belong together, and also to the process where the record was created. Records are physical or virtual, have content, a structure/form, are created in a context and are process bound information (Thomassen, 2001:375). However, these features do not make records unique in relation to other forms or sorts of information.

4.5 PROCESSING AND RECONCILING CONTROLS

The COSO report identified a range of control activities including approvals, authorisations, verifications, reconciliations, and reviews of operating performance, security of assets and segregation of duties (COSO, 2014). Directive controls provide guidance to employees to help achieve the desired objectives of the department. Preventive controls are designed to deter the occurrence of errors or other undesirable events. Detective controls identify, on a timely basis, when errors or other undesirable events have occurred. Corrective controls identify the flaws in the process and determine the actions needed to correct the problems. Examples of corrective controls are additional employee training and reassessment of the current procedures (COSO, 2014).

Control activities should be designed to limit the potential negative effects of risks identified during the assessment process. Internal audit must be conducted in accordance with the standards set by the IIA. The third component of the integrated framework is control activities. Control activities are the policies and procedures designed by management to help ensure that the organisation's objectives and goals are not impacted negatively by internal or external risks. Some common and important control procedures are bank reconciliations and the review of those reconciliations by supervisory personnel; segregation of duties so that no one person controls all phases of a transaction cycle; daily deposit of cash receipts; frequent password changes; and limiting access to check stock, signature plates and wire transfer software; and control procedures can be used to keep costs as low as possible. A common procurement control procedure is to require oral or written quotes for purchases not subject to competitive bidding. This procedure is used to lower the risk that cost conscious purchases will not be made (DiNapoli, 2010:10).

Reconciliation is a process in which financial records are compared and discrepancies resolved. Conducting verification frequently can help ensure that your institute is properly exercising its fiduciary responsibilities to safeguard taxpayers' funds and ensure that they are used as intended. Since no one may have the ability to change data that affect both authorisation and disbursement, if award entries

made by the financial office automatically roll over and populate award fields in the business office, then the separation of functions must take place elsewhere (derived from SDM policy manual). Before a manager can compare the department's records, they must ensure the financial office and the business office agree on the amount of funds that should have been drawn down from the budget to cover the funds disbursed to employees for that month only.

Therefore, the first step in the reconciliation process must be to confirm that the business office records of actual disbursements posted to employee accounts are consistent with financial office records of employee award and scheduled disbursement amounts as reflected from a performance assessment. Therefore, they could begin the internal reconciliation process by comparing a monthly financial office roster of scheduled disbursements to a monthly business office cash detail report that reflects funds drawn down and funds disbursed for the month. If discrepancies are discovered they must be resolved. In addition, business office and financial office records of adjustments (refunds of cash) made during the month should be compared. The following is the best practices list that will send the managers error-free account reconciliations and a more efficient financial close:

- Account reconciliations should be complete - no account left behind
- Account reconciliations should be accurate
- Account reconciliations should be completed and reviewed in a timely manner
- Account reconciliations should support the appropriate accounting principles
- The account reconciliation process should be constantly reviewed and improved

4.6 MANAGEMENT INFORMATION REPORT

In terms of Sections 4(1) and (3) of the PAA, financial management must be audited and reported on. Accordingly, the auditor's report reflects views on:

- financial information, through the auditor's opinion on the financial statements
- performance against predetermined objectives, reflected as findings under the predetermined objectives heading in the report on other legal and regulatory requirements section in the auditor's report

- compliance with applicable laws and regulations relating to financial matters, financial management and other related matters, reflected as findings under the compliance with laws and regulations heading in the report on other legal and regulatory requirements section in the auditor's report
- internal control, as indicated by the deficiencies in internal control that resulted in:
  - qualifications of the opinion on the financial statements
  - findings on the report on predetermined objectives
  - findings on compliance with laws and regulations (Auditor-General, 2011).

Table 4.2: Information report

Information report	Description
Bank and cash balances	This will reflect the utilisation of funds received and will furnish broad indication of how much has been spent on grants and on office/admin expenses. The opening and closing balances should be in agreement with the bank book.
Analysis of expenses against budget	This is the variance report on management of expenses budget and reflects whether the trend of expenses have to be reviewed in order to avoid any negative variation and take corrective action as necessary. Every positive and negative variance has to be commented upon citing reasons for variance and corrective action proposed.
Grant utilisation status	It is necessary to review on a monthly basis the utilisation status of grant budget in order to ensure that the actual spending is as per the planned budget and the phasing of utilisation.
Statutory compliance	The implications of non- compliance of statutory provisions are very serious and it is therefore necessary that the management is kept informed about the compliance or otherwise of these provisions, this report becomes useful for managers to monitor adherence to the requirements and due dates.
Fixed/consumable assets	The assets register needs maintenance as per the format authorisation of the same on a regular basis.

Source: Fundsforngos, LLC (2013)

The finance/accounts officer prepares and consolidates the reports. The report is submitted to the relevant persons, as the case may be, with a copy to the finance manager before the 10th of every month. In addition to setting up adequate internal control measures, management shall from time to time perform these checks to safeguard assets. The information report is managed under six headings presented in Table 4.2

4.7 REGULAR AND ACCURATE REPORTING

Public reporting on the financial performance of government agencies is an element of good governance and financial accountability. It involves providing information on the financial and managerial performance of public departments that enables the public to monitor and assess performance of government activities. The aim is to encourage dialogue to lead to improved service delivery. The International Monetary Fund (IMF) and other international bodies have developed a number of codes and standards that set out good practices in the areas of policy transparency, data dissemination and financial regulation and supervision. In relation to public reporting, the IMF has identified the following codes and standards:

- The public availability of information whereby the public should be provided with full information on the past, current and projected fiscal activity of government.
- Open budget preparation, execution and reporting. The budget documentation should specify fiscal policy objectives, the macroeconomics framework, the policy basis for the budget, and identifiable major fiscal risks.
- Budget data should be classified and presented in a way that facilitates policy analysis and promotes accountability.
- Procedures for the execution and monitoring of approved expenditures should be clearly specified.
- Fiscal reporting should be timely, comprehensive and reliable, and should identify deviations from the budget (Economic Commission for Africa, 2003:27).

The office of the Auditor-General also provides a critical link in the chain of public accountability, a role that is both unique and vital to the democratic process of responsible government. The Auditor-General 's role is to assist the legislature in overseeing the management of public money, by providing independent assessments of, and advice about, government accountability and performance. Reports should provide assessments and highlight issues requiring the attention of the legislature or government, and should also contain recommendations that could assist government organisations to improve their management and performance (Economic Commission for Africa, 2003:27).

4.8 PROPER IT SYSTEMS CONTROLS AND SOUND IT GOVERNANCE

The implementation of controls and information systems is essential to discharge management's responsibilities effectively. Probably the single most important and easiest control to implement is limiting access to the system administration sector of the entity's financial management software. DiNapoli (2010:16) indicates that the accounting officer and other managers need to be cognisant of the impact of information technology (IT) on the integrated internal control framework. What makes these environments so challenging is that the processing of financial transactions and the storage of sensitive information is virtually unseen and unheard, and modifications and intrusions into these systems are equally silent. The opportunities for the manipulation of data are high, especially if a dishonest and unethical individual is more knowledgeable in the functioning of the software than management is (DiNapoli, 2010:16).

DiNapoli (2010:16) further indicates that the second universally important IT control is the availability and periodic review of audit logs. An audit log records changes made in the administration of the financial management system, and also records any events where previously recorded (original) data is modified or system parameters are changed, even if temporarily. Audit logs can be an important detection control for possible manipulation of the financial data or other sensitive information (DiNapoli**,** 2010:16). Most CEOs and financial managers will need the help of a qualified IT professional to assess the risks adequately, and design and

monitor controls in a digital environment. In the SDM, the tender/procurement information is posted on the Sedibeng municipal website on the tender page. For example, a Tenders RSS Feed is also available on the website. All tenders are posted on the tenders' notice boards at the Sedibeng municipal offices, and advertised in the local and regional newspapers (Yes Media, 2012).

It is advised and recommended to have a systems-based approach to internal audit; this means that the internal auditor is a control expert. Information technology (IT) has become increasingly significant in recent years, particularly following greater use of the Internet and organisational intranets. Technology has increased the amount of data and information being processed and it has significantly impacted the control environment. ICT is also known as a key component of government entities business strategies and core business processing activities. The management of ICT now forms a key part of corporate governance. Accordingly, the effective and efficient management of ICT is vital to the success of most entities.

As computer technology has advanced n extent that government departments have become increasingly dependent on computerised information systems to carry out their business operations and service delivery and to process, maintain and report essential information. There are also an increasing range of ICT vulnerabilities and human resource matters that have to be managed effectively and efficiently. Consequently, the confidentiality, integrity, availability and reliability of computerised data and of the systems that process, maintain and report these data are a major concern to audit. Effectiveness and efficiency of IT controls in information systems and related operations to ensure they are operating as intended.

IT audit is the process of collecting and evaluating evidence to determine whether a computer system has been designed to maintain data integrity, safeguard assets, allows organisational goals to be achieved effectively and uses resources efficiently. An effective information system leads the organisation to achieve its objectives and an efficient information system uses minimum resources in achieving the required objectives. IT auditors must know the characteristics of users of the information

system and the decision-making environment in the audited organisation while evaluating the effectiveness of any system.

Use of computer facilities has brought about radically different ways of processing, recording and controlling information and has combined many previously separated functions. The potential for material systems error has thereby been greatly increased causing great costs to the organisation. The highly repetitive nature of many computer applications means that small errors may lead to large losses. For example, an error in the calculation of income tax payable by employees in a manual system will not occur in each case, but once an error is introduced in a computerised system, it will affect each case. This makes it imperative for the auditor to test the invisible processes and to identify the vulnerabilities in a computer information system, as human resource ought errors and irregularities, the costs involved can be high.

Increasing use of computers for processing organisational data has added new scope to the review and evaluation of internal controls for audit purposes. The IT internal controls are of great value in any computerised system and it is an important task for an auditor to see that not only adequate controls exist, but also that they work effectively to ensure results and achieve objectives. In addition, internal controls should be commensurate with the risk assessed to reduce the impact of identified risks to acceptable levels. IT auditors need to evaluate the adequacy of internal controls in computer systems to mitigate the risk of loss due to errors, fraud and other acts and disasters or incidents that cause the system to be unavailable.

Underpinning these goals and objectives is the need to ensure information technology, and the controls supporting such technology, assists the organisation to achieve its business objectives (effectiveness) with appropriate use of resources (efficiency).

4.9 EFFECTIVE AUDIT COMMITTEES

Section 76(4) (d) of the PFMA states that “the National Treasury may make regulations or issue instructions concerning Audit committee’s, their appointment and their functioning”. Sections 77 of PFMA and 166 of MFMA provide for the establishment, composition and frequency of meetings. An audit committee is established to serve as an independent governance structure whose function is to provide an oversight role on the systems of internal control, risk management, and governance. The AC assists the accounting officer (AO) in the effective execution of his/her responsibilities with the ultimate aim of the achievement of the organisation’s objectives (National Treasury, 2009:5).

The function of an AC is seen as assisting the board in providing an independent review of the effectiveness of the financial reporting process; internal control and risk management system of the entity; overseeing the audit process and performing other duties and responsibilities as assigned by the institute/board to operate effectively (Moeller, 2009). An audit committee requires the cooperation and support of the executive management in providing information and resources, and in implementing and carrying out the committee's requests and recommendations. Members of the committee, as non-executive directors, are an integral part of the board, with the same legal responsibilities as any other directors. It is, therefore, in their best interests as committee members to insist on the supply of adequate information by the executive management. Non-cooperation of the executive management can undermine the effectiveness of the audit committee.

The AC must ensure that the municipality has an audit committee charter; well-defined roles and responsibility of the AC; a risk management strategy; and the control framework. The respective important matters are discussed briefly below.

Audit committee charter

In relation to internal audit, the audit committee must ensure the clarity of the function of the charter, independence and activities of the internal audit, and respond to the objectives of the municipality and the legal framework. The Charter sets out

the specific responsibilities assigned by the council to the audit committee and details the manner in which the audit committee will operate. The charter is subject to annual review by the council (National Treasury, 2009:5). The contents of the charter for the AC define the purpose and scope of work, accountability, independence, responsibility, authority, standards and code of ethics, review period date that is accepted by the accounting officer and approved by audit committee date (National Treasury, 2009:85).

Roles and responsibility

The audit committee can act as a liaison between the internal auditor and the board. Possible additional roles for the audit committee include:

- Making recommendations to the board regarding the appointment of the internal auditor.
- Assisting in the oversight of the internal audit function, including reviewing the annual internal audit plan to ensure the periodic evaluation and testing of high-risk areas and key control activities.
- Reviewing the results of internal audit activities.
- Monitoring implementation of the internal auditor's recommendations.
- Participating in the performance evaluation of the internal audit function (DiNapoli**,** 2010:19).

Risk management strategy

In order to manage effective internal control the AC is also required to develop a risk management strategy plan. This is to ensure the effective management of the internal control system. Risk management is an essential part of effective corporate governance and whilst it is a management responsibility, management expects the AC to oversee and provide advice on the organisation's risk management (National Treasury, 2009:14). An effective audit committee will seek assurances on the entity's key risk areas, so that the management can assess whether the risks associated with the entity are managed appropriately. An internal audit can help to identify risks, which may lead an entity to fail in achieving its performance and profitability targets. Internal audits also aid in preventing a loss of assets and resources, in ensuring

reliable financial reporting, and in complying with laws and regulations (Russell, 2007).

Control framework

The AC members need to have a good understanding of the control framework. This understanding will enable the AC to evaluate the adequacy of the organisation's control environment and will be a basis from which reasonable assurance can be provided that the organisation's objectives and goals will be achieved efficiently and economically (National Treasury, 2009:14).

4.10 EFFECTIVE INTERNAL AUDIT FUNCTION

Both the PFMA and MFMA make provision for the establishment of the IAA to assist the AO and the AC in the effective discharge of their responsibilities. Internal auditing as, "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes" (National Treasury, 2009:5).

The Institute of Internal Auditors defines internal audit as an independent assurance and consulting activity designed to add value and improve the organisation's objectives. It also helps an organisation accomplish its objectives, and it improves the effectiveness of risk management, control and governance processes (Russell, 2007). It objectively examines, evaluates and reports on the adequacy of internal control as a proper, economic, efficient and effective use of resources. Table 4.3 presents the internal audit functions and the contents of the internal audit functions.

Table 4.3: Internal audit functions and the contents of the internal audit functions

Internal audit functions	Contents of Internal audit functions
Performing examinations of operating and financial controls.	The standards to be complied with.
Conducting efficiency and effectiveness reviews	The scope of work to be undertaken.
Conducting reviews of compliance with laws and other external regulations	The position of the IAA within the organisation.
Evaluating the design and execution of internal controls (DiNapoli, 2010:17).	A description of assurance and nature of consulting services.
	The period of review of the charter.
	The appointment and the dismissal of the CAE
	Access to information, properties and people (National Treasury. 2009:16).

The management of an entity should use risk management and its understanding of risks as an integral part of running the entity and its business, and should take action in respect of the associated risks and opportunities. Russell (2007) indicates that a comprehensive risk management model should include assurances that tell the management how well the processes are working and how well risks are managed. Assurances comprise both of internal and external factors. Internal audit can provide management with independent assurance on a diverse range of tasks, including but not limited to fair presentation of financial statements that the external auditor will do (Russell, 2007).

4.11 SOUND RISK MANAGEMENT FRAMEWORK

Risk may affect many areas of activity, such as strategy, operations, finance, technology and environment. In terms of specifics, it may include, for example loss of key staff, substantial reductions in financial and other resources, severe disruptions

to the flow of information and communications, fires or other physical disasters, leading to interruptions of business and/or loss of records (Bessis, 2002). More generally, risk also encompasses issues such as fraud, waste, abuse and mismanagement (Bessis, 2002). Risk management is essential for reducing the probability that corporate objectives will be jeopardised by unforeseen events. The board must determine the type and extent of risks that are acceptable to the company, and strive to maintain risk within these levels. Internal control is one of the principal means by which risk is managed (Bessis, 2002).

DiNapoli (2010:3) states that "managers and department heads are generally responsible for identifying potential risks, designing and implementing controls for their areas of responsibility, and keeping current with events and changes that affect the controls they have put into place". Gauthier (2006) offers the requirements for the risk management framework as follows:

- The internal environment is the tone of an organisation which, among other things, determines an organisation's risk culture and provides the basis for its internal controls.
- Objective setting is a critical process that supports an organisation's mission.
- Event identification identifies internal and external events that impact an organisation achieving its objectives. Events that may have a negative impact represent risks while those that may have a positive impact represent opportunities.
- The risk assessment allows an organisation to understand the extent to which potential events may affect objectives. Risks should be assessed from both the likelihood of happening and the impact if it happens;
- The risk response evaluates options to an identified risk and determines the course of action. Options available are (a) accept the risk and monitor it, (b) avoid the risk by eliminating it, (c) reduce the risk by implementing controls, and (e) share the risk with another entity;
- An organisation's control activities include policies and procedures, directives, etc. They occur throughout the organisation at all levels and functions;

- Information and communication is the identification and dissemination of pertinent information in a form and timeframe that enables people to carry out their responsibilities. Communication occurs in all directions and should flow in all levels of the institutional environment; and
- Monitoring the effectiveness of components includes on-going activities and/or separate evaluations and making modifications as necessary.

The following are risk management facets:

4.11.1 Risk committee

The main purpose of the risk committee is to assist the council in ensuring that management has an effective risk management process that identifies and monitors the management of the key risks facing the company in an integrated and timely manner (Moeller, 2011).

The audit charter of the SDM's audit committee was reviewed to include as its functions responsibilities related to risk management and performance management. In the year under review, assistant manager risk management was appointed in the office of the municipal manager. A risk service provider was appointed and facilitated, with all executive directors, identification of risks in all clusters, update of risk registers, and development of a risk assessment report. The strategic risk assessment report shall be finalised in the 2011/12 year (SDM, 2006-2010). The risk officer has the following responsibilities:

- institutional objectives support and align with the institution's mission
- significant risks are identified and assessed
- risk responses are appropriate to limit risk to an acceptable level
- relevant risk information is captured and communicated in a timely manner to enable the accounting officer/authority, management, the risk management committee and other officials to carry out their responsibilities
- assisting management to develop the risk management policy, strategy and implementation plan
- co-coordinating risk management activities

- facilitating identification and assessment of risks
- recommending risk responses to management
- developing and disseminating risk reports (Moeller, 2009).

4.12 EFFECTIVE LEADERSHIP CULTURE

Internal controls are essential to the effective operation of local governments. Internal controls activities are designed to provide reasonable assurance that operations are "going according to plan" (DiNapoli, 2010:2). Internal control enables the managers to have assurance that its goals and objectives will be achieved. DiNapoli **(**2010:2) further indicates that properly designed and functioning controls helps to reduce the likelihood that significant errors or fraud will occur and remain undetected. Internal controls also help ensure that departments (other than the main finance office) are performing as expected. Adeniyi (2010) outlines that the leader must possess the following attributes, namely self-assessment, a sharp perception, being responsive to the group's needs, and knowing the organisation.

4.13 OVERSIGHT RESPONSIBILITY

To execute its responsibilities effectively, management needs to understand how an integrated internal control framework should work (DiNapoli, 2010:2). The municipality also use the external auditors to evaluate internal controls as part of their audit planning process (DiNapoli, 2010:2).

An oversight responsibility may be placed upon the governing board. Most of the public sector entities have an established board that is responsible for internal controls. Primarily the boards are involved with the oversight, authorisation and ethical leadership. In order to perform the oversight role the accounting officer will rely upon the managers and department heads to recommend and implement procedures that lower identified risks. In the SDM, the audit committee 2010/2011, bursary committee, risk committee, and remuneration committee have been established to play the oversight role (SDM, 2011:35).

Audit committee 2010/2011 - SDM

The current audit committee has a three-year rolling contract to provide oversight to all audit functions within the Sedibeng district, 2010-2013. The audit charter was reviewed to include risk management and performance management as responsibility areas of the audit committee. The committee constitutes five external members, and internal senior officials attend per invitation. The audit committee convened four ordinary meetings and two special (SDM, 2011:35).

Bursary committee

SDM has a functional bursary board comprising of eight members, set up to oversee the screening, selection and awarding processes of bursaries to deserving students in the region. The committee comprises members of the public, *inter alia* educationists, women, youth and people with disabilities (SDM, 2011:35).

Risk committee

The audit charter of the SDM's audit committee was reviewed to include as its functions responsibilities related to risk management and performance management. In the year under review, assistant manager risk management was appointed in the office of the municipal manager. A risk service provider was appointed and facilitated with all executive directors, identification of risks in all clusters, update of risk registers, and development of a risk assessment report. The strategic risk assessment report finalised in the 2011/12 year (SDM, 2011:35).

Remuneration committee

SDM established a remuneration committee in line with good corporate governance mandate. The committee constitutes five members, three African National Congress, one Democratic Alliance and one Pan African Congress. The remuneration committee held three meetings to deal with matters of salaries and benefits of all Section 57 employees/officials including all employees employed on contractual basis. The salaries and benefits of all staff are negotiated at the South African Local Government Bargaining Council (SDM, 2011:35).

4.14 SOUND HUMAN RESOURCE MANAGEMENT

The latest audit spells out the problems with municipal accounting in the plainest terms yet; the municipalities that have seen an improvement in their audit outcomes have a few common characteristics. They have management committed to improving financial transparency and accountability. They have finance departments with qualified staff who work in co-operation with the auditor-general's office. They have taken the advice of previous audits to heart and have implemented the suggested changes (Berkowitz, 2012).

Sims (2002) explains human resource management as "a function in organizations designed to maximize employee performance in service of their employer's strategic objectives". Human resource is primarily concerned with how people are managed within organisations, focusing on policies and systems. It enables organisations to administer their human resource policies in an intelligent and consistent manner, benefits can accrue in several areas (Heneman & Greenberger, 2002).

4.15 EFFECTIVE AND UPDATED POLICIES AND PROCEDURES AND CLEAR ACTION PLAN

Morse and Struyk (2006) indicate that the policies direct workers to take action consistent with legal, ethical, and organisational requirements. Procedures provide explicit, systematic instructions. Together, they guide the documentation required to substantiate actions. Therefore, the following are policies used for compliance and towards reaching a clean audit.

An action plan is a way for an organisation to plan the elimination, as far as possible, of disability discrimination from the provision of its goods, services and facilities. An action plan is a tool in social planning. It considers details, may help limit setting for an organisation, and is efficient in that it is saving resources over trial and error. The greatest benefits are that organisations are able to, on a regular basis, evaluate progress and cross off the things that are being done to achieve goals. A written action plan also serves as a token for an organisation's accountability:

- It can help to comprehend what tasks need to be done to accomplish goals.

- It can provide a way to have a clear time-line on each of the jobs sothat goal progress can be tracked.
- It can provide lucidity for the resources that are needed to accomplish goals.

4.16 CONCLUSION

This chapter described the basic internal control function, as it is a requirement for managing the organisational activities. The illustration in this chapter provides important content for management to take note of in respect of the internal control process, and how important it is to understand their control environment. It provides the reader with the assurance aspects on effective and efficient control to be put in place by management. The understanding of the internal control process is in the hands of management to ensure that a good audit opinion is reported to the governance structures. Note should be taken in this chapter around the additional input towards the audit process, which relates to the oversight role within the governance structures.

CHAPTER 5 METHODOLOGICAL ORIENTATION AND RESULTS; PROCESSES AND PRINCIPLES OF SDM FISCAL ACCOUNTABILITY TO PROMTE A CLEAN AUDIT.

5.1 INTRODUCTION

This chapter explains the research design; the research methodology applied is also outlined. It describes the current status quo regarding internal controls and the audit outcomes by the Auditor-General within the SDM. It will also analyse the questionnaires and interviews held with various political office bearers and officials employed by the municipality. The chapter aims to point out the positive aspects of internal controls implemented towards clean audit, and the negative aspects related to lack of internal control and internal control weaknesses that exist, which require improvement and innovative mechanisms to minimise strategic and operational risk.

5.2 RESEARCH METHODOLOGY

The researcher began by defining the focus of this research. The researcher was interested in the internal control functions of a municipality. It was decided that the internal control would be the focal point of this research. The definition of the research also enabled the researcher to define the research problem. The definition of the research problem allowed the researcher to lay a foundation for this research and to select the research method applicable to this study. The following sections describe the application of questionnaires, research ethics considerations and the research sample for this study.

5.3 QUESTIONNAIRE ANALYSIS

A survey cannot attain success without a good and ordered questionnaire. The emphasis throughout will be on the SDM. It is important to note that the word analysis is used in this proposal to refer not only to the challenges faced by municipalities in achieving clean audit opinions (such as structured methods) but also to refer to those situations where no design method was previously used.

A list of functional areas to be used during the study in the SDM has been compiled. The review approach involves the use of a semi-structured questionnaire and was

conducted by way of taking a combined approach of quantitative and qualitative research designs of the political office bearers and management officials who were interviewed. Questionnaires were sent to all the selected politicians and employees who were willing to assist in the research, ensuring a high response rate. Interviews were conducted with political office bearers and management from within the municipality. Although the questions were operational in nature, notes of responses were documented and summarised to illustrate the views of interviewers. One set of questionnaire were designed and distributed to all levels of grouping to test the knowledge, attitude and contributions of the various respondent groups to internal control in achieving a clean audit. The questions were designed in the following order:

- Question 1 - Governance controls
- Question 2- Financial management controls
- Question 3- Predetermined objectives controls
- Question 4- leadership controls- compliance with laws and regulations
- Question 5- Cluster-specific controls
- Question 6- General and other information on controls

Closed-ended and open-ended questions were used to provide the respondent with options of yes/no/unsure, and to make comments where applicable to them. General statements and questions were asked regarding internal control and auditing.

Examples of some closed-ended questions are:

- Is there a delegation of authority policy in place?
- Does the municipality have an OPCAR action plan in place?
- Have all matters/issues from the last Auditor-General report been resolved?

Some examples of open-ended questions are:

- Please mention areas or issues where you think internal control in your cluster can be improved or resolved differently?
- Please list any attribute in your view and opinion that can add value to this study in your control environment.

- Does the municipality keep a record of complaints or queries? If yes, indicate the number of complaints over the last six months?

5.4 METHODS OF SURVEY AND INTERVIEWS

The methods for survey include one-on-one interviews, group discussions and email versions of the questionnaire, some of the respondents were not available for the one-on-one interviews, so a decision was made to allow them to complete the questionnaire in their own time and return when completed. Upon completion, follow-ups were made with the respondents to ascertain their understanding, clarity and knowledge of the research questions based on their responses. Most of the questions were altered to test the respondent's knowledge and skills as per the requirements outlined by MFMA.

5.5 RESEARCH SAMPLE

A researcher is required to select the type of survey that corresponds with the topic of study. The selection of the sample is one of the most critical decisions in many social research contexts. When selecting the sample the researcher must take into consideration how to identify the sample. The respective groups are presented in Table 5.1.

Table 5.1: Summary of questionnaire distribution

	Group 1 – Mayoral committee	Group 2- Section 80 councillors	Group 3- Executive management	Group 4- Middle management	Group 5 – Ordinary officials (junior staff)
Questionnaires distributed	5	5	10	5	5
Questionnaires received	1	4	10	5	5
Questionnaires usable	1	4	10	5	5
Questionnaires unusable	4	1	0	0	0

Furthermore, the researcher is required to determine the accessibility of the respective sample population. Internal control function is undertaken mainly by policy implementers, which consist of different stakeholders. Such stakeholders are responsible to carry out the legislative mandate of the respective municipality. The sample for this research comprised of five groups selected from the SDM. Employee selection is done by way of random sampling in such a way that the main operational and corporate functions as listed are covered.

5.6 PERMISSION TO CONDUCT RESEARCH

This research concentrates mainly on public finance; specifically focusing on the internal control functions of the municipality. Permission to conduct this research was firstly obtained from the municipal manager of the SDM and he acted as a custodian for the research study. A sample of the permission letter to the custodian is attached in Appendix B. The North-West University also approved the research proposal presented to the research ethics committee. A consent form was developed. The consent form was issued to every participant of this research. The participants were willing to participate in the research process. The names of the respondents are not included in this report.

5.7 BACKGROUND OF THE SDM

The SDM comprises Emfuleni, Lesedi and Midvaal local municipalities. The SDM is a Category C municipality. The SDM is the fourth-largest contributor to the Gauteng economy. The SDM reached a momentous milestone on 3 December 2013, when the Auditor-General released its 2012/2013 audit opinions on Gauteng municipalities. The SDM became the first municipality in Gauteng to reach the 2014 target of operation clean audit. When asked about how they achieved the clean audit, the municipal Manager (Mr. Yunus Chamda) outlined that:

the ‘Clean Audit’ target was a special target set by COGTA since audits of public departments require more than just financially unqualified findings. A ‘Clean Audit’ is therefore based on three factors refered below:

Firstly, the financials must be unqualified. Secondly, the performance of the institution must be managed consistently, reliably and accurately. Thirdly, an institution must have no areas of non-compliance with laws and regulations.

Data presented in Table 5.2 about the financial health of the SDM was observed during the literature review processes.

Table 5.2: Financial Information of the SDM

Audit outcome	2011/12 Financially unqualified with findings	2010/11 Financially unqualified with findings
Total net assets	175 352	171 543
Surplus/Deficit for the year	4 425	(39 853)
Unauthorised, irregular, fruitless & wasteful expenditure	-	88 772

The interesting part was to see that during the financial year 2011/12 the SDM had no unauthorised, irregular, fruitless and wasteful expenditure as compared to the financial year of 2010/11. This is a pleasant gesture to indicate that the public money is spent in a meaningful way.

5.8 STATUS QUO REGARDING INTERNAL CONTROLS AT SDM

Various internal control documents, action plans, tools, and policies are currently in place at SDM. This research has found that these documents are kept in archives for record keeping and the volumes are excessive. It is for this reason that the establishment and maintenance of an effective control environment is one of the key elements of an effective operating and financial reporting process. The control environment, therefore, sets the tone of the organisation, influences the consciousness of its people, and is the foundation for all other components of internal control, providing discipline, structure and contribution to a culture that helps to minimise the risk of loss from fraud and errors.

The framework for SDM is confined into various guidelines articulated in municipal laws and regulations. This is one of the gaps already identified within the vast functions from a local government internal control perspective. In this process, regular assessments are required to be done across to this framework and a policy and procedure handbook must be kept in various functions. The current status based

on this research is that the finance cluster has all this processes in place and have compiled a detailed financial policy and procedure manual (refer to Appendix A), an internal control assessment and a Operation Clean Audit Plan (OPCA).

5.9 SEDIBENG DISTRICT FINANCIAL POLICY AND PROCEDURE MANUAL

The office of the CFO informed the researcher that the SDM has developed the financial policy and procedure manual. It was also explained that the officials do not normally read the volumes of laws and regulations set out for them to know and be familiar with in performing their fiduciary responsibilities and duties. This is because they primarily focus on service delivery issues and sometimes ignore the compliance part. On the part of officials, it was found that they require a step-by-step process, explaining all the activities of the various functions. This was done primarily to make the procedure easily adaptable for new and existing employees from a skills transfer perspective in bringing knowledge across from a diverse number of experienced staff within the finance cluster.

The approach in developing the procedure manual within SDM comprised the following:

- Complete assessment of SDMs control environment and connective aspects towards finance
- Confirmation of key objectives and critical success factors
- The complete assessment of the organisation, its policies, procedures, accounting, budgeting, reporting and IT environment
- Benchmarking and GAP analyses
- Action plan development and implementation with a project plan
- Monitoring and evaluation.

As an innovative concept, the document has become a become a working document, which can be customised to any municipal environment. This was done as a move to ensure norms and standards are documented. It also ensures that the control environment within finance is assured and verified by internal audit to give credence towards a working document and/or tool that can be easily adapted at various municipalities across South Africa. In this manner, the document can be

updated annually should there be a change in the internal control activity. The procedure manual excludes the governance (such as human resources, IT and audit) and leadership (code of conduct) aspects.

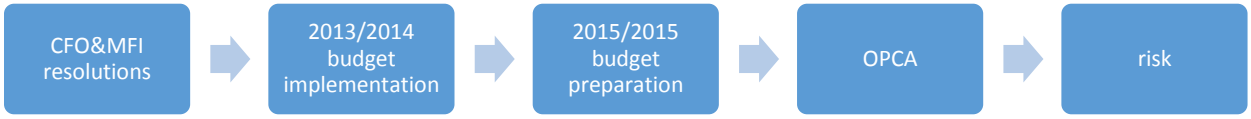
5.10 INTERNAL CONTROL ASSESSMENT

During the interviews, it was found that over the last four audit periods, the Auditor-General and all its stakeholders had numerous forum meetings and indaba's as informative action plans were discussed to drive the clean audit concept among municipalities in South Africa. Most sceptics indicated that there is no such thing called a clean audit. If so, it would not be possible for municipalities to achieve a clean audit, as there are issues of reliance, assurance, review, compliance, shortage of capacity and various other reasons provided that would negate municipalities from achieving a clean audit. SDM became the only municipality in Gauteng that obtained a clean audit in 2013.

Leading up to this achievement one of the key attributes were the internal controls and financial procedure assessment done by SDM and the implementation of the key control review process document designed, performed by the AGSA and later taken-over by the municipalities internal audit division used to curb the risk component from a sample basis. The Auditor-General's key control process serves as a measuring tool of how the identified internal control weaknesses are being addressed by the municipality. This is not a full audit, but it provides early red flags of non-compliance toward the OPCA process and where action must be taken on matters of priority. The key controls have been designed specifically to focus on the matter most likely to audit findings. The report provides green, amber and red faces on the four control priorities. Once a green face is received, it is an indication that it is at an advantage position for achievement from an assurance point. If it is amber, the finding is in progress, whilst a red face requires action and intervention to correct the finding immediately. This action is performed quarterly and measures assurance and reliability of internal controls specific to the four focus areas taken from the questionnaire. This process assisted SDM mainly to improve on its audit outcome as illustrated in the Auditor-General's findings over this period. The awareness of this campaign is beneficial in SDM; however, it was found that some municipalities lost experienced staff and no succession plan, retention plan, or talent management plan

existed as a human resources strategy to serve a common goal. It has now become evident that municipalities must invest in their human capital and appreciate the work that their staff performs. These issues raised might look minute, but it impacts on the internal control environment in any organisation from an emotional intelligence perspective.

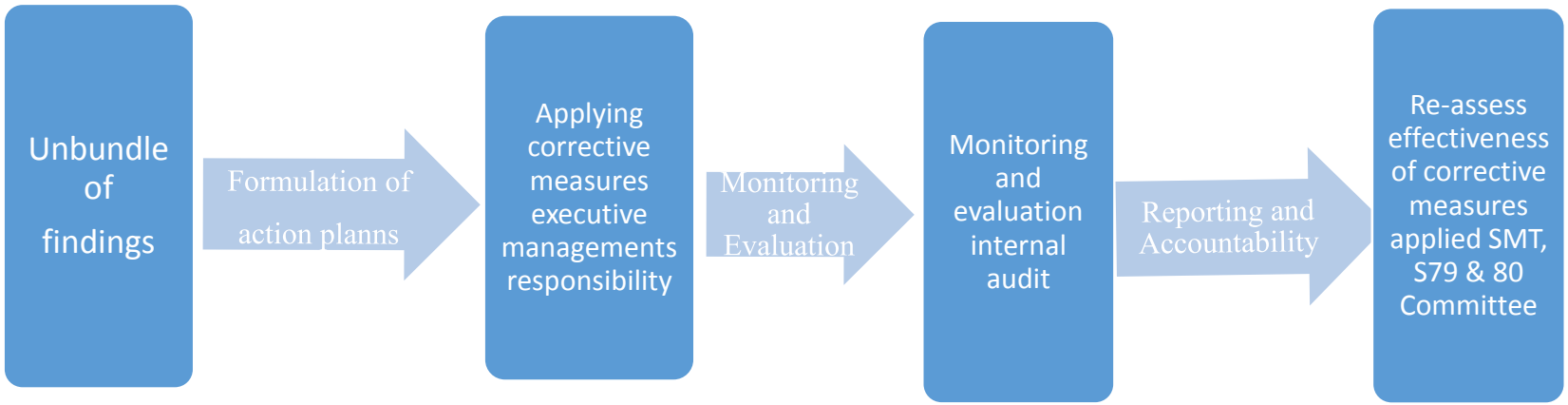
Figure 5.1: Stakeholder process map on OPCA



5.11 OPERATION CLEAN AUDIT ACTION PLAN (OPCA)

SDM does have an OPCA plan in place. The CFO and the accounting officer drive the plan, where the management committee serves as the responsible governance structure with the audit and mayoral committee to ensure that matters are appropriately addressed and implemented. The OPCA plan is taken from the summary of the management letter from the Auditor-General and converted into a project plan, which states the responsible person, responsible department, actions to be taken, due date, progress report and monitoring controls. The research found that this plan is monitored closely and any deviations trigger an immediate action for management to address. As indicated earlier, the plan serves as a control panel where appropriate weaknesses, such as risks within the internal control, are addressed. The identified housekeeping matters from the Auditor-General should be taken seriously as it is a sign of internal control weaknesses.

Figure 5.2: Process for addressing management letter (audit findings)



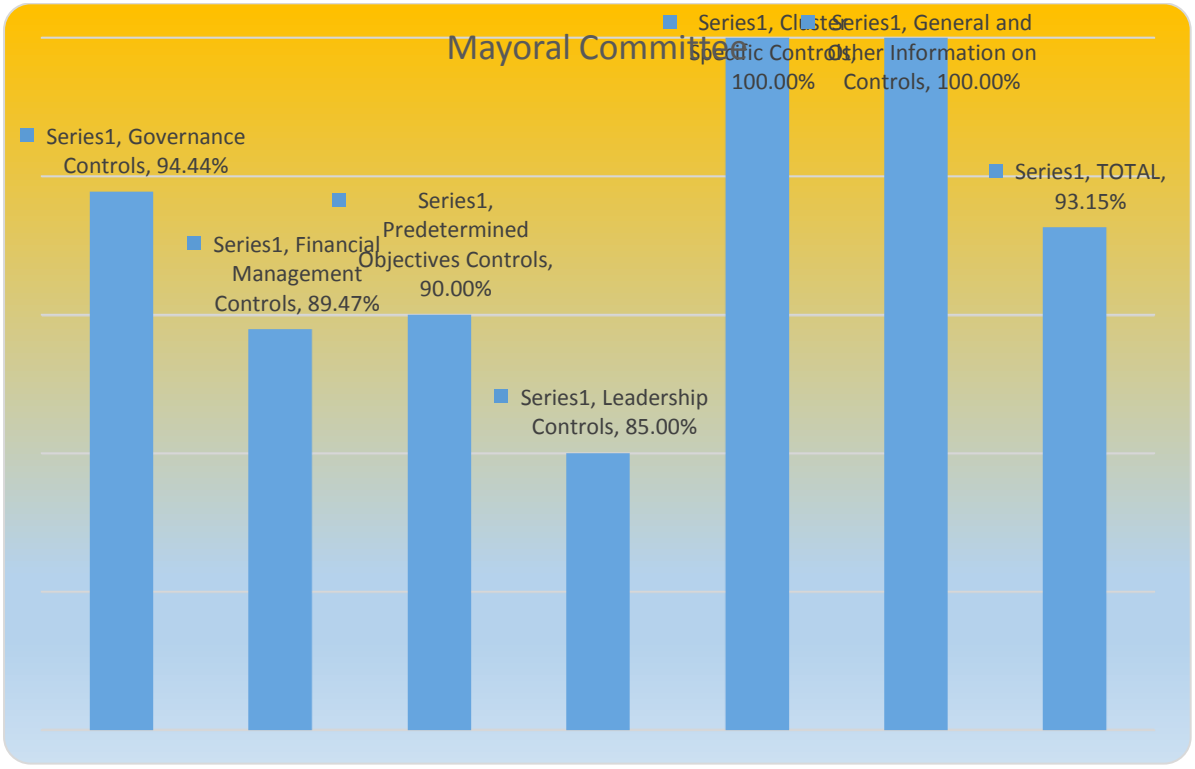
5.12 RESEARCH RESULTS

The target audience that was chosen is all employees of SDM together with their serving councillors, political management team, and mayoral committee, from which five groups were created. The responses of the participants are discussed in the sections below.

5.12.1 Group 1 – Political management team and mayoral committee members

Group 1 consists of five political management team and mayoral committee members, to determine the level of knowledge and involvements in the internal control and means of achieving a clean audit. The respondent's summary is discussed as follows:

Figure 5.3: Political management team and mayoral committee members' outcomes



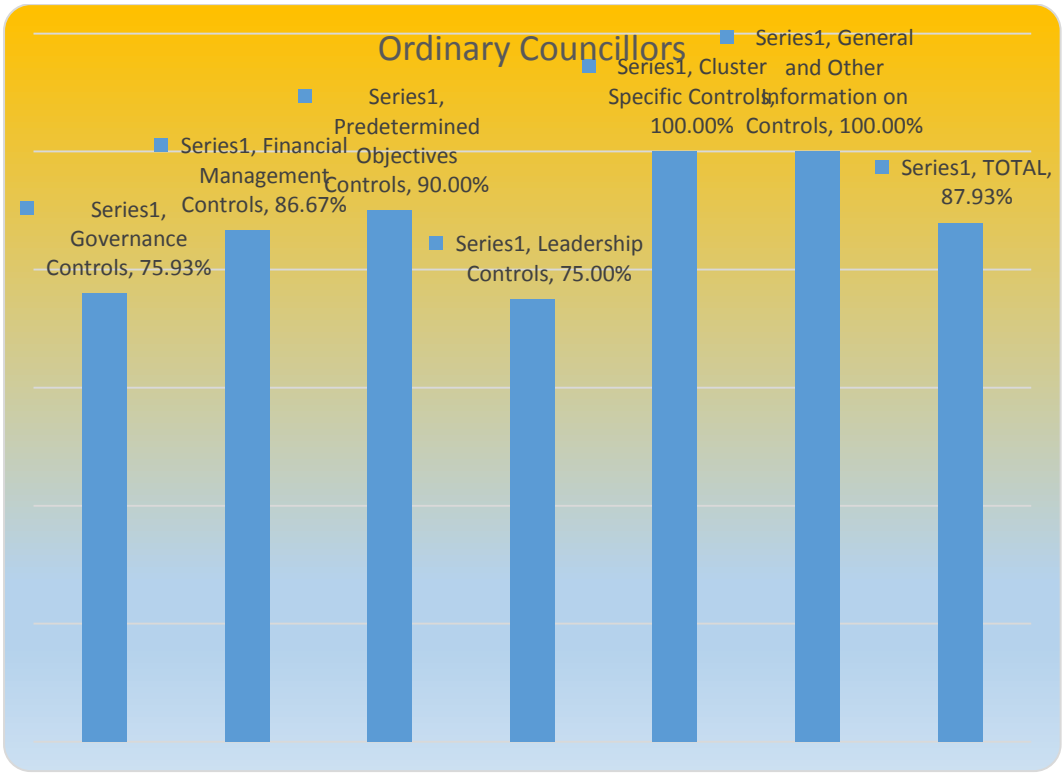
In Group 1, there is a general understanding of the controls that require oversight from the group on all categories. The non-response clearly implies that either the political leadership do not treat internal control as important, or they just do not have

the time to look into their role within the internal control environment that is currently ongoing. This is evident from the one response received, which clearly identifies that training and workshops are required to ensure that the political management team and mayoral committee gets updated on all the categories of controls based on changes to laws and regulations. In this way, they are able to perform their role and responsibilities better, and keep officials accountable.

5.12.2 Group 2 – Ordinary councilors

Group 2 consisted of ordinary councillors who are in political positions. The reason for the analysis was to determine what level the political structure within the SDM were updated and aware of their internal control environment that are in place towards achieving a clean audit. The respondent's summary is as follows:

Figure 5.4: Ordinary councillor's outcomes



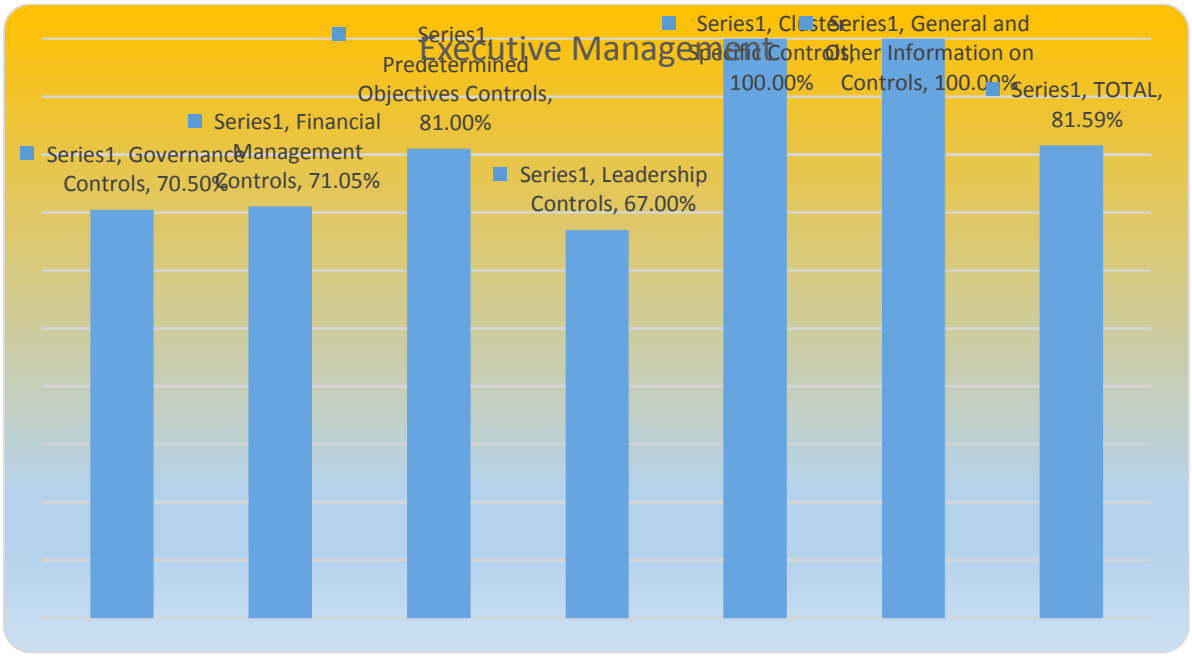
In Group 2 during the interview process it was found that, many of the ordinary councillors require training on their responsibilities, and the control environment within which they work. This is obtained purely on the unsure response, which is a real risk towards their oversight responsibility by just adopting policies without being

informed what the impact is of the policy towards good governance. It was found that councillors have the impression that they decide and the officials must perform. This is a serious risk, which requires clarity on the powers and functions delegated to council, the mayor, the speaker of council, the chief whip of council, the municipal manager, and the executive management team.

5.12.3 Group 3 – Executive management

Group 3 consisted of ten officials occupying management positions such as directors and executive directors. The reason why these respondents were chosen was to determine the level in which management is updated and aware of internal control management procedures, tools and policies within the SDM. The respondent's summary is as follows:

Figure 5.5: Executive management outcomes



In Group 3, the sample was extended as the bulk of internal controls are managed at this level. As the internal audit has been outsourced, the response received from the internal audit is a concern, as most of their responses were unsure. This is a serious risk, as selective audits are being done and clearly indicate that some of the internal control environments are not audited or subjected to audit review and assurance. Communication within this group also requires improvement. Follow-ups on action

plans, council resolutions and management decisions must be maintained and monitored. Leadership controls seem to be a serious risk as all of management indicated that it must be effective. Top down, bottom-up approach affects this aspect. Training as a requirement has also been raised in this group towards a clean audit and compliance. Give recognition, involve all in operations and strategy matters. Do not delegate and start taking responsibilities for your actions.

5.12.4 Group 4 – Middle management

Group 4 consisted of five officials who are occupying middle management positions. The reason for categorising this group of individual was to determine the level of middle management employees and how well they are updated and are aware of internal control management procedures, tools and policies within the SDM. The respondent's summary is as follows:

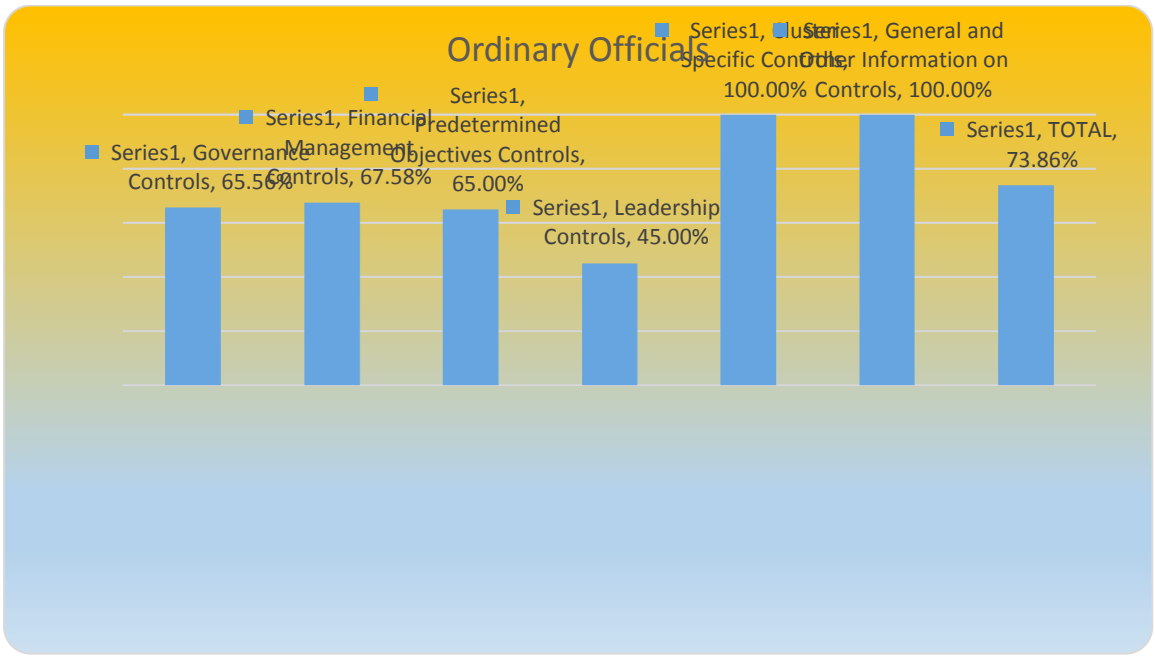
Figure 5.6: Middle management outcomes

In Group 4, middle management has a good grasp of the internal controls in place. It is their responsibility to apply, perform and action it. However, based on the percentage understanding, there is a gap in training on governance and compliance matters in order for them to be skilled as managers.

5.12.5 Group 5 – Ordinary officials

Group 5 officials consisted out of five junior staff members to determine their understanding of internal control mechanisms within their working environment. The respondent's summary is as follows:

Figure 5.7: Ordinary officials consolidated outcomes



Group 5, the armed forces of any organisation, understand their own working responsibilities on internal controls. The percentage on all control categories clearly illustrates that the group requires training in order to be developed. The risk on leadership is mainly that communication is not conveyed properly from the top down, and that they are not aware, or unsure, of what is happening in the organisation.

5.13 WEAKNESSES SPECIFIC TO INTERNAL CONTROLS

During the analysis of all groups, a number of weaknesses were noted from the respondents and are stipulated in no specific order:

- Insufficient skills and capacity to execute and support a turnaround strategy towards an effective internal control environment
- Lack of limited resources to address the risks identified from a internal control perspective
- Political commitment to ensure effective internal control environment

- Lack of proper communication from the top down
- Lack of leadership and strategic HR to recruit, retain and develop the best available talent and skills, especially the best possible leadership
- Weakness and lack of quality in the performance management system
- Lack of human capital appreciation to recognise performance through rewards and remuneration as a link to performance; the tone is not set appropriately at the top
- Improvement of culture is required, to establish a people-centred culture of service delivery and customer care along the Batho Pele principles. Being a municipal employee should be about serving our citizens, not about entitlement and power
- Lack of planning to ensure the effectiveness of governance structures, people, process, systems, infrastructure and oversight mechanisms which must be optimally aligned to the mandate, as defined by a realistic integrated development plan (IDP) and applicable legislation
- Improvement of all aspects relating to the financial sustainability (financial health as a going concern) and management to ensure that economic and financial viability and prosperity of the municipality is a priority
- Lack of understanding information technology (IT) controls, for example IT governance, security management, user access management, and IT service continuity
- Lack of understanding supply chain management (SCM) controls.

5.14 COMPARISON AND ANALYSIS OF DATA

This section will compare and analyse the groups based on all the questions that were asked of respondents within the questionnaire. The respondents were asked various questions compiled within six main categories for each group, governance controls, financial management controls, predetermined objectives, leadership controls, cluster specific controls, and lastly, general and other information on controls. Table 5.3 presents the summary of the research outcomes.

Table 5.3: Consolidated comparison amongst the groups

Category		Mayoral Committee	Councillors Section 80	Executive and municipal manager	Senior middle management	Ordinary officials
1	Governance controls	94.44%	75.00%	70.50%	78.89%	65.56%
2	Financial management controls	89.47%	87.11%	71.05%	84.00%	67.58%
3	Predetermined objectives controls	90.00%	92.50%	81.00%	91.00%	65.00%
4	Leadership controls	85.00%	80.00%	67.00%	82.00%	45.00%
5	Cluster specific controls	100%	100%	100%	100%	100%
6	General and other information on controls	100%	100%	100%	100%	100%
TOTAL		**93.15%**	**89.10%**	**81.59%**	**89.31%**	**73.86%**

Figure 5.8: Combined group analysis

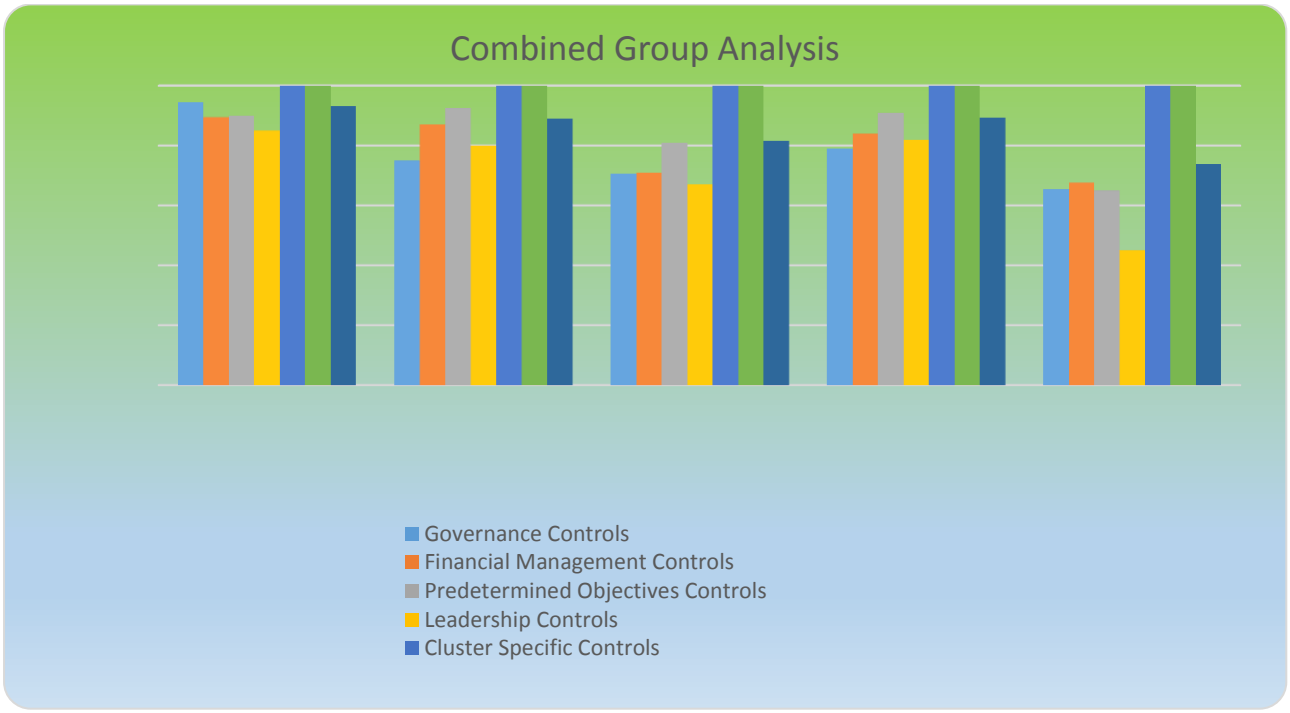


Figure 5.9: Governance controls

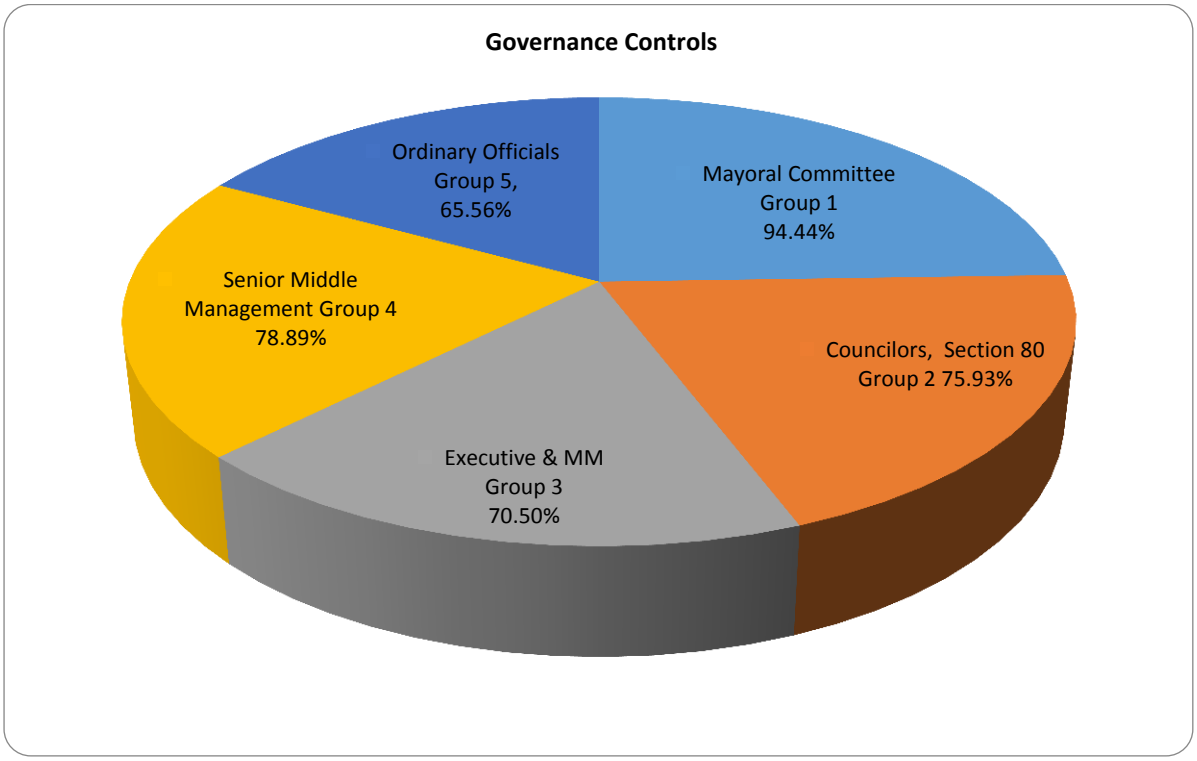


Figure 5.10: Financial management controls

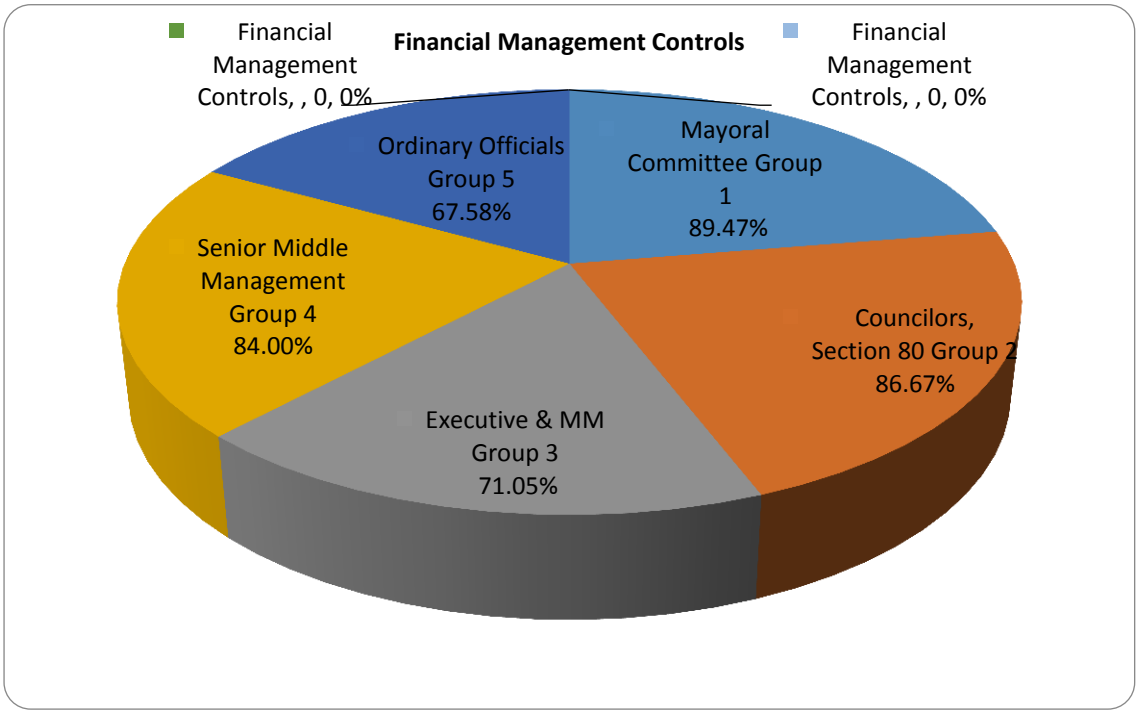


Figure 5.11: Predetermined objectives controls

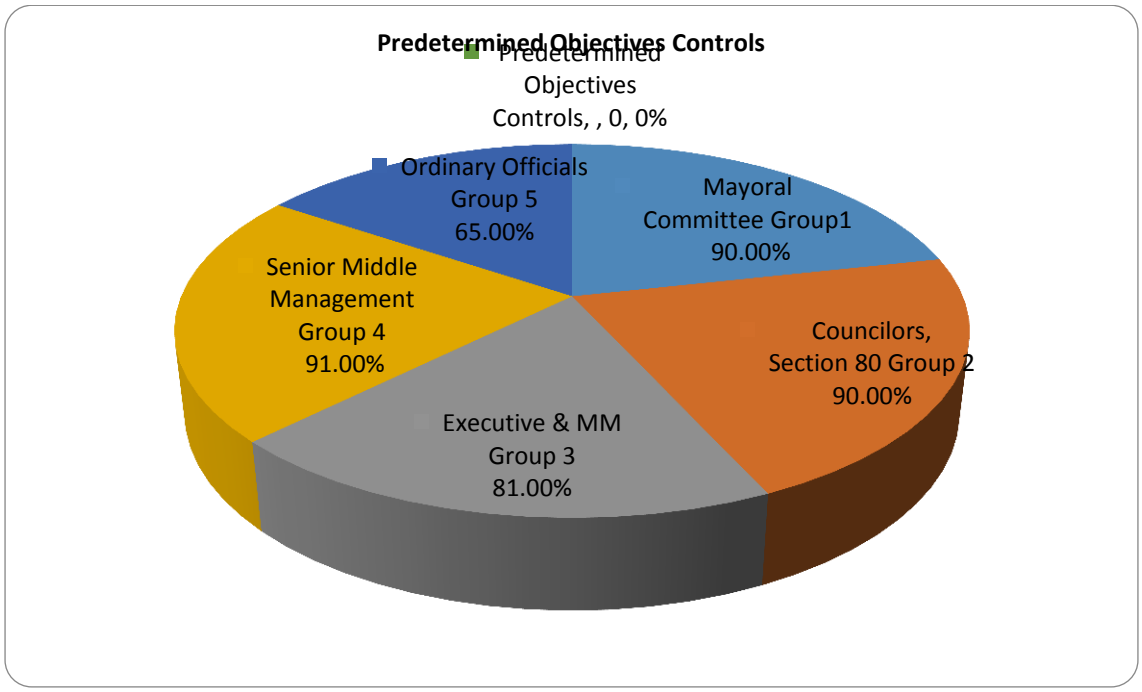


Figure 5.12: Leadership controls

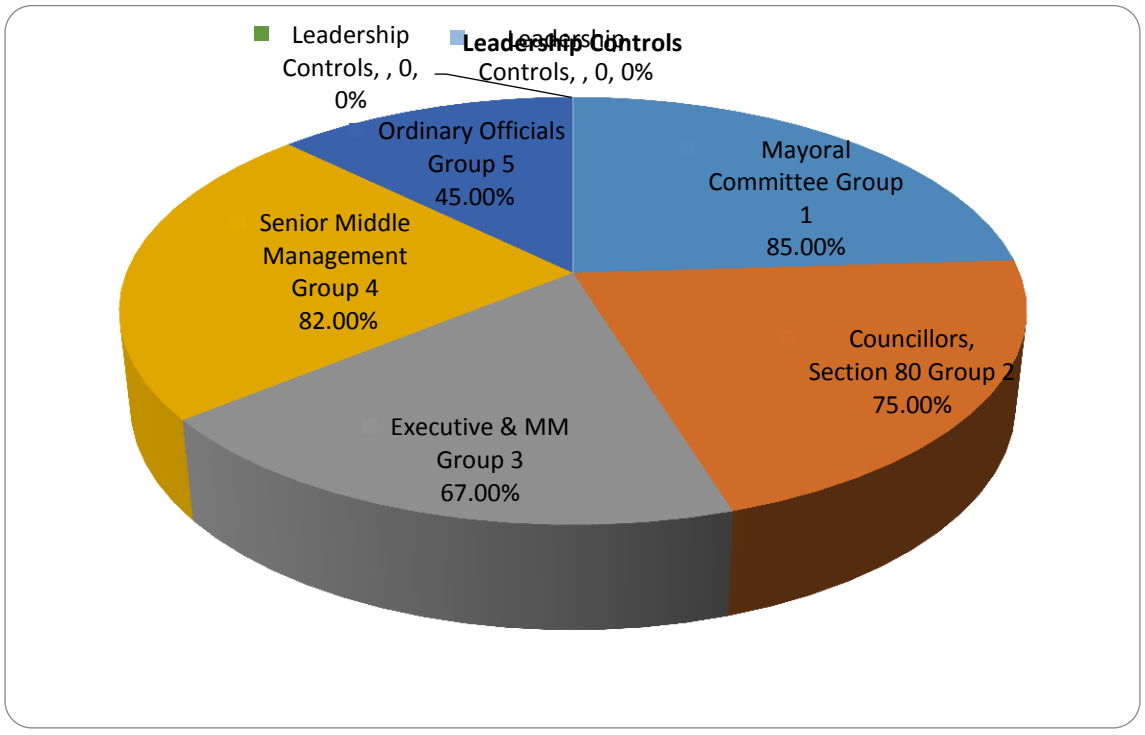


Figure 5.13: Cluster specific controls

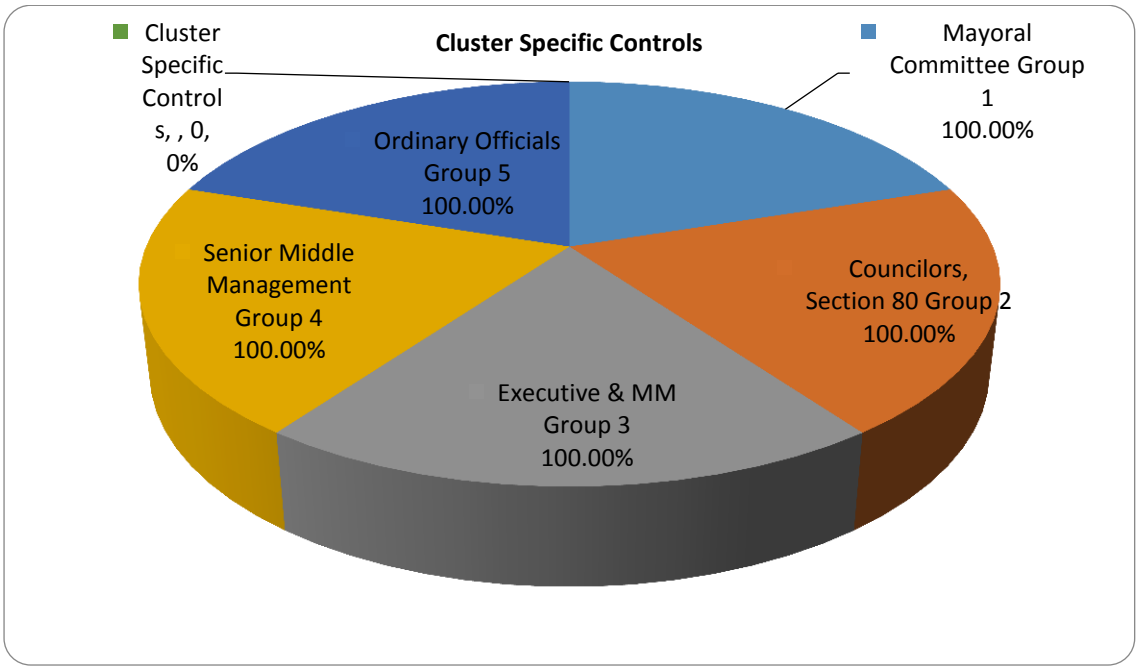
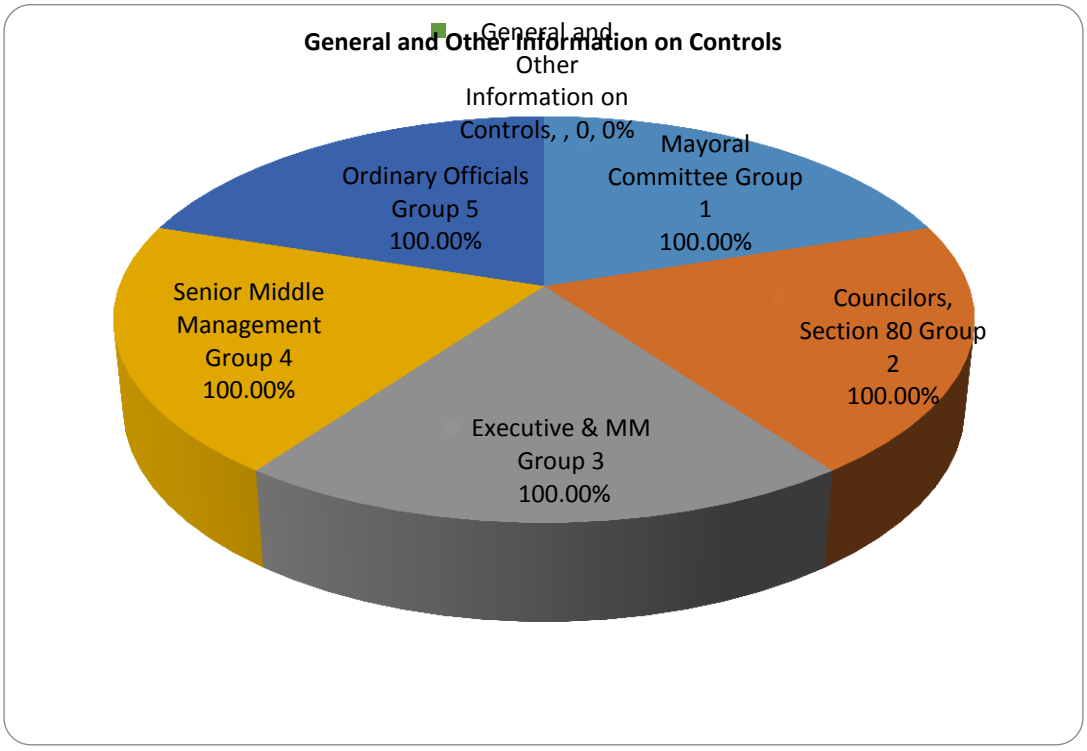


Figure 5.14: General and other information on controls



5.15 PERCEPTIONS OF THE RESPONDENTS

The researcher provides a summary of the perceptions of the respondents who participated in this study. The analysis is presented in a collective manner as it relates to the respondents understanding towards effective internal control environment.

5.15.1 Submissions

Based on the questionnaire responses it was evident that the participants understood the organisational commitment towards internal controls within the municipal environment. Knowledge of the principles of internal control is crucial, especially when the public entrust the municipal government to allocate resources in a meaningful way.

5.15.2 Governance controls

In terms of governance controls, the interviews revealed that the SDM officials have the knowledge of managing public funds. The respondents also indicated that the managers had a hands-on approach with good knowledge of the municipal environment and the controls associated with governance.

5.15.3 Financial management controls

Based on the assessment the impression is that financial controls are in place with limited improvements needed. The SDM established the audit committee, which includes the internal audit activities and the external audit committee. It was also indicated that the financial management controls are directly linked to the performance management system.

The respondents showed a good understanding of what is needed to comply with the requirements as set out in the legislation. The respondents also showed oversight competency, and therefore, showed a good understanding of the requirements. The conclusion of this chapter is presented below.

5.16 CONCLUSION

This chapter discussed the status quo regarding internal control environment that currently exist within the SDM. The questionnaire design, ethics and permission obtained were discussed. The analysis of the questionnaires was done in detail per group, and compared per control category. In addition, weaknesses observed during the interviews were reported on in this chapter. From the questionnaire analysis, it can be concluded that there are not so many shortcomings regarding internal controls and assessment within the SDM, but internal controls must remain a priority.

The shortcomings identified can be possibly resolved with proper training and workshops.

It was also concluded the differences in the responses that they have given can be observed amongst the groups. In the upcoming chapter, Chapter 6, the recommendations will be discussed.

CHAPTER 6 SUMMARY, CONCLUSIONS, FINDINGS AND RECOMMENDATIONS

6.1 INTRODUCTION

The word internal control has a significant meaning within the natural and working environments as it encompasses an individual character, work ethic, leadership, and the principles of corporate governance. Internal control embraces emotional intelligence, innovation, and knowledge exchange derived from a psychological perspective. The performance of local government in South Africa is under scrutiny because it reflects service delivery failures, civil unrest, mismanagement of financial resources, and skills shortage. Poor audit outcomes and inadequate infrastructure planning also form part of the challenges encountered by various municipalities. Ethical conduct is seen as the maintenance and investment, corruption and abuse, political infighting, labour unrest and various interventions by national and regional government. As a result of this analysis, the internal control environment has become an environment where management must ensure that effective and efficient system policies and procedures are in place to avoid weaknesses or potential losses or deficiencies.

Internal control processes do have, or will eventually have a risk implication on any organisation. Therefore, it is critical that internal control be prioritised in the accounting standards as an on-going concern to be addressed daily, weekly, monthly, quarterly and annually, within a project plan format on all functions in the municipality. In this chapter, the researcher summarises the discussions of the preceding chapters. The findings of this study are also outlined. This chapter concludes with identifying recommendations that seek to contribute to the management of internal control for municipalities.

6.2 SUMMARY OF THE STUDY

Chapter 1 presented the orientation and background to the study. Also, the problems related to the topic were identified in order to develop a focus for this study. Each study must have a foundation for defining the research to be undertaken. For this research, the aim of the study was defined and this allowed the researcher to

develop the research questions and objectives. The chapter also gave details about the research design for this study and the chapter layout.

Chapter 2 mainly described the concept of the internal control. Illustrations were made about the components and principles of internal control. The chapter also provided an overview of the importance of the internal control environment, definitions, policies and best practices.

Chapter 3 examined the overview of the municipal audit. The chapter investigated the concept of audit, its differences, principle, legal framework, problems, audit scope, objectives, and the importance of municipal oversight.

Chapter 4 analysed the applications of internal controls for achieving a clean audit. The chapter discussed the proper record keeping, processing and reconciling controls, and regular and accurate reporting. Various legislative frameworks guide government activities; the chapter also discussed the compliance with the legislative framework, which introduced the audit charter for the audit committee and the internal auditing activities. Chapter 4 described the importance of proper IT system controls for recording financial data. Risk management, as it relates to the importance of internal control, was outlined. Internal control also depends on strong management structure, which leads the institutional mandate. The role of leadership was discussed for determining the role of the municipal leadership. The chapter concluded with an assessment of the oversight responsibility and the functions of human resources for effective internal controls for achieving clean audits.

In Chapter 5, the researcher discussed the research methodology and presented the research results for the interviews conducted in the management area of the SDM.

Chapter 6, as a concluding chapter, describes the summary of the chapters, the findings of the study, and recommendations for improving internal controls.

6.3 RESEARCH FINDINGS

The theoretical analysis is a useful guide that can be used to improve connected internal controls within any environment and function. Internal control was identified as on-going concern, which not only must be prioritised by management but as a principle from which any manager has to take responsibility and accountability.

Internal controls are essential to the effective operation of local governments and school districts. Internal auditors and audit committees enhance the effectiveness of the control framework and assist the governing board in meeting its oversight responsibilities for internal controls. The findings observed during the data collection process are presented by means of the basic internal control framework specified by COSO:

6.3.1 Proper record keeping and regular and accurate reporting

Public reporting on the financial performance of government agencies is an element of good governance and financial accountability. The researcher discovered that the SDM has a proper record-keeping mechanism; however, the function has its own challenges. On yearly basis, the SDM releases its annual report, which provides a description of the municipal finances. The report also outlines the performance of the respective departments. The SDM is also required to present a risk assessment report, which details the threats associated with the organisational arrangements of the municipality. The municipality has a scheduled timetable about the public participation plans and the imbizo outreach programmes for involving all stakeholders.

6.3.2 Compliance with the legislative framework

The Office of the Auditor-General believes that the framework will set the tone and create the necessary impetus for a sustainable and effective internal auditing mechanism in government. This framework is not meant to be prescriptive and should enhance the quality and standard of public sector auditing. A number of pieces of legislations have been, or are in the process of being enacted by government.

Chapter 10, Section 195(1) & (2) of the Constitution of 1996 states, “Democratic values and principles that include, amongst others, a high standard of professional ethics; efficient, economic and effective use of resources; accountability and transparency must govern public administration. The principles apply to administration in every sphere of government, organs of state, as well as public enterprises”.

Chapter 13, Section 215(1) of the Constitution of 1996 states, “National, provincial, and municipal budgets and budgetary processes must promote transparency, accountability, and the effective financial management of the economy, debt and Public Sector”.

Proper IT system controls

The implementation of controls and information systems is essential to discharge management’s responsibilities effectively.

6.3.3 Audit committees and internal committee

Both the PFMA and MFMA make provision for the establishment of the internal audit activity to assist the accounting officer and the audit committees in the effective discharge of their responsibilities. The SDM has an established function for the audit committees.

Audit committees

The research found that the audit committees are important as they are established to serve as an independent governance structure whose function is to provide an oversight role on the systems of internal control, risk management, and governance. The AC assists the accounting officer in the effective execution of his/her responsibilities with the ultimate aim of the achievement of the organisation’s objectives.

Internal audit

The literature review discovered that the National Treasury of South Africa developed the internal audit framework for managing internal controls on municipal finances. The Office of the Auditor-General believes that the internal audit framework will set the tone and create the necessary impetus for a sustainable and effective internal auditing mechanism in government. This framework is not meant to be prescriptive and should enhance the quality and standard of public sector auditing.

Sound risk management framework

Institutions are required to identify potential risks, and design and implement control measures to eliminate dysfunctional situations that may hinder the organizational

arrangements. The researcher observed that the SDM has an audit charter. The SDM also has an established audit committee. During the financial year of 2011/2012 the SDM appointed the assistant manager, risk management, situated in the office of the municipal manager to monitor the risk within the municipality. The SDM also prepare the risk assessment report.

6.3.4 Effective and updated policies and procedures

The National Treasury released the MFMA in 2003. The National Treasury has corrected this legislation through the issuing of regulations 1 – 73 as at the date of this research study. The purpose of the MFMA only focused on finance, but the connected functions relating to finance have not received much attention or priority. Limited focus was placed on the importance of internal controls in these circulars and/or to put a process in place in consolidating all activities into an internal control procedure manual.

6.3.5 Oversight responsibility and effective leadership culture

To form a strong foundation of ethical governance, four values of good and ethical governance should be entrenched in all levels of an institution. The following values are applicable to the SDM, namely responsibility, accountability, fairness, and transparency. Overall, the inextricable link between leadership and ethics is an expectation of good corporate governance, which was eminent in the municipality. The tone at the top is a powerful preventative control mechanism and an effective and corrective control mechanism, which to a degree has also been noted as being average. This was witnessed by applying decisive management and leadership characteristics to perform an oversight control. The study found that the management role was applied separately from a leadership perspective. The management perspective focused on the processes, control measures, problem solving, preventative measures and ensuring compliance with the legislative frameworks. Municipalities are required to ensure that a leadership perspective is taken into consideration. It was also observed that the municipality considers working with all stakeholders in a proactive manner to minimise risk.

6.4 FINAL RECOMMENDATIONS

The internal control environment impacts on accounting standards and the psychological importance of proper leadership in any municipality. This is eminent to ensure that proper managers are appointed with proper capacity to take full accountability for their control environment and functions. The remedy of internal control is risk management. Managers are advised that the two activities are integrated, and will ensure a positive outcome towards efficiency, cost savings, quality, and positive productivity in any working environment. Therefore, the right manager must have the gift of emotional intelligence to take the right decisions at the right time in consultation with his/her management team.

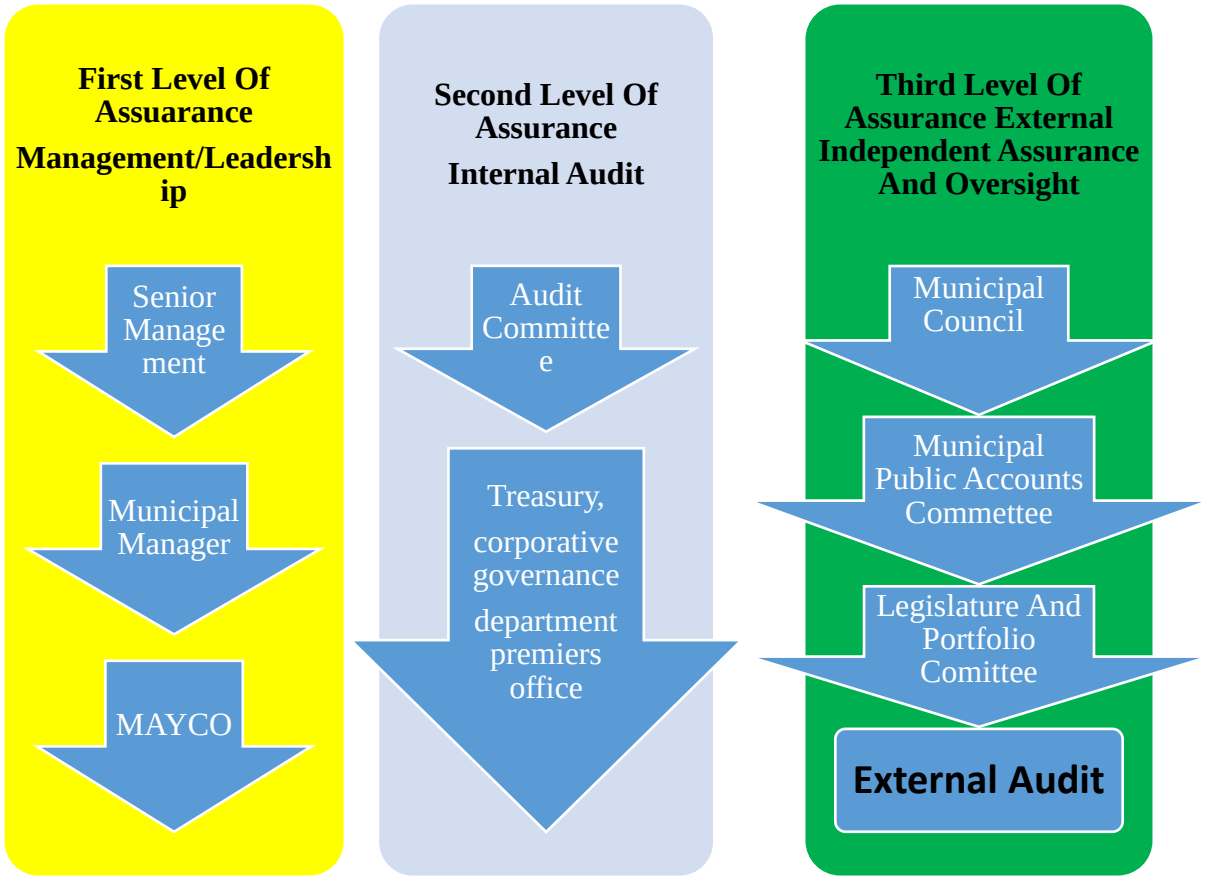
Based on the outcome of the study, including the analysis of the case study and internal control guides, the following recommendations are made:

6.4.1 Recommendations towards political management team (Group 1), councilor (Group 2), and executives and directors (Group 3)

The steps as recommended are to ensure that a sound internal control environment is established to assist, capacitate, train and provide tools within their specific clusters to direct council accordingly.

- The municipality should conduct a workshop to substantiate strong and visionary leadership that is not negotiable (political and administrative interface), and ownership of internal controls towards a clean audit is a collective process.
- Compliance should not be compromised. Training solutions to ensure cooperation, mutual support, value for money, performance incentives and greater collaboration between council, the mayoral committee, the audit committee, MPAC, and the administrative executive are of paramount importance to ensure integrated reporting is performed towards a clean audit. Figure 6.1 illustrates this.
- The risk management strategy, as the remedy for internal controls and weaknesses, must be a priority to ensure that all connected internal control functions are assessed, evaluated and corrected.

Figure 6.1: Extensive assurance by the key role players



- The planning process in the IDP is an on-going strategic document, which should reflect realities to ensure that the monitoring and evaluation progress is relevant for management information purposes. This means regular and accurate feedback sessions must be held with stakeholders in the public participation domain.
- The drivers of the key control exercise should be performed continuously by the internal audit department quarterly, and reported to the above committees to ensure that there is no regression in leadership, financial management, performance management and governance. The document must indicate the extensive process of assurances that must be provided by key role players.
- The focus of internal audits value and performance must be extended to maximise the impact of its contribution, particularly in areas of internal control and its connected functional areas. Constant planning and dialogue is critical in determining the internal audit ability to understand what matters most to the municipality.

- Management must continually develop a comprehensive OPCA plan to prioritise its operational plan focusing on the following:
    - Oversight responsibility (IDP, risk, internal audit and audit committee)
    - HR management
    - Supply chain management
    - Information technology governance
    - Assurance to assess systems and processes connected to finance
    - Proper record keeping
- The Chief Financial Officer conducts an annual financial statement readiness analysis to ensure the timely performance of daily and monthly financial reconciliations in line with a regular financial framework as stipulated and in compliance to the MFMA.
- The complete internal control environment, excluding the finance cluster, is documented to ensure that it serves as a training manual to improve the institutional capacity of municipal staff in the municipality.
- The Accounting Officer should include key internal controls priorities into the performance agreement of all section 56 managers as a target outcome with no performance bonuses unless unqualified audit opinions are obtained and action to improve performance is taken seriously.
- Based on the findings the strategic value of innovation to appoint a Chief Compliance Officer to be responsible for the on-going compliance and internal control improvement will assist the municipality to deal with the compliance check list for use by the Accounting Officer to ensure full compliance.

6.4.2 Recommendations towards non-management officials (Group 4 and 5)

Based on the outcome of the study, including the analysis of the case study and internal control guides, the following recommendations are made:

- Ensure that each staff member documents their internal control activity that it can be reviewed by management as an assurance tool towards an effective and efficient internal control environment towards on-going capacity building.

- Provide and supply each staff member with a complete and consolidated internal control procedure manual focused on the effective leadership culture, compliance to financial management, effectiveness of performance management and good governance practices for them to be familiar with and to note of the common strategic objective of the municipality.
- Ensure that training and continuous workshops are conducted to enable all officials to understand the importance of internal controls towards a clean audit opinion.
- Emphasise that all staff have a role to play in the internal control environment as they are the ones that would identify weaknesses in the control environment during the performance of their job.
- Ensure that there is a culture of transparency and fairness to report weaknesses to management within any control environment.

6.4.3 Future research

As internal control serves as the basis of any environment, future research within local government as well as within the private sector can still be undertaken based on each functional area. The intention would be to expand the sample of respondents and to test the hypothesis in other municipalities. Best practice guides will have to be analysed in order to ensure that there are perfect internal controls with tools put in place in order to increase the awareness within local government.

The procedure manual that covers all the activities and functional areas of local government specific to the four focused areas of leadership, financial management, performance management, and good corporate governance can be compiled. This training manual will aim to bridge the capacity and skills gap within the local government environment by training officials, managers, and political office bearers within any municipality on the importance of their control environment. The manual as compiled could be converted to short courses to obtain quick results in capacity and skills development for all municipal officials and political office bearers. This will reduce the risk once the research is undertaken, and will place local government in a better light with a view to improve audit outcomes in South Africa.

6.5 CONCLUSION

It is critical that all factors emanating from any control environment be prioritised to ensure that there are no weaknesses within the internal control space as to prevent fraud and corruption. Internal control plays a very important role towards any clean audit objective. Municipalities must know that if their control environment is effective and efficient, and the guidelines from the Auditor-General of South Africa towards the key control factors are performed, they would achieve an unqualified opinion and clean audit.

The saying ‘prevention is better that cure’ clearly opens highlights the integrated partnership that internal controls has with planning and risk management within any environment both in the public and private sector. It is the researcher’s view that under every leadership structure of governance (SALGA, CoGTA, DPSA) a united force is required to ensure that good governance and sound financial administration with a good performance management culture is in making a clean administration possible. The clean audit 2014 government deadline, which is upon all municipalities, remains achievable as long as every stakeholder is committed towards a sustainable clean administration with good governance principles.

To conclude, it is important to note that internal controls is not only important for those dealing directly with risk and audit issues within the municipality but must also become part of the processes, procedures and systems managed by all officials and practitioners.

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ANNEXURES

ANNEXURE A: CONSENT FORM

INFORMED CONSENT FORM - REQUEST TO PARTICIPATE IN INTERVIEW:

Political Management team, Mayoral Committee members, Councillors, Officials and employees currently employed by the SDM.

To the interviewee:

_____

Request:

With this letter you are kindly requested to participate in an interview as part of a MASTER Degree research project at the North-West University –VTC (Vaal Triangle Campus) under the supervision of Dr. T. Mzini. The interviews will take about 15 – 30 minutes each. Time is valuable and will be scheduled as such subject to confirmation of your availability. The aim of the interviews is to explore the importance of internal control mechanisms in attaining a Clean Audit at SDM. The interviews will be conducted in April 2014.

MORE DETAILS ABOUT THE RESEARCH PROJECT

Researcher : B.J. Scholtz

Title of Research Project: Exploring the Importance of Internal Control Mechanisms in Attaining a Clean Audit – The case of SDM.

PURPOSE OF THE RESEARCH

- What mechanisms and concepts exist as theories, principles and outcomes of internal controls and clean audit for SDM?

- What legislation, regulations, policies and best practice guidelines constitute the statutory and regulatory framework that govern the importance of clean audits in the local government environment and what are the requirement of this framework?

- Which principles and best practices are used towards achieving a Clean Audit from internal control and risk management perspective in SDM?

- What are main attributes, principles and contributions in achieving a Clean Audit at SDM?

- What are the opinions and perception of SDM officials of internal control practices and its applications?

- What processes, practices and guidelines based on legislations, theory and sample testing should be included as recommendations for an ideal management model to achieving a clean audit and to sustain it at SDM?

Duration	The interviews will be scheduled At a suitable time in April 2014 and will take between 15 – 30 minutes.
Procedures	A set of questions will be prepared for discussions.
Possible Risks	No risks are anticipated as a result of the interview. No participant will be held liable for the information provided to assist the completion of the study.
Benefits	The results of the survey and of the eventual study will be made available to SDM.
Voluntary Participation	Every participant contributes voluntarily to the research. No one is obliged to participate in the research against one's will.
Confidentiality	The data gathered will be treated with strict confidentiality and will be reported in a confidential manner as well. It will be privilege information between the researcher and the participant. Under no circumstances will the information be released without the knowledge and the permission of the other/participant.
Dissemination of information	Information will be utilized as part of the Masters Degree study and for future articles to be published in municipal or local government journals and to be presented at various conferences in government.
Contact details of the Researcher	Mr. B.J. Scholtz Cell: 082 889 7034 Email: brendonS@sedibeng.gov.za

Permission for identification for follow-up evaluations: if needed, although it is not expected, the researcher requests permission to have a follow-up meeting with relevant respondents.

This research project was approved by the North-West University, Ethics Sub Committee for Social and Behavioural Sciences on: _____. The Ethics approval number is: _____.

Informed Consent

I _____ (initials & surname of the participant) have read and understood the nature of any participation in this research project and agree to participate.

Signature (responded) _____ Date: _____

Researcher: _____

Informed consent and permission to be identified for follow-up evaluations.

I _____ (initials & surname of the participant) have read and understood the nature of any participation in this research project and agree to be identified and invited to participate in follow-up evaluations.

Signature (responded) _____ Date: _____

Researcher: _____

ANNEXURE B: GROUP QUESTIONNAIRE

Research: Exploring the Importance of Internal Control Mechanisms in Attaining a Clean Audit – The Case of SDM.		
Reason for research study:	**Partial fulfilment of masters degree in development and management**	
Reason for interview:	**To determine views on the extent of Clean audit control mechanism at the Municipality.**	
Respondent:	**Name :**	**Surname :**
Department:		
Position held:		
Date:		
Time:	**Start:**	**End:**
Name of interviewer:	**Mr. Brendon James Scholtz**	

1. GOVERNANCE CONTROLS		Yes	Unsure	No	Comments
1.1	Is there a delegation of authority policy in place?				
1.2	Are the delegation of duties between the Councillors and Officials clearly stated?				
1.3	Is there an Internal Audit Department?				
1.4	Does the Internal Audit Department have an Audit Charter and Internal Audit Plan?				
1.5	Has the Internal Audit Department done a Risk Assessment on internal controls?				
1.6	What is the frequency of reporting Internal Audit matters?				
1.7	Is there an Internal Audit Committee in place to deal with: • Financial Reporting;				
	• Auditor-General Report;				
	• Performance Audit Reporting;				
	• Audit Charter;				
	• Risk Management;				
	• Fraud and Corruption; and				
	• Internal Control environment.				
1.8	Does the Municipality have an OPCAR action plan in place?				
1.9	Has all matters/issues from the last Auditor-General report been resolved?				
1.10	Is there a Code of Conduct for Councillors and Officials and has this been updated and approved by Council?				
1.11	Does the Municipality have a Risk Management Strategy in place?				
1.12	Does the Municipality perform Risk Assessments and how often does this happen?				
1.13	Does the Municipality consider the IT Risks?				
1.14	Is there a Fraud Prevention Plan in place?				
1.15	Does the Municipality review all risks applicable to its core business?				
1.16	Has the impact and probability of these risks been assessed?				
1.17	Does the Municipality have a fully functioning MPAC Committee?				
1.18	Does the MPAC Committee add value in line with compliance, laws and regulations?				

2. FINANCIAL MANAGEMENT CONTROLS		Yes	Unsure	No	Comment
CREDIT CONTROL					
2.1	**Is there a Credit Control & Debt Collection Policy?**				
	Is it formulated?				
	Is it approved by Council?				
	Is it implemented?				
TARIFF POLICY					
2.2	**Does the Municipality have a Tariff Policy in place?**				
	Has the Municipal service tariffs been revised in the last 12 months?				
SUPPLY CHAIN MANAGEMENT POLICY					
2.4	**Does the Municipality have a Supply Chain Management Policy?**				
	Is it formulated?				
	Is it approved by Council?				
	Is it implemented?				
CASH MANAGEMENT AND INVESTMENT POLICY					
2.5	**Does the Municipality have a Cash Management and Investment Policy?**				
	Is it formulated?				
	Is it approved by Council?				
	Is it implemented?				
BUDGET POLICY					
2.6	**Does the Municipality have a Budget Policy?**				
	Is it formulated?				
	Is it approved by Council?				
	Is it implemented?				
FIXED ASSET POLICY (GRAP COMPLIANT)					
2.7	**Does the Municipality have a Fixed Asset Policy (GRAP Compliant)?**	**Yes**	**Unsure**	**No**	**Comments**
	Is it formulated?				
	Is it approved by Council?				
	Is it implemented?				
2.8	**List other policies adopted.**				
2.9	**Internal Controls**				
	Are there effective internal controls in place for the following?				
	Income?				
	Expenditure?				
	SCM Committees?				
		Yes	**Unsure**	**No**	**Comments**
	Budgetary Control?				
	Cash Controls?				
2.10	Are there effective internal controls in place for the Debtors System?				

	Age analysis?				
	Meter reading?				
	Disconnection list?				
	Indigent subsidies?				
	Monthly account process?				
2.11	Is the Municipality Clearing the Auditor-General Report (Financial and Control issues)?				
2.12	Does the Municipality have Risk Assessment and Internal Audit Plan (3-year) in place?				
2.13	Are all reconciliations performed?				
2.14	Adoption and implementation of policies/procedures?				

2.15 PERSONNEL STRUCTURE AND CAPACITY BUILDING		**Yes**	**Unsure**	**No**	**Comments**
2.15.1	Are actual salaries for the past financial year unreasonable when compared to total expenses?				
2.15.2	Are salaries in line with current guidelines?				
2.15.3	Are Councillors paid at their correct level as per the Municipal grade and their grade?				
2.15.4	Are statutory deductions deducted and paid?				
2.15.5	Does the existing organisational structure require review?				
2.15.6	Has a skills audit and training needs assessment been done for:				
2.15.7	Councillors?				
	Finance Department?				
	Other departments?				
2.15.8	Has a training program been developed for:				
	Councillors?				
	Finance Department?				
	Other departments?				
2.15.9	Are personnel enrolled as part of the Mentorship program				
	Positions?				
	Approved?				
	Available?				
	Frozen?				
	Currently advertised?				
2.15.10	Are learnership programmes offered?				
	Provide a list of vacancies (obtain and review the organogram)				

2.16BUDGETS		Yes	Unsure	No	Comments
2.16.1 Is there operating budget?					
	Is it balanced?				
	Is it cash funded?				
	Is it approved by Council and National Treasury?				
2.16.2	Is it GRAP/GAMAP Compliant?				
2.16.3	Does it include?				
	Bad debt provision				
	Indigent provision				
	Working Capital Reserve				
2.16.4	Has the Capital Budget:				
	Been aligned with the Integrated Development Plan?				
	Approved by Council and National Treasury?				
	Provided adequate funds for reserves and loans?				
	Is GRAP/GAMAP Compliant?				
2.16.5	Is the budget compliant with Chapter 4 and 9 of MFMA?				

2.17 FINANCIAL INFORMATION		Yes	Unsure	No	Comments
Annual Financial Statements (AFS)					
2.17.1	Is the AFS compilation up to date for previous years?				
2.17.2	Comment on status of accounting records:				
2.17.3	Date last bank reconciliation completed?				
2.17.4	Are accounting records updated on a monthly basis?				
2.17.5	Is there a fixed assets register?				
2.17.6	Is the register GRAP/GAMAP compliant?				
2.17.7	Is the fixed assets register updated regularly?				
2.17.8	Is there a loan register?				
2.17.9	Is the loan register updated regularly?				
2.17.10	Is there an investment register which is updated regularly?				
2.17.11	Is the AFS GRAP/GAMAP compliant?				
2.17.12	Is Financial reporting compliant with MFMA?				

2.18 FINANCIAL REGULATIONS		Yes	Unsure	No	Comments
Financial Management					
2.18.1	Is the a proper reporting by CFO to Council on:				
	Debtors outstanding				
	Bank position				
	Investment portfolio				
	Loan repayments				
2.18.2	Are correct financial regulations applied in respect of the budget process and budget prioritizing?				
2.18.3	Are correct financial regulations applied in respect of assets control?				
2.18.4	Are correct financial regulations applied in respect of financial powers?				
2.18.5	Are time frames in terms of financial statements adhered to?				
2.5.6	Is the budget properly balanced and completed within legal time frames?				
2.18.7	Have the latest monthly financial report been submitted to:				
	Council?				
	Province?				
2.18.8	Are the following financial indicators being reported in accordance with the provisions of regulations?				
	Debtors (Age analysis, turnover rate, numbers of accounts issued, disconnections and reconnections and legal action)				
	Bank reconciliation				
	Investments				
	Cash Flow Forecast				
	Stock turnover rate				
	Payment of creditors				
2.18.9	Is capital and operating budgets (year to date, variances and excess expenditure) being reported in accordance with the provisions of the Regulations?				

3	PREDETERMINED OBJECTIVES CONTROLS	Yes	Unsure	No	Comments
3.1	Has the Council adopted a PMS policy?				
3.2	Is there a dedicated PMS Manager?				
3.3	Has the Council adopted an IDP?				
3.4	Is there a dedicated IDP Manager in place?				
3.5	Is the IDP regularly reviewed and adopted?				
3.6	Is the IDP linked to the PMS and Budget?				
3.7	Have the needs and priorities of the communities been addressed in the IDP?				
3.8	Have strategies and time frames been set to achieve the IDP?				
3.9	Have progress been initiated to achieve the IDP goals?				
3.10	Have the performance management targets been set and communicated?				
3.11	Does the Council review the performance of each Cluster?				
3.12	Is proper record-keeping done on performance information as evidence?				
3.13	Does the Council have a PMS system, is it manual or automated?				
3.14	How often is performance assessed and reviewed?				
3.15	Is the PMS reviewed and monitored in line with applicable laws and regulations?				
3.16	Do Council officials understand the PMS system?				
3.17	Is the KPA's aligned to the IDP?				
3.18	Does each Cluster have an SDBIP in place?				
3.19	Are the targets measurable and achievable?				
3.20	Do Council officials meet their set KPA's and KPI's?				

4.1 LEADERSHIP CONTROLS – COMPLIANCE WITH LAWS & REGULATIONS		Yes	Unsure	No	Comments
4.1	**Council meetings and minutes**				
4.1.1	Do regular meetings of the Council take place?				
4.1.2	Do any other meetings take place and what are they?				
4.1.3	Are minutes of the meetings being recorded?				
4.1.4	Are these minutes recorded timeously for distribution?				
4.1.5	Are Council's resolutions been implemented?				
4.1.6	Are Council's resolutions been monitored?				
4.1.7	Is a registry of resolutions being monitored and followed-up?				
4.1.8	Is there an effective communication in terms of MAYCO resolutions and Cluster reports?				

4.2 PUBLIC RELATIONS AND COMMUNICATIONS		Yes	Unsure	No	Comments
4.2.1	Does the Municipality have a communication policy that has been:				
4.2.2	Approved?				
4.2.3	Implemented?				
4.2.4	Does the Council formally consult on a regular basis with the Community to identify matters affecting them?				
4.2.5	Does the Municipality provide help or information to address customer queries?				
4.2.6	Does the Municipality keep a record of complaints or queries, if yes, indicate number of complaints over the last 6 months?				
4.2.7	Does there appear to be effective communication between Clusters?				

4.3 COUNCIL AND MAYCO COMPOSITION		Yes	Unsure	No	Comments
4.3.1	Is Council/MAYCO aware of the standing rules of Council?				
4.3.2	Does Council/MAYCO keep themselves up to date on technical and legislative issues?				
4.3.3	How often does the Council/MAYCO meet?				
4.3.4	Do you know who is responsible for or has inputs into the Council/MAYCO agenda?				
4.3.5	Do you know how Council/MAYCO gives strategic direction to the Municipality?				

5 CLUSTER SPECIFIC CONTROLS		Yes	Unsure	No	Comments
5.1	Please mention areas or issues where you think internal control in your Cluster can be improved or resolved differently?				
6 GENERAL AND OTHER INFORMATION ON CONTROLS		**Yes**	**Unsure**	**No**	**Comments**
6.1	Please list any attribute in your view and opinion that can add value to this study in your control environment.				

Thank you!

Annexure