

# Causes of qualified audit opinions: A case study of Mafikeng Local Municipality North West Province.

Ngomba Mbua

17070708

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West University

Supervisor: Professor S. W. Musvoto

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**Declaration**

I, Emmanuel Ngomba Mbua, declare that this study was carried out and completed by myself. I further declare that all the ethical considerations with regard to this study were observed throughout the process.

The implications emanating from the process and the declaration are understood by me.

**Mr E.N. Mbua**

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## **Abstract**

The issue of financial statements of municipalities, being qualified yearly by the Auditor General of South Africa, is a cause for concern to the general public and government. For the past five years more than 75% of municipalities in the North West Province have annual financial statements, which are continuously qualified by the Auditor General of South Africa. The Mafikeng Local Municipality is one of these municipalities.

A quantitative study was undertaken to investigate the causes of qualified audit opinions in municipalities, with a case study of Mafikeng Local Municipality in the North West Province. Recommendations are offered to improve the quality of the financial statements and consequently limit the possibility of a qualified audit opinion.

The main objective of the study was to determine the factors that influence the financial statements of Mafikeng Local Municipality to be qualified by the Auditor General.

Data were sourced from managers and accountants working in the financial department of Mafikeng Local Municipality. The results indicated that the poor quality of the financial statements and consequently their qualification by the Auditor General could be attributed to a lack of ethics and accountability of municipal officials and their lack of adequate education and professional experience in preparing the financial statements in the financial department of Mafikeng Local Municipality and the Audit Committee. This suggests that there is need for proper monitoring and enforcement of the Municipal Fund Management Act with regard to ethics, accountability, educational requirements and professional experience of officials in key positions in the financial department of the municipality.

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## **List of acronyms/definitions**

|       |                                                    |
|-------|----------------------------------------------------|
| AGSA  | Auditor-General of South Africa                    |
| AICPA | American Institute of Certified Public Accountants |
| CFO   | Chief Financial Officer                            |
| COGTA | Cooperative Governance and Traditional Affairs     |
| GAGAS | Generally Accepted Government Auditing Standards   |
| GRAP  | General Recognised Accounting Practice             |
| IIA   | Institute of Internal Auditing                     |
| MFMA  | Municipal Finance Management Act                   |
| OCA   | Operation Clean Audit                              |
| PSC   | Public Service Commission                          |
| SALGA | South African Local Government Association         |

## **Annexures**

Appendix A: Questionnaire

Appendix B: Letter of Permission to conduct Research

Appendix C: Language Editor's Declaration

## **Chapter 1: Introduction**

### **1.1 Introduction**

The purpose of this study is to investigate the causes of qualified audit opinions in municipalities, and to recommend possible solutions to mitigate these causes, with a case study of the Mafikeng Local Municipality.

The incidence of financial statements of municipalities being qualified yearly by the Auditor-General of South Africa (AGSA) is a cause for concern to the general public and the government. Such is the purpose of this study that examines the causes of qualified audit opinions of municipalities with a case study of Mafikeng Local Municipality in the North West Province.

Firstly, according to the Institute of Internal Auditing (IIA, 2014), only fifteen municipalities and two municipal entities achieved clean audits for the financial year ending 2013. This was more than the thirteen that succeeded in 2012. This represents only 9% of the 319 municipal entities that were audited nationally. None of the municipalities with unqualified audit opinions were from the North West Province, which is the focus for this study.

Secondly, in accordance with the Auditor-General's Annual Report for the North West Province for the year ending 2013, a total of 21 (78%) municipalities failed to obtain unqualified audit opinions for the past three municipal financial years. The annual financial statements of seventeen (63%) municipalities were again disclaimed due to the unavailability of documentation and/or information to form an audit opinion (AGSA, 2013). The Mafikeng Local Municipality was one of the seventeen municipalities with a disclaimer of opinion.

Thirdly, in the municipal year ending 30 June 2012, only four of the 23 municipalities in the North West Province obtained unqualified audit opinions with findings, three obtained qualified audit opinions with findings and sixteen were disclaimers of opinion with findings (AGSA, 2013), Mafikeng Local Municipality once more formed part of the sixteen municipalities with disclaimer with opinions.

These findings reflect the need for municipalities to focus on concepts of the legislative framework for professionalism, accountability and ethics (Edwards, 2008). One can argue that sound ethical behaviour and accountability form part of the essential values of municipal administration and are prerequisites to gain public trust as a keystone to good government.

For the past five years more than 75% of municipalities in the North West Province had their annual financial statements qualified by the Auditor-General (AGSA, 2013) and Mafikeng Local Municipality is one of these municipalities whose annual financial statements have been repeatedly qualified by the Auditor-General.

It is in the light of the above-mentioned statistics that it was found necessary to carry out this study to investigate the causes for the qualification of annual financial statements of municipalities and to come up with possible solutions on how to minimize these qualifications in future.

## **1.2 Background**

The Republic of South Africa's constitution mandates the AGSA to review and give an opinion on the financial affairs of all municipalities and municipal entities in South Africa (Constitution of the Republic of South Africa, 1996) In accordance with the Public Audit Act (2004), the AGSA has constitutional and other functions, which it performs to comply with its constitutional mandate as described in the Constitution. In accordance with the Public Audit Act, Section 4 (2004) AGSA has the following constitutional functions:

- The AGSA must audit and give an opinion on the financial statements of national government departments as required in section 8 of the Public Finance Management Act.
- It must give an opinion on all provincial governments departments as required by section 19 of the PFMA; and
- Finally, the AGSA must audit and report on the consolidated financial statements of all municipality and municipal entities as recommended by the Municipal Finance Management Act (Public Audit Act, 2004).

The municipal accounting officer of every municipality must prepare annual consolidated municipal financial statements for the year within two months after the end of the financial period to which these financial statements relate, must submit the statements to the AGSA for auditing, and must in addition, prepare the consolidated annual financial statements in terms of a prescribed frame work and, within three months after the end of the financial year the accounting officer must submit the financial statements to the Auditor-General for auditing (MFMA, 2003). This Act also mandates the Auditor-General to submit an audit report on the audited financial statement of municipalities submitted for audit by no later than 31 October of each year to Parliament and the provincial legislatures, a list of any municipalities or municipal entities that failed to submit their financial statements to the Auditor-General for auditing on time (MFMA, 2003).

For the past five years more than 75% of the municipalities in the North West Province's annual financial statement have been qualified by the Auditor-General (AGSA, 2013), because of factors which we will discover from this study. Mafikeng Local Municipality which this study is going to be based on is one of these municipalities in the North West Province whose annual financial statement has been repeatedly qualified by the Auditor-General.

### **1.3 Preliminary literature review**

The purpose of this review is to have a brief background understanding of what has been written in the past about the subject of this study in existing literatures.

A municipality is a voted local administrative body with a corporate status and limited self-governance rights, which serves a specific political unit such as a town or city (Business Dictionary, 2015). A municipality expresses executive and legislative authority within an area determined in terms of the 25<sup>th</sup> Local Government Municipal Demarcation Act 1998 and it is an organ of state within the local scope of government (Local Government Municipal Structures Act, 117 of 1998). The Constitution of South Africa makes provision for three categories of municipalities, namely category A

Metropolitan, category B District and category C local municipalities. South Africa has 278 municipalities comprising eight metropolitan, 44 district and 226 local municipalities. Mafikeng Local Municipality on which this study will be focusing on is one of the 226 local municipalities (Powell *et al.*, 2014).

Municipalities are governed by The South African Local Government Association (SALGA). SALGA is an independent association of municipalities with which its mandate is derived from the Constitution of South Africa.

According to SALGA (2014), the roles of SALGA in terms of municipalities are:

- to protect, promote and represent the interest of local government in South Africa;
- to assist local government in fulfil its developmental roles;
- to raise the profile for local government;
- to encourage participation of women in local government; and
- to develop and improve capacity within municipalities.

### **1.3.1 The Municipal Finance Management Act**

The Municipal Finance Management Act 32 of 2003 (MFMA) aims to streamline accountability, budgeting and financial management performance by stabilizing local government finances on a sustainable footing in order to improve the capacity of municipalities and consequently improving service deliver in communities. Its purpose is to establish a sound financial management framework by specifying and clarifying the roles and responsibilities of the council, mayor and officials.

The MFMA is supported by the Constitution, which mandates all three spheres of government to be transparent in carrying out their financial management. It is also an important component of the broader reform package for local government, as outlined in the 1998 White Paper on Local Government (Local Government, 1998). In other words, the MFMA gives guidelines for financial and operational performance of municipalities,

provides guidelines on which financial statements should be prepared and it also provides standards to which municipalities can be evaluated on (MFMA 2013).

### **1.3.2 The internal audit function**

The internal audit unit of a municipality is a management function which is accountable to the council, in accordance with the IIA(2014). An internal auditing function is an independent, objective assurance and consulting activity aimed at adding value and improving an organisation's operations. It assists organizations in accomplishing their objectives by bringing a systematic, disciplined approach to assessing and improving the effectiveness of risk management, control and governance processes (IIA, 2014). In accordance with the Institute of internal auditing (2014), 91% of the 319 municipal entities nationally, financial statements were qualified, only thirteen municipalities nationally succeeded to have clean audit opinions from the Auditor-General in the municipal financial period ending 2013, and in the municipal financial year ending 2012, 95% were qualified, only 5% of municipalities' financial statements were unqualified. Unfortunately, none of the municipalities were from the Eastern Cape, Free State, Limpopo or the North West Province, in which this study is going to be based on what is needed to achieve a clean audit.

### **1.3.3 The financial department**

The financial department of municipalities is headed by the chief financial officer (CFO). This department's purpose is to ensure sustainable municipal financial management in compliance with the MFMA (Government Gazette, 2000). The department is made up of the following divisions: planning, budgeting and reporting, supply chain management, revenue management, expenditure management, assets and risk management, data and information management. Each division is headed by a manager and the financial department is headed by a CFO (MFMA, 2003).

The CFO is answerable legislatively to the municipal manager who is the accounting officer of the municipality. Section 57 1 (a) of the MFMA stipulates that the CFO's of municipalities sign a performance contract with the municipality and one of the terms of

this contract is the annual preparation of consolidated performance and financial statements for the municipality in line with a recommended framework.

The MFMA states that the purpose of the financial statements is to make information available to the general public about the financial performance and changes in financial position of the municipality. In other words, the financial statements are a declaration of the way in which the management have managed the financial and operational affairs of the municipality in that year. These financial statements constitutionally have to be appraised by the Auditor-General and in the case of Mafikeng Local Municipality the Auditor-General has been qualifying their financial statement (AGSA, 2014) for the past five years.

#### **1.3.4 The Auditor-General of South Africa**

The AGSA is established by the Constitution of the Republic of South Africa to support constitutional democracy (The Constitution of the Republic of South Africa, 1996). The AGSA is like a "watchdog" over the government departments and municipalities.

According to Section 4 of the Public Audit Act of 2004, the AGSA has the following constitutional function:

The AGSA must audit and give an opinion on the financial statements of national government departments as required in Section 8 of the Public Finance Management Act. Also it must give an opinion on all provincial government departments as required by Section 19 of the PFMA and finally the AGSA must audit and report on the consolidated financial statements of all municipalities and municipal entities as recommended by the MFMA (Public Audit Act, 2004). The constitution has given the AGSA powers to review and give an opinion on the annual financial statements of all municipalities. In accordance with the Auditor-General's Annual Report on municipal audits for the North West Province for the financial year ending June 2013, overall 22 auditees (81%) received modified audit opinions (Qualified/adverse/disclaimed with findings). There was a slight decrease in the number of disclaimers, namely one regression and two improvements.

A total of two auditees (Moses Kotane and Rustenburg) that were previously disclaimed improved to qualified opinions in the current year. The opinion for Greater Taung regressed from qualified to a disclaimer. A total of 21 (78%) have failed to obtain unqualified audit reports for the past three years with Mafikeng Local Municipality being part of these statistics. The annual financial statements of seventeen (63%) auditees were again disclaimed due to the unavailability of documentation and/or information to form an audit opinion. In the Auditor-General annual municipal audit report for the North West Province (2013c?) for the municipal financial year ending 30 June 2012, out of the 23 municipalities in the North West Province four obtained unqualified audits with finding audit opinions, three qualified audit opinion with findings and 16 a disclaimer of opinion with finding. Mafikeng Local Municipality which will be the case study for this study obtained a disclaimer from the Auditor-General. It is from this shocking statistic as noted above that the research found it paramount for this study to be carried out.

#### **1.3.5 The Audit Committee**

An audit committee of a municipality is a council's independent advisory committee which has oversight responsibilities on the effectiveness of financial statement preparation and it is responsible to respond on matters raised by the Auditor-General in the audit report to council (Deloitte, 2014). In accordance with Klein (2006), the main responsibility of an audit committee is to direct the financial reporting process of the municipality. The audit committee can achieve this goal by regularly reviewing the municipality's financial statements, internal accounting controls and the audit process by meeting regularly with the municipality's internal financial manager's department and its external auditors.

In accordance with PWC (2005), although the audit committee can take up numerous additional responsibilities, the central reason for the existence of the committee is to oversee the integrity of the financial statements.

In order to provide the council of the municipality or in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, the audit committee of a municipality must review the annual financial statements

of the municipality. The audit committee must also review the financial statements to give assurance to council on its efficiency, effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation (MFMA, 2003). The MFMA also gives minimum qualification and competency requirements for the composition of the audit committee members in order for the audit committee to achieve its financial reporting functions, its composition and the competency of its members should meet the requirements of the MFMA (MFMA, 2003).

### **1.3.6 The internal control**

Arwinge (2013) defined internal controls as a unit established by management to ensure the integrity of financial and accounting information, and also highlighted that in order for organizations to achieve profitability and operational targets the organization needs a fully operational internal control system and secondly a fully operational internal control system will transmit management policies throughout the organization. Finally, Arwinge (2013) alluded that an internal control system is designed to provide reasonable assurance regarding the achievements of objectives in the following categories:

- compliance with laws and regulations;
- efficiency and of effectiveness operations; and
- consistency and reliability of financial reporting.

Scholtz (2014) alluded to the fact that organizations cannot achieve the concept of planning without establishing a full operational and effective internal control system. Planning and internal control systems are intertwined and are critical to any control environment and the establishment of its origin. The analysis of this theory provides content as interpreted from a practical perspective and its significance towards achieving a clean audit.

### **1.3.7 Qualities for competency and efficiency**

The concepts of accountability, professionalism and ethics are components of the fundamental values of municipal management and require to be exposing and to be

taken seriously by the leaders of the municipalities and also by all municipal officials. One can argue that sound ethical behaviour and accountability of public administration are prerequisites to and underpin public trust as a keystone to good government. Attention should be focused by municipalities on the legislative framework on ethics professionalism and accountability (Edwards 2008).

In accordance with Edwards (2007), the concept of ethics has been broadened to include not only the characteristics of the good person and theoretical knowledge but it refers also to best practice. In general, ethics refers to a set of moral principles or values that directs the behaviour of municipal officials in terms of what is wrong and what is right.

Mafunisa (2000) associated professionalism with being qualified, efficient and competent. This implies that professionalism is a continuing process of development. An important aspect of professionalism in municipalities is that municipal administrators must have a specific competence to be able to execute their official duties. The public holds elected political office-bearers and public officials to a higher standard of ethical conduct and professionalism and accountability. Therefore, professionalism requires of municipal officials to fulfil their roles and duties as efficiently as possible and to do so with competence, pride and precision.

### **1.3.8 Summary**

From the literature on a municipality's financial and operational managements, it can be summarised that the MFMA gives the guidelines on how municipalities should prepare their annual financial statements (MFMA, 2003). The purpose of the financial department of municipalities is to ensure sustainable financial management in accordance with the requirements of the MFMA and the preparation of consolidated annual financial statements in accordance with the requirements of the Act (MFMA, 2003).

The audit committee is responsible for the review of the financial statements and the overall coordination of the audit process with the external auditors (Klein, 2006). The Auditor-General is mandated by the constitution to review the financial statements

prepared by the financial departments of municipalities and to give an opinion as to whether the financial statements have been prepared in accordance with the requirements as stipulated in the MFMA (Constitution of South Africa, 1996). For the past five years, more than 75% of municipalities in the North West Province's financial statements have been qualified by the Auditor-General, and Mafikeng Local Municipality forms part of the 75% (AGSA, 2014). This implies that more than 75% of municipalities in the North West Province's financial statement did not fairly represent their financial position and performance in accordance with the prescribed framework.

#### **1.4 Problem statement**

Out of the 319 municipalities and municipal entities audited nationally by the Auditor-General for the financial year ending 2012 only thirteen municipalities received an unqualified report (IIA, 2014). In 2013 out of the 319 municipalities and municipality entities that were audited only fifteen received unqualified audit opinions from the Auditor-General, and this implies that 305 municipalities and municipal entities' financial statements were qualified and Mafikeng Local Municipality is one of the municipalities with a qualified opinion. Also from 2007 to 2011 the Auditor-General's national report for municipalities indicated that out of the 278 municipalities in 2007, only three municipalities received an unqualified opinion, and in 2008 only one municipality, in 2009 only four municipalities, in 2010 only six municipalities and 2011 had thirteen municipalities receiving unqualified audit reports (Powell *et al.*, 2014).

In the past five years more than 75% of municipalities in the North West Province annual financial statements were qualified by the Auditor-General (AGSA, 2013). Mafikeng Local Municipality is one of the municipalities whose financial statement has been repeatedly qualified in the past five years by the AGSA. This implies that more than 75% of municipalities' financial statements did not fairly represent their financial positions and performance in accordance with the recommended framework. However, the causes of the persistent qualified financial statements have not been adequately investigated. This study set out to investigate the causes of qualified audit opinions in municipalities.

## **1.5 Research questions**

The purpose of this study is to discover answers to the following questions:

Main question:

- What are the factors that prevent Mafikeng Local Municipality from obtaining unqualified audit opinions?

Sub-questions:

- Are the municipal officials of Mafikeng Local Municipality ethical in carrying out their financial reporting functions?
- Are the municipal officials of Mafikeng Local Municipality accountable for their actions in carrying out their financial reporting functions?
- Do the audit committee, internal audit function and financial department of Mafikeng Local Municipality meet the minimum educational qualification standards and experience as recommended by the MFMA?

## **1.6 Objectives of this study**

Research objectives are based on the questions of research outlined in the above section. They include the following:

Main objective:

- To determine factors influencing the financial statements of Mafikeng Local Municipality to be qualified by the Auditor-General.

Sub-objectives:

- To determine whether the qualification of financial statements of the Mafikeng local Municipality is caused by unethical practices by municipal officials.
- To determine whether the qualification of the financial statements of Mafikeng Local Municipality is caused by unaccountability of municipal officials.
- To determine whether the qualification of financial statements of Mafikeng Local Municipality is caused by the audit committee, the internal audit function or the

financial department not meeting the minimum qualification and competency requirements prescribed by the MFMA.

### **1.7 Significance of the study**

This study is going to be significant to a range of government entities.

In 2009 the Minister for Cooperative Governance and Traditional Affairs (COGTA), Sicelo Shiceka, launched Operation Clean Audit (OCA) in 2014 (OCA, 2014), which was the flagship of the first Zuma Government's broader plan to "turn around" local government. In accordance with UWC (2014), Operation Clean Audit 2014 had two targets: First, by 2011, no municipality or provincial department should have a disclaimer or adverse opinion or fail to submit financial statements for auditing and second, by 2014 all municipalities and provincial departments should achieve a clean audit (UWC, 2014; Powell *et al.*, 2014).

Significance to municipalities: the findings and recommendations of this study will be used by struggling municipalities to improve the effectiveness of their financial departments in preparing annual financial statements which will lead in them achieving the national campaign of OCA.

Significance to the provincial and national departments of finance: the findings and recommendations of this study can be used as a benchmark of standards for struggling municipalities, not only in the North West Province but also in the rest of South Africa, to achieve the national campaign of OCA..

### **1.8 Delimitations of the study**

Cooperation with the respondents from the sample was necessary with the use of a questionnaire as a data-collection technique. Not everyone from the sample was willing to share all the evidence required for the study. It is also important to take note of the barriers caused by language and culture which may result in incorrect answers being provided. Apart from language being the medium of communication, it also plays a role in a person's self-identity and relational orientation. The social identification theory suggests that a study can have a negative outcome because of the inability of a respondent to identify himself with other social and cultural groups (Kim & Mattila,

2011). This can be identified by having response rate, which may be below the acceptable level, which when analysed will producing distorted results or outcomes. Moreover, some respondents may not understand the questions which will lead to them not being truthful in their responses.

Geographical scope: the study was limited only to municipalities in the North West Province with an in-depth study of Mafikeng Local Municipality.

Participants: the participants of this study were management in the finance department of Mafikeng Local Municipality, management of the internal audit function of Mafikeng Local Municipality and the AGSA. Another limitation is that this study is a mini-dissertation which has limited capacity, and this limited capacity has certain restrictions on the range of material presented and the scope of the study. Being aware of these limitations, this study was guided professionally and each step was meticulously monitored.

## **1.9 Research methodology**

According to Babbie and Mouton (2002), research methodology is concerned with research processes and the decisions that have to be taken by the researcher to execute the project. The research design that will be applied in this study will be exploratory in nature and the data-collection method will be quantitative (Brynard & Hanekom, 2006). A quantitative methodology relates to “analytical research and intends to reach a universal statement”. Numbers are assigned to observations and data produced by means of counting as well as measuring things or objects.

### **1.9.1 Data-collection method**

This study will make use of a survey research methodology for the collection of data, which will include the use of a questionnaire as an information collection tool. A questionnaire is a tool designed specifically to collect evident that will be analysis to back the conclusions and recommendations of this study (Babbie, 2010). In the study the questionnaires will be electronically distributed to all managers and their accountants in the finance department of Mafikeng Local Municipality and the AGSA.

This study will make use of a case study research method with Mafikeng Local Municipality being the case studied. In accordance with business dictionary.com a case study is a detailed examination of a single example of a class of phenomena. Yin (1984) defined a case study as a research strategy which focuses on understanding the dynamics present within single settings. Examples of case study research include Selznick's (1949) description of TVA, Allison's (1971) study of the Cuban missile crisis, and Pettigrew's (1973) research on decision-making at a British retailer. Case studies can involve either single or multiple cases, and numerous levels of analysis.

### **1.9.2 The population of the study**

According to Babbie (2010), the most essential attribute in selection of the population for a study is the researcher's knowledge of the population, its elements and the purpose of the study. Consequently, the population for this study will be intentionally selected taking into account its suitability for the fulfilment of the objective of the study, which is to identify factors that hinder municipalities from obtaining clean audit opinion from the Auditor-General.

The population selected for this study consisted of all managers (senior and middle), and their accountants in the finance department of Mafikeng Local Municipality and the Auditor-General. The study deals with a target population, and this target population is important because they will provide the needed information for this study.

### **1.9.3 Sample selection**

There are, however, a moderate number of senior and middle managers in Mafikeng Local Municipality (nine managers, eight accountants and the Auditor General) and the study sample therefore will constitute 100% of the total population. This is called a total study; a total study is where every component of the population which is relevant to the study is actually evaluated. This is possible only if all the respondents are available for the study and the population is not too big (Burger & Silima, 2006). They also stated that a population, which is selected non-randomly, will provide relevant information for the study.

### **1.10 Research ethics**

Du Toit *et al.* (2002) referred to ethics as “general application of systems of moral principles” related to what is right and wrong when research is conducted. Brynard and Hanekom (2006) stated in their studies that the researcher is committed to the code of ethics and demonstrates an acceptable behaviour throughout the research process. The information gathered from both the Mafikeng Local Municipality and the Auditor-General will be kept confidential at all times. In order to reaffirm the commitment to ethical conduct, the researcher will ensure that the following processes unfold:

- Permission will be obtained from the Municipal Manager of Mafikeng Local Municipality to conduct the research.
- A specimen questionnaire will be submitted to the Ethics Committee for evaluation.
- Respondents will be assured of anonymity.

### **1.11 Proposed structure of this study**

#### **Chapter 1: Introduction**

This chapter is comprised of an introduction and background of the study area. A brief literature review of existing literature about the study area and the formulation of the problem statement and research questions.

#### **Chapter 2: Literature Review**

The literature was reviewed by a desktop study of information from Acts of government, policies, text books, journals, newspapers, articles, magazines; internet and database sources. This provided background knowledge of research previously identified in line with the objectives of this study.

#### **Chapter 3: Research methodology**

This chapter outlines the research methodology followed in the research process. It also identifies the target or population group, sampling method, the size of the population group and the research techniques.

#### **Chapter 4: Data presentation, analysis and interpretation**

This chapter discusses the analysis of the data. The research will determine and select from the general field the exact data which is required for the observation of the code of conduct and corrective measures to be implemented. The massive amount of data available is sifted until only that which is critical to the research remains.

#### **Chapter Five: Conclusions and recommendations**

This is the final chapter of the study. It gives the main conclusions drawn from the study and the recommendations pertaining to the critical issues raised. Critical issues of further research are also identified.

## **Chapter 2: Literature review**

### **2.1 Introduction**

Section 188 of the Constitution of South Africa (1996) mandates the Auditor-General to audit and give an opinion on the consolidated financial statements of all Parent municipalities and all municipal entities under its sole or effective control as required in the MFMA in order to uphold constitutional democracy. In accordance with Powell (2014), for the past five years the Auditor-General has been giving an adverse audit opinion to more than 75% of municipalities and municipal entities in the Republic. In this chapter the concept of audited municipal financial statements is discussed in detail, the responsibilities of the different stakeholders in the preparation and auditing of the municipal financial statements are also discussed and explained in different contexts and the reasons for qualified audit opinions of municipal financial statements are discussed and explained in different contexts.

### **2.2 Statistical background**

Every year the Auditor-General publishes an annual report on the outcomes of audits conducted in the country's 278 municipalities (including the 60 municipal entities) in the preceding financial year. The report examines the extent to which municipalities have complied with national standards for municipal financial management and performed against predetermined objectives for service delivery. It identifies key trends and risks and makes specific recommendations about how major problems should be addressed by an appropriate level of government. The annual audit of local government is a vital component in the regulatory regime that governs financial management, budgeting, accounting, and reporting (Powell, 2014).

The AGSA uses six categories to classify municipalities according to their level of compliance and performance in the financial year that is under review (AGSA, 2014), namely:

- *Unqualified with no findings (Clean Audit)*: No material misstatements were found in the financial statements, there were no material findings on (a) reporting on performance objectives or (b) non-compliance with legislation. In accordance

with Wiese (2006) an unqualified or clean audit opinion in the USA is based upon the finding by the auditor that the financial statements fairly represent the finances of the component according to Generally Accepted Government Auditing Standards (GAGAS). GAGAS incorporate the standards and reporting requirements of the (American Institute of Certified Public Accountants, AICPA).

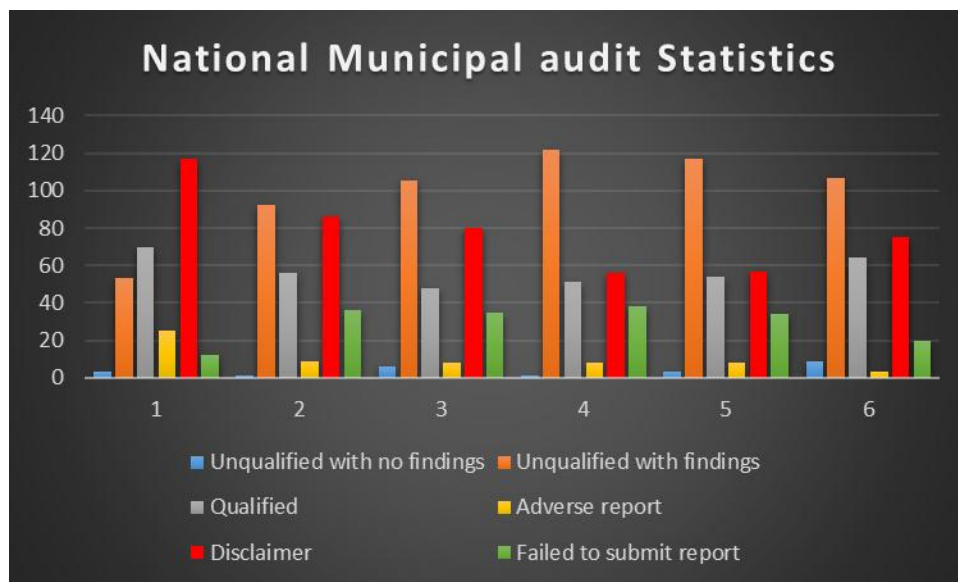
- *Unqualified with findings*: Financially unqualified, however, there were findings on (a) reporting on performance objectives or (b) non-compliance with legislation.
- *Qualified with findings*: The financial statements contain material misstatements in specific amounts, or there is insufficient evidence for AGSA to conclude that specific amounts included in the financial statements are not materially misstated.
- *Adverse opinion with findings*: There were material misstatements that substantially affected the credibility of the financial statements.
- *Disclaimer of opinion with findings*: Insufficient evidence was provided upon which to base an audit opinion.
- *Outstanding audits*: Failure to submit financial statements for audit (Powell, 2014).

Table 2.1 illustrates the national statistics for municipal audit outcomes from 2007 to 2012 (AGSA, 2014).

**Table 2.1: National Municipal Audit Outcome Statistics**

| Audit opinion                | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|------------------------------|------|------|------|------|------|------|
| Unqualified with no findings | 3    | 1    | 6    | 1    | 3    | 9    |
| Unqualified with findings    | 53   | 92   | 105  | 122  | 117  | 107  |
| Qualified                    | 70   | 56   | 48   | 51   | 54   | 64   |
| Adverse report               | 25   | 9    | 8    | 8    | 8    | 3    |
| Disclaimer                   | 117  | 86   | 80   | 56   | 57   | 75   |
| Failed to submit report      | 12   | 36   | 35   | 38   | 34   | 20   |

This is illustrated graphically in Figure 2.1.



**Figure 2.1: National Municipal Audit Outcome Statistics**

## **2.3 Overview of the North West Province**

The North West Province is located in the north of South Africa on the Botswana border, fringed by the Kalahari Desert in the west, Gauteng Province to the east and the Free State Province to the south. It covers an area of 104 882km<sup>2</sup> and has a population of 3 509 953 inhabitants. Much of the North West Province consists of flat areas of scattered

trees and grassland. The Vaal River flows along the southern border of the Province (Mafikeng Local Municipality 2015).

The North West Province is divided into four district municipalities which are further divided into nineteen local municipalities namely,

- 1) Bojanala Platinum District :Kgetlengrivier Local, Madibeng Local, Moretele Local, Moses Kotane Local and Rustenburg Local.
- 2) Dr Kenneth Kaunda District: City of Matlosana Local, Maquassi Hills Local, Tlokwe City Council Local and Ventersdorp Local.
- 3) Dr Ruth Segomotsi Mompati District: Greater Taung Local, Kagisano-Molopo Local, Lekwa-Teemane Local, Mamusa Local and Naledi Local.
- 4) Ngaka Modiri Molema District: Ditsobotla Local, Mahikeng Local, Ramotshere Moiloa Local, Ratlou Local and Tswaing Local municipalities.

## **2.4 Mafikeng Local Municipality**

Mafikeng Local Municipality is located in Mafikeng and Mafikeng is the capital city of the North West Province of South Africa. Mafikeng was originally known as “Mahikeng”, a Setswana name meaning “place among rocks”, is the capital city of the North West Province next to the Botswana border. Mafikeng is just a three-hour drive from Johannesburg and about 294 km from Pretoria, the political capital of South Africa. The total area of the Mafikeng Local Municipality is approximately 3 703 km<sup>2</sup>. It is divided into 28 wards consisting of 102 villages and suburbs. The population of the municipality is estimated at 271 501 people (Mafikeng Local Municipality, 2015).

Administratively the municipality is made up of six departments, namely Finance, Community Service, Planning and Development, Public Safety and Corporate Support Service (Mafikeng Local Municipality, 2015).

### **2.4.1 What is a municipality?**

In accordance with the Business Dictionary (2015), a municipality is an elected local government body having corporate status and limited self-governance rights, and serving a specific political unit such as a town or city. The Municipal Systems Act (2000)

states that a municipality is an organ of state within the local sphere of government exercising legislative and executive authority within an area determined in terms of the 25 Local Government Municipal Demarcation Act, 1998. It can be deduced from these definitions that a municipality is usually an urban or rural administrative division having corporate status and powers of self-government or jurisdiction.

In South Africa the constitution provides for three categories of municipalities, namely category A is Metropolitan, category B is District and category C is Local Municipalities (The Constitution of the Republic of South Africa, 1996). There are 278 municipalities in South Africa, comprising eight metropolitan, 44 district and 226 local municipalities. Mafikeng Local Municipality which is the case study of this study is a category C municipality (Powell, 2014).

#### **2.4.2 Purpose of the financial department**

The financial department of municipalities is mandated to ensure sustainable financial management in compliance with the MFMA. The department is made up of the following divisions: planning, budgeting and reporting, supply chain management, revenue management, expenditure management, assets and risk management, data and information management. Each division is headed by a manager and the financial department is headed by the CFO (MFMA 2003). In accordance with section 57 1 (a) of the Local Government Municipal Act, the CFOs of a municipality must enter into a performance contract with the municipality and one of the terms of this contract is the annual preparation of consolidated performance and financial statements of the municipality in accordance with a recommended framework.

According to Wiese (2006), CFOs in the USA are regulated by the CFO Act of 1990. The purpose of this act is not only to improve financial management and internal controls of the executive branch of the U.S. government, but also to establish a leadership structure to provide for long-range planning, requiring audited financial statements and strengthening public accountability reporting.

The Act was intended to provide audited financial statements and clearly defined practices and to provide timely, useful financial information to the public.

In accordance with the MFMA, the purpose of the financial statements is to provide the general public with information about the management of the financial and operational affairs of the municipality in that year.

The responsibility for the preparation of the financial statement of municipalities is thus vested legislatively in the financial department of the municipality.

### **2.4.3 Responsibilities for the preparation of municipal financial statements**

In accordance with Section 60 of the MFMA (2003) the municipal manager of a municipality is the accounting officer of that municipality. Section 62 (1) states that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the resources of the municipality are used effectively, efficiently and economically, that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards (financial reporting framework) and that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control and of internal audit operating in accordance with any prescribed norms and standards (MFMA, 2003).

Section 62 of the MFMA delegates the CFO to perform the financial administration and other duties as these may be delegated by the accounting officer from time to time. Furthermore Section 122 of the MFMA (2003) states that every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly present the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year in accordance with an accepted financial reporting framework (MFMA, 2003).

From these Sections of the MFMA it is deduced that the legislative responsibility for the preparation of the financial statement of a municipality is vested in the accounting officer of the municipality and the accounting officer should delegate this function to the accounting department which is headed by the CFO.

## **2.5 Compliance with the MFMA educational and professional experience requirements of finance department officials**

A greater number of researchers are of the opinion that cognitive abilities decline at some stage in adulthood. In accordance with Verhaegen and Salthouse (1997), in their analyses of 91 organisations they conclude that the cognitive abilities reasoning, speed and episodic memory decline significantly before 50 years of age and more thereafter. Bratsberg *et al.* (2003) concluded that older researchers publish less than younger ones in leading journals and that the rate of decline is the same for top researchers as among others. Kutscher and Walker (1960) provided some evidence that mail sorters and office workers kept productivity quite stable at higher ages, while factory workers' productivity fell after the age of 55 years of age. On the other hand, Warr (1994) in his study concluded that the decreased cognitive abilities of older workers can lead to lower productivity, unless their longer experience and higher levels of job knowledge outweigh the decline in mental abilities. Finally, Hoyer and Lincourt (1998) alluded in their studies to the fact that accelerating technological progress can increase the importance of being able to learn and to adjust to new ways of working, while a long work experience may become less important. This is particularly problematic for older employees, due to age-related declines in the processing speed and in learning capacities.

In accordance with the Auditor-General's national report for local government for the municipal financial year ending June 2011, officials in key positions at more than 70% of the municipalities did not have the minimum competencies and skills required to perform their jobs. While a lack of dedicated capacity is at the root of the weaknesses in service delivery reporting, the skills gap is most pronounced in the financial discipline (AGSA, 2012). In the municipal financial audit report for the Limpopo Province for the financial year ending in 2012, although the Province commenced with a process to appoint competent CFOs, there is still a critical shortage of skills and competencies at 72% (cf 87% in 2010-11) of the municipalities. The lack of skills resulted in a significant reliance (R51 million) on the use of consultants in the preparation of financial statements at 72% of the municipalities (AGSA, 2013).

### **2.5.1 Minimum competency requirements for management of the financial department**

Sections 107 and 119 of the MFMA (2003) specifically contain enabling provisions requiring all officials who manage, supervise and operate within the financial management and supply chain management disciplines, to meet minimum competency requirement levels. Section 119 further makes this requirement compulsory and stipulates that a municipality and a municipal entity must provide resources or opportunities for the training of officials to meet the prescribed competency levels. The provincial treasury or a National Treasury is also given responsibility to assist in the training of municipalities and municipal entity officials.

In accordance with the National Treasury guidelines in 2007 municipal managers up to the 01 January 2013 are required to meet the minimum competency level and new employees will also benefit from this transitional period. Municipalities are required to develop appropriate strategies to assess staff competencies, provide suitable resources and opportunities for staff training and development. Furthermore, they must ensure that the attainment of competencies is included as a performance target in the official's, performance agreement.

### **2.5.2 Minimum qualification for municipal managers**

Senior managers of low and medium capacity municipalities with an annual budget of a value below R500 million for the current financial year must have at least National Qualifications Framework level 7, translated as a three-year bachelor's degree or a national diploma or a certificate in municipal financial management qualification, approved by the South African Qualifications Authority (National Treasury, 2007).

Senior managers for higher capacity municipalities and medium capacity municipalities with an annual budget of equal to or more than R500 million must have at least a National Qualification Framework 8 and this is translated as a higher degree, i.e. Honours (National Treasury, 2007).

### **2.5.3 Work-related experience**

A minimum of five years at middle management level, and for higher capacity municipalities, a minimum of seven years at senior and middle management levels of which at least two years must be at senior management level, are required by the Draft Guideline on Regulations for minimum competency levels (National Treasury, 2007).

### **2.5.4 Competency areas**

Finally, National Treasury (2007) guidelines stipulate the following minimum financial and supply chain management skills required, and these requirements are categorised into eleven competency areas, which include:

- Strategic leadership and management;
- Strategic financial management;
- Operational financial management;
- Governance ethics and values in financial management;
- Financial and performance reporting;
- Risk and change management;
- Project management;
- Legislation, policy and implementation;
- Stakeholder relations;
- Supply chain management; and
- Audit and assurance.

From the above-mentioned minimum requirements guideline from National Treasury, it's obvious that if a municipality's senior manager (CFO) or middle manager line managers in the financial department for example the supply chain manager do not have the stipulated minimum requirements, this may lead to ineffectiveness in the performance of some of their major roles and responsibilities like the preparation of the annual financial statements in accordance with a recommended framework, which may lead to an adverse audit opinion on the financial statement.

## **2.6 The internal audit function as a management function**

The internal audit function of a municipality is a management function, which is accountable to the municipality's accounting officer in accordance with the Institute of Internal Auditors (IIA, 2015). Internal auditing is 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 (IIA, 2015). In accordance with the MFMA, the internal audit function of a municipality is responsible for the following::

- to prepare a risk-based audit programme for each year;
- to advise the accounting officer and report to audit committee on its plan on matters relating to internal audit, internal control, accounting procedures, practices risk and risk management, performance management, loss control and compliance with the MFMA Division of Revenue Act and any other applicable legislation; and
- to perform such other duties as may be assigned by the accounting officer.

Mculu (2008) explained that the role of the internal auditors is as follows:

- Planning the audit; internal auditors should plan each audit before the start of the audit process,
- Examination and evaluating of information; internal auditors should collect, analyse, interpret, and document information to support the audit results;
- Communicating; internal auditors should report the results of their audit to their employer, and
- Follow the audit; they should make a follow-up to establish whether appropriate action has been taken on reported findings.

In his study of the coordination role between the internal and the external audit functions Diamond (2002) recommends that there should be proper coordination between the external and internal audit functions to ensure adequate audit coverage

and to minimize duplication of functions. They should have access to each other's plans, programmes and have periodic meetings to discuss matters of mutual interest.

In accordance with the Institute of Internal Audit South Africa (IIA, 2015), internal auditors must prepare risk-based audit plans and report to the audit committee on the following matters:

- Implementation of the audit plan,
- Internal controls,
- Risk management,
- Compliance management,
- Performance management, and
- Loss control.

The Institute for Internal Auditors also maintained that to ensure that professional audit services are provided to municipalities on assessment of internal audit, functions need to be revised at least every three years to ensure compliance with the internal audit standards.

Finally, in accordance with the National Treasury's Internal Audit Framework (2009) an Internal Audit Activity is an important component of internal control, risk management and corporate governance and provides the necessary assurance and advisory services to a municipality. Internal Audit Activity is one of the most significant management tools and can provide value-added services to a municipality. When objectively and adequately resourced, an Internal Audit Activity should be in a position to provide management with much of the assurance it requires regarding the effectiveness of the system of internal control risk management and governance processes. The internal audit activity must be well planned, organised, staffed, trained, directed and monitored.

From the above stated literature it is obvious that the internal audit function is a very crucial and important financial management function which if properly planned, organised, staffed, trained, directed and monitored will lead to efficient financial

statement review and consequently limit the possibility of the annual financial statements of municipalities being misstated and qualified by the Auditor-General.

## **2.7 The audit committee**

The audit committee is an independent advisory body of the council which has oversight responsibilities for the effectiveness of financial statement preparation and responds to the Council on any issues raised by the Auditor-General in the audit report. In accordance with Smith (2003) the reason for forming an audit committee, is that while all directors have the duty to act in the interest of the company this committee has a particular role acting independently from the executives, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

Benjamin (2008) stated that for an audit committee to effectively perform its financial and control oversight roles, it is essential the committee be provided with all the relevant information and facts in an open, honest and transparent manner and for this to be effective it is important that the independence and scope of the audit committee are embedded in the audit committee charter.

In accordance with Deloitte (2014) the audit committee plays a critical role in overseeing internal control. Although their primary focus may be on internal control over financial reporting, audit committees are taking the lead in overseeing controls pertaining to compliance and operational matters. Expectations of the audit committee's role have expanded due to enhanced company and external auditor reporting requirements, along with an increased focus on compliance by regulators. This issue of the Audit Committee briefly highlights hot topics related to internal control over financial reporting in light of the issuance of the Committee of Sponsoring Organizations of the Treadway Commission's (COSO, 2013).

The audit committee has a very important role to play in strengthening the external audit's independence and to ensure that they can perform their work objectively and without interference or pressure from management. This oversight role should significantly increase the quality of the audit opinion and contribute in ensuring financial reporting that is accurate credible and reliability (ICAEW, 2003).

Also in accordance with PWC (2005), the audit committee can take up numerous additional responsibilities but the central reason for the existence of the committee is to oversee the integration of the financial statements.

Klein (2006) in his study alluded that the board of directors manages the business and affairs of the corporation. Directors are voted in by their shareholders; thus their fiduciary responsibilities are to the shareholders. In the case of the municipality the fiduciary responsibilities of the board are to the council, since the 1970s, the New York and American exchanges have required or strongly recommended to all large U.S. listed firms to maintain board audit committees comprising a majority of independent directors. The audit committee's primary function is to oversee the financial reporting process of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit processes and internal accounting controls.

In accordance with the MFMA (2003), an audit committee must be established by each municipality/municipal entity: an audit committee is an independent advisory body which must:

- A. Advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the 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 this Act, the annual Division of Revenue Act and any other applicable legislation;

- Performance evaluation; and
  - Any other issues referred to it by the municipality or municipal entity;
- B. Review the annual financial statements to provide the council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation;
- C. Respond to the council on any issues raised by the Auditor-General in the audit report; and
- D. Carry out such investigations into the financial affairs of the municipality or municipal entity as the council of the municipality, or in the case of a municipal entity, the council of the parent municipality or the board of directors of the entity.

An audit committee in government has an important role to play and also offers the same strategic benefits as audit committees in the private sector. An audit committee serves as the cornerstone of good governance and provides an objective assessment of whether or not public resources are responsibly and effectively managed. It also promotes accountability and integrity, as well as improvement in government operations (Deloitte, 2011). As an oversight structure, an audit committee also provides a valuable benefit, as it results in a greater focus on controls and risk management, as well as financial reporting. An audit committee should also promote the integrity and effectiveness of audit activities. An audit committee as a mediator between the external audit and the organisation ensures that the audit results that are recommended in the form of corrective actions are implemented (IIA, 2015).

The establishment of audit committees in the local sphere of government came with the reform of the budget and financial activities in local government. The objective of the reform was aimed at improving the financial affairs of local government, as well as strengthening good governance and accountability (National Treasury, 2004) and

therefore, the formation of audit committees in the local sphere of government serves as a mechanism to promote much-needed financial accountability.

In recent times, the need for an effective audit committee within the local sphere of government has become even more important, mainly in order to assist management to be more focused on how to use their resources optimally. The current economic climate has resulted in an increasing number of businesses experiencing financial problems, which has a ripple effect on local government revenue. The budget shortfalls and the struggle to sustain service delivery with fewer resources require local government to diligently monitor expenditure. This ensures that effective revenue collection policies are in place and that such revenue is optimally allocated to appropriate programmes.

### **2.7.1 Composition of the audit committee and quality of the chairperson**

Section 166 of the MFMA provides for a minimum requirement for the composition of an audit committee. The audit committee must comprise at least three (3) persons with relevant educational qualifications and experience in financial statement preparation and should consist of a majority of members who are not employees of the municipality or municipal entity (MFMA, 2003).

One of the audit committee members should be appointed as the chairperson and the chairperson must:

- have good standing and ability to lead discussions;
- create vision and provides direction at meetings;
- build municipal capabilities by guiding management based on expert knowledge and skills;
- promote and achieve quality outcomes at meetings;
- have the ability to speedily and effectively advise council or the board of directors of any impending non-compliance with the legislative framework;
- have the ability to encourage other members to participate in audit committee meetings; and
- conduct meetings in a manner that demonstrates a desire to establish effective communication with all stakeholders (National Treasury, 2012).

The National Treasury also stipulates that, in determining suitable candidates for an audit committee and maintaining a balanced composition, the accounting officer should seek to appoint members from different areas of expertise to enhance the audit committee's overall knowledge of the municipality or entity and the ability to discharge its obligations and provide appropriate recommendations to the council.

The appointed members should collectively possess the following skills and experience:

- private and public sector experience;
- an understanding of service delivery priorities;
- good governance and/or financial management experience;
- an understanding of the role of council and councillors;
- an understanding of the operations of the organization;
- familiarity with risk-management practices;
- an understanding of internal controls;
- an understanding of major accounting practices and public sector reporting requirements;
- an understanding of public sector reforms;
- familiarity with legislation applicable to municipalities;
- an understanding of the roles and responsibilities of internal and external auditors;
- an understanding of the treatment of allegations and investigations; and
- an understanding of the performance management system.(National Treasury, 2012).

From the above quoted literature, it is obvious that if a municipality's audit committee does not meet the minimum requirement as stipulated by National Treasury it will affect their oversight responsibility of financial statement preparation and the overall responsibility of driving the financial statement audit which will affect the quality of the

financial statement and consequently influence the external auditor's (Auditor-General) opinion.

## **2.8 The internal control system**

Arwinge (2013) defined internal controls as methods put in place by an institution to ensure the integrity of financial and accounting information, and he emphasised that internal controls enable institutions to meet operational and profitability targets and transmit management policies throughout the organization. COSO (2013) defines a system of internal control as "an initiated process put in place by management of an institution to provide assurance that is reasonable with regard to the attainment of the set objectives which is related to compliance, operations and reporting". Certain fundamental concepts are reflected in this definition. According to COSO (2013), a framework for internal control is:

- aimed at the attainment of goals in different categories: reporting, compliance and operations;
- an on-going process of activities and tasks;
- executed by people and not only procedure and policy documents;
- has the ability to provide absolute assurance to the management of an institution; and
- has the ability to adapt to the structure of an institution (COSO, 2013).

According to Section 36 of the MFMA, the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control (MFMA, 2003).

According to Cahill (2006), the systems of internal control involve the financial and administrative checks and balances that are designed and supported to ensure that the goals, objectives and responsibilities of the institution are realised. Internal control operates as the most valuable tool used to manage financial activities of any

municipality. The responsibility of internal control is to identify, mitigate and manage control risks that may hamper achievement of the municipality's objectives to effectively, efficiently and economically manage financial and related resources (COSO, 2013).

According to the Committee of Sponsoring Organisations of the Treadway Commission (COSO, 2007), there is a non-exhaustive list of internal control measures which includes staff competency; delegation of duties; isolation of responsibility; access and authorisation; comparisons; reconciliations; and source document design. Various elements should be examined closely in order to understand a system of internal control accordingly (Visser, 2011). These elements are called the four pillars of the control system, namely policies, management, reasonable assurance and control objectives. They are the basic assumptions upon which all systems of internal control are designed. They can be unpacked as follows:

*Policies:* They are formalised directives and procedures issued to employees by the management of a public institution that describe in detail how certain activities must be performed. These policies are mainly in the form of a written document or manual and serve as the basis for internal control.

*Reasonable assurance:* The definition endeavours to indicate that there are various elements that impede the effective implementation of an internal control system, and therefore, the assumption that, where internal control is applied, no fraud and errors could occur is a myth. The system only makes provision for assurance that fraud, damage, theft or errors will be prevented. These inherent limitations on internal control that only permit reasonable assurance include human error (mistakes), misunderstanding, and management override, intentional errors and fraud as well as the cost-benefit aspects of specific internal controls.

*Management:* The management of a public institution should be given the responsibility to develop, design and implement systems of internal control although they often delegate these responsibilities to a responsible official who must report to them, since they are ultimately accountable for internal control.

*Control objectives:* These are objectives that management envisages to achieve through the implementation of an effective internal control system. These objectives are as follows:

- Reliable accounting and financial information to be provided.
- Validity of all transactions to be ensured.
- Accuracy of the recording of transactions to be maintained.
- Completeness of the recording of transactions to be ensured.
- Assets of the institution to be safeguarded.
- Promotion of efficiency.
- Compliance with procedures, laws, policies and regulations to be ensured.

The 2012/13 Auditor-General's Report shows that the spheres of government in South Africa are struggling to monitor public financial resources. Some employees take advantage of poor internal control systems to commit fraud and corruption by misusing public funds that are budgeted for service delivery, thus many government departments are unable to receive clean audit outcomes. The lack of internal control in all these departments results in irregular, fruitless, unauthorised and wasteful expenditure of public funds (AGSA, 2013).

From the above-mentioned literature, it is obvious that the effectiveness of the internal control of a municipality will influence the effectiveness of the financial department in performing their functions of financial statement preparation and consequently the type of Auditor-General's opinion on the financial statement.

## **2.9 Responsibility of the Auditor-General**

Section 188 of the Constitution mandates the AGSA to perform constitutional and other functions. Constitutional functions are those which the AGSA performs to comply with the broader mandate described in the Constitution. In accordance with Section 4 of the Public Audit Act (2004) the Auditor-General has the following constitutional function:

- The Auditor-General must audit and report on the consolidated financial statements of National Government as required by Section 8 of the Public Finance Management Act 25.
- All provincial governments as required by Section 19 of the Public Finance Management Act and parent municipality and all municipal entities under its sole or effective control as required in the Municipal Finance Management Act (MFMA, 2003).

## **2.10 Factors that prevent municipalities from obtaining unqualified audit opinions**

According to the Institute of Internal Auditing (IIA, 2014), 91% of the 319 municipalities and municipal entities nationally had financial statements which were qualified because of insufficient, inadequate audit evidence to justify the disclosures in their financial statement. Only thirteen municipalities nationally succeeded to have an unqualified audit opinion from the Auditor-General in the municipal financial year ending 2013. In accordance with the AGSA report for the municipal financial year ending 2011 for Mpumalanga Province, sixteen municipalities' financial statements were qualified because of the unavailability of adequate and reliable supporting documentation to support material disclosures in their financial statements (AGSA, 2012).

In accordance with the Auditor-General for Northern Cape Province for the municipal finance year ending 2012 municipalities' audit opinions were again disclaimed. These municipalities have been disclaimed since 2009–2010 mainly due to a lack of consequences for poor performance and transgressions and the poor response by the councils of these municipalities to implement basic financial disciplines that will ensure production of monthly credible financial and performance information (AGSA, 2013). In accordance with the Auditor-General's national report for local government for the municipal financial year ending 2011, officials in key positions at more than 70% of the municipalities do not have the minimum competencies and skills required to perform their jobs. While a lack of dedicated capacity is at the root of the weaknesses in service delivery reporting, the skills gap is most pronounced in the financial discipline. The Auditor-General also found that more than half of the municipalities can attribute their

poor audit outcomes to mayors and councillors who are not responsive to the issues identified by the audits and do not take their recommendations seriously. They are slow in taking up their responsibilities and do not take ownership of their role in implementing key controls. If this widespread root cause is not addressed, it will continue to weaken the pillars of governance (AGSA, 2012).

In the municipal financial audit report for the Limpopo Province year ending 2012, although the Province has commenced with a process to appoint competent CFOs, there is still a critical shortage of skills and competencies at 72% (87% in 2010–11) of the municipalities. The lack of skills resulted in significant reliance (R51 million) on the use of consultants in the preparation of financial statements at 72% of the municipalities. (AGSA, 2013).

#### **2.10.1 Auditor-General's opinion for Mafikeng Local Municipality**

The Auditor-General has disclaimed the financial statements of Mafikeng Local Municipality in the past five years and this implies that the Mafikeng Local Municipality has not provided sufficient appropriate audit evidence to support the disclosures in the financial statement to facilitate the decision of the auditor (AGSA, 2014).

In the financial year ending 2013 the Auditor-General disclaimed the financial statement of Mafikeng Local Municipality for the following reasons (AGSA, 2014):

*Property plant and equipment:* In accordance with the Auditor-General of South Africa's Report for Mafikeng Local Municipality (2014) the municipality did not comply with the requirements of paragraphs 38, 39, 53, 61, 71, 73 of the South African Standards of General Recognised Accounting Practice (GRAP). GRAP 17 *Property Plants and equipment's* as the municipality has not completed the process of unbundling properties, plant and equipment. I was unable to practically quantify the extent of the misstatement, and in addition I was unable to obtain sufficient appropriate audit evidence for other changes and movements identified and could not physically verify that all movable assets were included in the asset register. I was unable to confirm property plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment relating to property plant and equipment of R

446 870 064 disclosed in the statement of financial position and the related depreciation and amortisation expense of R27 764 412 were necessary.

Asset management is one of key functions of the financial department of a municipality from the above-mentioned iteration. It is obvious that the financial department of Mafikeng Local Municipality was ineffective in managing their assets in the 2012/2013 financial year and they were also ineffective in the preparation of asset notes to the financial statements, which is why the Auditor-General disclaimed assets as a line item in the financial statement and the asset notes to the financial statement.

*Trade and other receivables: SA Standard of GRAP 104; Financial instruments* require that an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. The municipality did not correctly assess receivables from exchange transactions, individually or by category, for any indication that these assets may be impaired. It was unable to confirm this impairment by alternative means. In addition, I was unable to obtain sufficient appropriate evidence to support debtor balances (AGSA, 2013).

Consequently, I was unable to determine whether any adjustments relating to trade and other receivables of R92 576 514 and the related allowance for impairment of R466 329 082 disclosed in the statement of financial position and note 9.10 and 11 to the financial statements and the debt impairment expense of R20 390 554 disclosed in the statement of financial performance and note 29 had been necessary (AGSA, 2014).

From the above quoted disclaimer by the AGSA on trade and other receivable, it's obvious that the financial department is inefficient because they cannot assess whether the assets of the municipality were impaired in accordance with GRAP 104 financial instruments; this implies that the financial department was unable to implement GRAP 104 which is one of their key functions.

*Trade and other payables:* In accordance with the Auditor-General of South Africa's Report for Mafikeng Local Municipality (2014) one was unable to obtain sufficient appropriate audit evidence regarding Sundry Creditors as the municipality did not have an adequate document management system. I was unable to confirm the Sundry

Creditors by alternative means. Consequently, I was unable to determine whether any adjustment relating to Sundry Creditors of R8 520 662 included in trade and other payables disclosed in statement of financial position and note 17 to the financial statements was necessary. In the preceding year, I was unable to obtain sufficient appropriate audit evidence regarding unallocated receipts and accrued leave pay due to a lack of proper accounting records. I was unable to confirm these trade and other payables by alternative means. Consequently, I was unable to determine whether any justification relating to the corresponding figures for unallocated receipts of R4 260 280 and accrued leave pay of R14 674 860 included in trade and other payables disclosed in the statement of financial position and note 17 to the annual financial statement was necessary.

Trade and other payables are liabilities to the organisation, that is, they will lead to an outflow of assets in future if the financial department can disclose liabilities in their financial statement to the values of R4 260 2800 and R14 674 860, without adequate appropriate proof and this implies that the financial department is inefficient and preparation of the financial statements was ineffective.

*Cash and cash equivalents:* I was unable to obtain sufficient appropriate audit evidence regarding the bank overdraft as the municipality could not provide proper substantiating records for reconciling items included in the bank reconciliation. I was unable to confirm this balance by alternative means (AGSA, 2014).

Consequently, I was unable to determine whether any adjustment relating to the bank overdraft of R11 586 341 (2012: R29 992 590) as disclosed in statement of financial position and net accumulated surplus of R321 996 659 (2012: R303 829 336) in the financial statements was necessary. From the above stated disclaimer, it is obvious that the financial department was not diligent in the preparation of the municipality's bank reconciliation which also constitutes evidence of inefficiency.

*Revenue:* I was unable to obtain sufficient appropriate audit evidence that the management has properly levied and accounted for service charges for the current year. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any adjustment to service charges of R106 523 941

disclosed in the statement of financial performance and note 22 to the financial statement was necessary. Secondly in the 2012 financial year, I was unable to obtain sufficient appropriate audit evidence that management had properly managed and accounted for licences and permits, fines, rental of facilities and other Sundry revenue. I was unable to confirm these classes of transactions by alternative means. Consequently, I was unable to determine whether any adjustment of these classes of transactions of R11 759 853 disclosed in the statement of financial performance was necessary (AGSA, 2014).

From the above-mentioned disclaimer from the Auditor-General, for two years in a row, the financial department of the municipality has not been able to account for its revenue generated. This can only imply that the financial department is not diligent in performing its duties.

***Irregular expenditure:*** Section 125(2) (d) (I) of the MFMA requires of the municipality to disclose particulars of irregular expenditure. The municipality made statements in contravention of the supply chain management requirements which were not included in irregular expenditure disclosed in note 43, resulting in irregular items being understated by R2 782 173. In addition, I was unable to obtain sufficient appropriate audit evidence for the irregular expenditure disclosed in the prior year. I was unable to determine whether any further adjustments to irregular expenditure of R39 587 650 disclosed in note 43 to the financial statement were necessary. Irregular expenditures are expenditures made in contravention to the relevant legislation and acts (MFMA supply or chain management polity) (AGSA, 2014). From the above-mentioned disclaimer it is obvious that management is overriding policies, that is why procurements are made in contravention of the policies and procedures.

***Prior period errors:*** I was unable to obtain sufficient appropriate audit evidence that all the prior period errors had been appropriately corrected and disclosed as required by SA Standard of GRAP, GRAP 3, Accounting policies, changes in accounting estimates and errors. Consequently, I was unable to determine whether any adjustment to prior period errors disclosed in note 48 or any other account balances, transactions and

disclosures affected by these prior errors to the financial statements were necessary (AGSA, 2014).

In accordance with the Auditor-General of South Africa's Report for Mafikeng Local Municipality (2014) also identified the following matters and drew the attraction of the users to the following line items that were inefficiently disclosed in the 2013 and 2012 financial years respectively.

*Unauthorized, fruitless and wasteful expenditure:* As disclosed in note 41 to the financial statements, unauthorized expenditure of R111 809 414 in respect of prior years had not yet been dealt with in accordance with Section 32 of the MFMA.

As disclosed in note 42 to the financial statements, fruitless and wasteful expenditure of R97 087 was incurred in the current year and fruitless and wasteful expenditure in respect of prior years of R5 270 237 had not yet been dealt with in accordance with Section 32 of the MFMA (AGSA, 2014).

*Material underspending of conditional grants:* As disclosed in note 15, the municipality underspent the conditional grants by R42 003 921. As a consequence, this contributed to the municipality not achieving its predetermined objectives (AGSA, 2014).

From the above disclaimers emphasised by the Auditor-General, unauthorised expenditures are expenditures that were not budgeted for and if the municipality procures items that were not budgeted for, it indicates inefficiency in its operations and secondly the material underspending on the conditional grants also indicates inefficiency and ineffectiveness of management which has led to less service delivery and may lead to uprisings in the community.

### **2.10.2 Political intervention in financial management of municipalities**

In accordance with Rotich *et al.* (2005) the introduction of political pluralism in Kenya has led to political jostling for power across the country which peaks at the local authorities. The councillors get elected or nominated to local authorities through their affiliated political parties and will usually pursue the interests of their parties and not the interests of the municipality when voting or decision making in council. Joseph *et al.* (2007) in their studies identified that almost 27% of the CEOs in a sample of 790 newly

and partially privatized firms in China are former or current government bureaucrats. Firms with politically connected CEOs underperform as against those without politically connected CEOs by almost 18% based on three-year post-IPO (initial public offerings) stock returns and have poorer three-year post-IPO earnings growth, sales growth, and change in returns on sales. The negative effects of the CEO's political ties also show up in the first-day stock return. Also, firms led by politically connected CEOs are more likely to appoint other bureaucrats to the board of directors rather than directors with relevant professional backgrounds.

According to the South African Government News Agency (2015), the Local Government department in the North West is to take over financial control of five local municipalities falling under the Ngaka Modiri Molema District Council. The municipalities to be placed under administration are Mahikeng, Ratlou in Setlagole, Ditsobotla in Lichtenburg, Tswaing in Delareyville and Ramotshere Moiloa in Zeerust. The reason for the placement of these municipalities under administration is because of political influence in the running of the financial affairs of these municipalities which has led to high levels of irregular, fruitless and wasteful expenditures in the financial performance of these municipalities. The provincial government says audits have shown the councils are unable to run their own financial affairs. The provincial government also stated that during the intervention, the administrator will be expected to check on the following (reasons for putting this municipality under administration):

- Contravention of any law, policy and regulations by any councillor or official.
- Allegations of nepotism, unfair labour practice and irregular appointment of staff.
- Investigate noncompliance with supply chain management processes in particular procurement of services, contract management issues.
- Alleged maladministration on conditional grants and expenditure thereof.
- Alleged preferential treatment or ill treatment of service providers.
- Investigation of quality of work done by service providers.

- Investigation of outstanding water services debts and agreement with water boards in their local municipalities (South African Government News Agency, 2015).

### **2.10.3 Impact of unethical behaviours and accountability to the audit opinion (Qualities for competency and efficiency)**

Ababio (2007) defined accountability as the answerability for performance and the obligation that public officers have to give a satisfactory explanation to the public concerning the authority and recourses entrusted to them. Mafunisa (2000) argued that professionalism refers to being competent, efficient and qualified. This implies that professionalism is an on-going process of development. An important aspect of professionalism in the municipalities is that municipal officials must have a specific expertise or competence to be able to execute their official duties.

The public holds elected political office-bearers and public officials to a higher standard of ethical conduct and professionalism and accountability. Therefore, professionalism requires municipal officials to fulfil their roles and duties as efficiently as possible and to do so with competence, pride and precision (Mafunisa, 2006).

Coherent processes and mechanisms to manage professional ethics are essential in combating unethical conduct, corruption and maladministration in the public sector. Although there are specific constitutional bodies for combating unethical conduct, one can argue that sound ethical behaviour and accountability of public administration are prerequisites to and underpin public trust as a keystone to good government. Attention should be focused by municipalities on the legislative framework on ethics professionalism and accountability (Edwards, 2008).

In accordance with Edwards (2007), the concept of ethics has broadened to include not only the characteristics of the good person and theoretical knowledge but it refers also to best practice. In general, ethics refers to a set of moral principles or values that directs the behaviour of municipal officials in terms of what is wrong and what is right.

An investigation was conducted in fifteen national and provincial departments by the Public Service Commission (PSC). The PSC on the evaluation the consistency of

sanction imposed for misconduct in the public service listed the following catalogue of unethical conduct and sections imposed (PSC, 2008).

*Inappropriate or unacceptable behaviours:* There were 16 cases of inappropriate or unacceptable behaviour, sanctions imposed varied from five written warning two counselling, two verbal warnings, two suspensions without pay for two months, four final warnings and one dismissal.

*Gross dereliction of duty:* There were 30 cases that sanctions varied from dismissal as the harshest consequence to verbal warning as the minimal disciplinary action.

*Fraud:* There were 44 incidents of fraud which resulted to the following sanctions:

Nineteen dismissals, one suspended dismissal for a twelve-month period, fifteen cases of final warnings, five written warnings, one verbal warning, one demotion and two final warnings coupled with two months' suspension.

*Unauthorised absences:* The 42 incidences of sanctions varied from unpaid leave to dismissal.

*Contravention of policies or procedures:* Four cases were reported and writing warnings were given to them.

*Financial misconduct:* Four cases were identified followed by two dismissals and two written warnings.

*Misuse of state property:* There were 23 cases and the sanctions varied from dismissals, suspension and final written warnings.

*Corruption:* In the six cases of corruption reported the sanctions were four dismissals and two final written warnings. The public service report (PSC, 2008) stated that current trends in the number of qualified audit opinion and qualified audits in the public sector raise important questions about the seriousness with which government's systems of accountability are being taken and are related to the unethical behaviours of government officials. In accordance with Section 61 of the MFMA (2003) the accounting officer of a municipality must act with fidelity, honesty, integrity and in the best interests of the municipality in managing its financial affairs. Disclosure of all material facts,

which are available to the accounting officer or reasonably discoverable, and which in any way might influence the decisions or actions of the council or the mayor is essential.

In accordance with Section 171 of the MFMA (2003), the CFO of a municipality commits an act of financial misconduct if that officer deliberately or negligently fails to carry out a duty delegated to that officer by the accounting officer, makes or permits, or instructs another official of the municipality to make an unauthorised, irregular or fruitless and wasteful expenditure; or provides incorrect or misleading information to the accounting officer.

Section 171 (4) of the MFMA (2003) states that a municipality must investigate allegations of financial misconduct against the accounting officer, the CFO, a senior manager or other official of the municipality unless those allegations are frivolous, vexatious, speculative or obviously unfounded; and if the investigation warrants such a step, institute disciplinary proceedings against the accounting officer, CFO or that senior manager or other official in accordance with systems and procedures referred to in section 67 of the Municipal Systems Act, read with Schedule 2 of that Act.

The concepts of ethics, professionalism and accountability form part of the fundamental principles of municipal administration and need to be exposed and practised by the leaders within the municipalities and by all municipal office bearers and municipal officials.

## **2.11 Conclusion**

This chapter has reviewed the work of other researchers who have come up with reasons affecting the effectiveness of municipalities in preparation of financial statements in accordance with a prescribed framework, which will consequently lead to the type of auditor's general opinion on the financial statement. It also illustrated the responsibility of different officials of the municipality and their minimum competency levels required, in terms (Section 79 of the MFMA No. 56 of 2003) the manager of the municipality may delegate the financial duties of the municipality to competent staff members of the senior management team or any official of the council. The guideline on municipal regulations for minimum competency level requires the CFO to have certain

expertise; as a result, the CFO is the most eligible staff member of the senior management who could be entrusted with the financial management of the municipality (MFMA, 2003).

This chapter has also pointed out that the reasons for poor financial statements preparation and audit opinion are not only related to the quality or efficiency of staff members of the financial department, but also depend on the effectiveness of council committees (audit committee) internal control and political influence. In accordance with Edwards (2008), one can argue that sound ethical behaviour, accountability and efficiency of municipal administration are prerequisites to effective financial reporting in accordance with a recommended framework.

## **Chapter 3: Research methodology**

### **3.1 Introduction**

In this chapter the focus will be on establishing the reasons for the quality of the financial statements of municipalities and to identify the factors that influence the poor quality of financial statements in the particular case of Mafikeng Local Municipality. This chapter will be discussing the research design and methodology which will be adopted in this study. Discussions in this chapter will also include the identification and description of the population, criteria used for sampling selection from the population, and finally the data-collection and analysis methods and procedures.

### **3.2 Research methodology**

Fox and Meyer (1995) defined methodology as a systematic study of processes and principles that guide scientific investigation and research or the study of the processes and principles that guide scientific investigation. Research methodology focuses on the process of research and decisions that the researcher has to take to execute the research project (Brynard & Hanekom, 2006). A research methodology comprises aspects such as the tools and procedures to be used for the identification of the population, criteria used in selecting the sample and finally the data-collection and analysis techniques employed in the study (Mouton, 2012).

There are generally two research methodologies or methods that most researchers in the past decade have used, namely the quantitative and qualitative methods.

In the case of this study a quantitative method will be adopted, with the use of a questionnaire as a data-collection tool. The questionnaires have been purposefully designed with questions that seek answers to address the research questions and achieve its objective. The questionnaire was electronically distributed to the target sample of managers and accountants in the financial department of Mafikeng Local Municipality. After collecting the questionnaires, data was processed and analysed. Then the findings were interpreted to provide the basis for the recommendations.

### **3.3 Research design**

In accordance with SAGS (2008), research designs are the procedures that researchers use for their plans to extend from decisions based on broad assumptions to detailed methods of data collection and analysis. This entails making several decisions and taking different steps, but the overall decision will be to choose the design in line with the research objectives. These designs include qualitative, quantitative and mixed designs respectively. Harwell (2010) argued that the most important aspect of a research study is the identification of the research design because it communicates information about key features of the study, which can differ for qualitative, quantitative, and mixed methods. One identical point about all research designs are that one phase of the study will include data collection and analyses in different ways and for different purposes. Finally, Crotty (1998) has identified four essential elements to consider when selecting a research design, namely the epistemology that informs the research, the philosophical stance underlying the methodology in question, the methodology itself, and the techniques and procedures used in the research design to collect data.

#### **3.3.1 Quantitative methodology**

Brynard and Hanekom (2006) argued that a quantitative methodology relates to “analytical research and intends to reach a universal statement”. Numbers are assigned to observations and data is produced by means of counting as well as measuring things or objects. The questionnaire is designed in such a way that the researcher is able to count the number of respondents with a common answer to a specific question. The total number of respondents with a common answer to a particular question gives the researcher qualitative data. In accordance with Lincoln and Guba (1985), quantitative methods are frequently described as deductive in nature, in the sense that inferences from tests of statistical hypotheses lead to general inferences about characteristics of a population. Quantitative methods are also frequently characterized as assuming that there is a single “truth” that exists, independent of human perception. Du Plessis (2015) in her study highlighted that quantitative approaches address the ‘what’ of the problem, and to get answers to the questions it uses the systematic standard approach. It contains the following characteristics:

- Emphasises the measurement of variables and the objectives of the process;
- Aims to quantify the extent of variation in a phenomenon;
- Regards reliability and validity of findings as important;
- Communicates findings in an analytical and aggregate manner; and
- Makes conclusions and inferences that can be generalized.

For the purpose of this study the research methodology that will be adopted is relevant for the investigation of the factors that influences the qualification of financial statements of Mafikeng Local Municipality. For this reason, this study implemented a quantitative research method for data collection where data was collected with the use of electronically distributed questionnaires as a data-collecting tool. But because the study is a case study data will be analysed qualitatively.

### **3.3.2 Qualitative methodology**

Qualitative methodology refers to research that produces descriptive data generally the participant's own written or spoken words pertaining to their experience or perception (Brynard & Hanekom, 2006). In most cases, there are no numbers or counts that are assigned to these observations. Hiatt (1986) stated that qualitative research methods focus on discovering and understanding the experiences, perspectives, and thoughts of participants, and this implies that qualitative research explores the meaning, purpose, or reality of data collected.

### **3.4 Case study research method**

A case study is a detailed examination of a single example of a class of phenomena (Dictionary.com, 2016). In accordance with Flyvbjerg (2006), a case study is a necessary and sufficient method for certain important research tasks in the social sciences and it is a method that holds up well when compared to other methods in the gamut of social science research methodology. Finally, Yin (1984) concluded that a case study is a research strategy which focuses on understanding the dynamics present within single settings. Case studies can involve either single or multiple cases, and numerous levels of analysis.

#### **3.4.1**

In accordance with Robert (1994), it is preferable to use a case study research method in the following situations:

- the type of research question: typically to answer questions like how or why;
- extent of control over behavioural events: when investigator has a little/no possibility to control the events;
- general circumstances of the phenomenon to be studied: contemporary phenomena in a real-life context are examined, which is the case with the topic of this study, which deals with the causes of qualified audit opinions in municipalities.

### **3.4.2 Advantages**

Case studies allow a lot of detail to be collected that would not normally be easily obtained by other research designs. The data collected is normally a lot richer and of greater depth than can be found through other experimental designs (Burger & Silima, 2006).

Case studies tend to be conducted on rare cases where large samples of similar participants are not available. To be able to gain knowledge of brain functions the differences between people have to be exactly known to ensure you are testing the right thing, this can generally only be done through case studies (Burger & Silima 2006).

A case study approach is adopted for this study because this study will be examining in detail a specific case, and the specific case chosen to be examined is Mafikeng Local Municipality.

### **3.5 Population and sample size**

Population refers to any group of individuals or objects that share common characteristics and represents the whole or sum total of cases involved in a study (Notsi, 2012). According to Brynard and Hanekom (2006), a sampling is “an approach used to select a particular sample with a view to determine the features of a large group”. It can also be referred to as a way of collecting data for generating theory, whereby analysts code and analyses the same data collectively. According to Babbie

(2010), it is important to have an in-depth knowledge about the individual items in the population and the purpose of the study in order to select a sample that will be a true representative of the population. For this reason, the population for this study was purposely identified and the sample selected with consideration of its appropriateness to achieve the objective of the study, which is to identify the factors that hinder municipalities from obtaining clean audit opinion from the Auditor-General.

The population selected for this study consisted of all managers and their accountants (there are nine managers and eight accountants) in the finance department of Mafikeng Local Municipality and the Auditor-General. There are, however, a moderate number of managers and accountants in Mafikeng Local Municipality, the sample therefore will constitute 100% of the total population. This is known as a total study, where every unit of the population which is relevant for the study is actually evaluated. This can only be possible if the population is small and all units are available and willing to participate in the study and it is also significant when carrying out a case study. Finally, in accordance with Burger and Silima (2006) a non-randomly selected sample will provide relevant information for this study.

The questionnaire for this study was distributed electronically and the respondents were requested to submit answered questionnaires electronically, but the researcher physically collected the questionnaires from the respondents if they could not submit them electronically, with their consent. The population comprised nine managers and eight accountants in the finance department and the Auditor-General.

### **3.6 Data collection**

This study made use of a survey research methodology for the collection of data, which included the use of a questionnaire as an information collection tool. A questionnaire is a tool designed specifically to collect evidence that will be analysed to back the conclusions and recommendations of this study (Babbie, 2010). In this study the questionnaires were electronically distributed to all managers and their accountants in the finance department of Mafikeng Local Municipality and the Auditor-General of South Africa, accompanied by a letter of consent. The letter of consent served as an introductory note in which the importance of the research was emphasised, and it also

provided an explanation regarding the purpose of the research. The letter made provision for the respondents to acknowledge their voluntary participation in the study. An assurance of the confidentiality of the information obtained through the questionnaire and the anonymity of the respondents was guaranteed.

The questionnaires were electronically submitted after completion by the respondents as indicated before and a follow-up exercise was conducted physically to collect the outstanding questionnaires from those respondents who did not submit electronically after the due date for submission had elapsed.

### **3.6.1 Research instruments**

Research instruments are tools or equipment used by researchers for data-collection purposes. According to Melville (1995), in order for the research instrument or tool to be effective and efficient it is expected for these tools to meet two most fundamental criteria, namely reliability and validity. Amongst the many research instruments available to researchers, Melville (1995) highlighted tests, interviews and questionnaires as the most commonly used tools.. For the purposes of this study a questionnaire was used for data-collection.

#### **3.6.1.1 Validity**

Validity is defined as the ability of an instrument to measure what it is supposed to measure (Brynard & Hanekom, 2006). The measurement made by an instrument gives an accurate reflection of the concept it is intended to measure (Notsi, 2012:73). According to Bless and Higson-Smith, cited in Brynard and Hanekom (2006:48), there are five validity criteria that can be used to test the validity of a design or an instrument, namely,

- *Content validity*: Usually refers to the correctness and appropriateness of the questions included in a test or questionnaire. It is advisable to test the correctness, relevance and lucidity of the questions in a preliminary investigation. Duplication of questions can thus be avoided. The results of a preliminary investigation will also help determine whether or not the questions included are relevant to the research problem (Brynard & Hanekom, 2006).

- *Criterion-related validity*: Involves testing whether or not an instrument (A) selected for data collection measures what it is expected to measure and whether or not it can be compared to another instrument (B), which is known to be valid. If the data collected through both instruments closely matches, then instrument (A) is also valid. The stipulation is that the two sets of data should be collected from the same group of subjects (Brynard & Hanekom, 2006).
- *Construct validity*: Refers to the degree to which a measurement technique uncovers the information which it was designed to uncover. For example, questions for a questionnaire should be specifically designed to obtain the desired information (Brynard & Hanekom, 2006).
- *Face validity*: Face validity is concerned with the way an instrument appears to the participants. For example, do they view it as so simple, childish and boring that they experience it as an insult to their intellect, or does it appear so difficult that the participants give up even before starting? It is therefore based on the subjective judgment of the researcher and the respondents (Brynard & Hanekom, 2006).
- *External validity*: Refers to the applicability to similar problems of the conclusions drawn from the research, provided that the sample is representative and that the study is a simulation of the real world and real-life situations.

For the purpose of this study the data collection method used (the questionnaire used for the collection of data) is valid, correct and appropriate for the study because it was able to determine the factors that influence the financial statements of Mafikeng Local Municipality to be continuously qualified, these factors identified are explicitly outlined in chapter four of this study.

### **3.6.1.2 Reliability**

Reliability refers to consistency and correctness of measures taken (Brynard & Hanekom, 2006). If the same instrument is used under the same conditions at a later stage, it must be able to produce the same data. The techniques that follow have been developed in order to ensure accuracy on reliability (Notsi, 2012).

- **Reliability of research workers**

The researcher attempts to verify selected pieces of information. The researcher has taken the initiative in calling some of the respondents in order to check the reliability of the given information (Brynard & Hanekom, 2006).

- **The split-half method**

The researcher makes more than one measurement of any subtle or complex social concept such as prejudice, alienation, organisational culture or social class. This procedure lays the groundwork for another check on reliability (Notsi, 2012).

- **Test-retest method**

The same measurement is repeatedly made by the researcher.

- **Using established measures**

The information is received from people by means of using measures that have proven their reliability in previous research (Notsi, 2012).

The use of a questionnaire is a reliable data-collection method for this study. The questionnaire was designed to identify factors that influence the qualification of Mafikeng Local Municipality's financial statements. The questionnaire is regarded as reliable when it can be used by any other researcher, and the results are replicated.

### **3.6.2 The questionnaire as a research tool**

In accordance to Kumar (2014), a research questionnaire is a written pre-determined list of questions, which are supposed to be answered by the respondent. Kumar (2014) claimed that the use of a questionnaire is less expensive, saves time, human and financial resources and offers respondents the comfort of being anonymous. Melville (1996) recommended that questions should be structured in a simple and easy way for respondents to understand as the researcher would normally not be around to explain or assist in completing the questionnaire.

For the purpose of this study a closed-ended questionnaire was designed to investigate the problem statement to achieve the research objectives scientifically. It is possible to measure people's knowledge, skills, likes and dislikes, attitudes and perceptions with the use of this research instrument (Gravetter & Forzano, 2009). The questions in the questionnaire are based on the theory discussed in chapters two. This questionnaire was used to determine the factors that influence the continuous qualification of financial statements of municipalities with a case study of Mafikeng Local Municipality. The most significant aspect of this type of data collection is that the questionnaire is the primary means of communication between the respondents and the researcher as alluded to by Struwig and Stead (2001). With the use of a questionnaire the researcher can make logical and informed conclusions and recommendations on the subject matter, as the questionnaires were used to obtain, information and evident relevant for these conclusions (Huyseman, 1994).

### **3.7 Data analysis**

Data can be analysed for research purposes with the use of various statistical tools such as Statistical Package for Social Sciences (SPSS), SAS, E-view, etc. For the purposes of this study, the data from this case study will be analysed qualitatively with the aid of graphs and tables.

### **3.8 Ethical considerations**

Ethical considerations have been an issue of concern in the past decade. In accordance with Filck (2006), the ethical aspect of research has been an issue on a wider scale — in some countries codes of ethics has been developed and ethical committees established to implement and monitor the code. The main reason for this is to protect the interests of the respondents and to prevent scandals from emanating from data manipulation.

For the purpose of this study, ethical concerns were evaluated and an ethical clearance was issued which confirmed that this study does not impinge on the sensibilities and rights of other people, and that it upholds integrity and ethical standards. Finally, it was

confirmed that all the participants in this study did so under consensus, with the understanding that the researcher has agreed to confidentiality.

### **3.9 Aligning the questions in the questionnaire to the research objectives.**

| <b>Objective</b>                                                                                                                                                                                                                                                     | <b>Questions</b>                                          |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------|
| To determine factors influencing the qualification of financial statements of Mafikeng Local Municipality.                                                                                                                                                           | <b>4,5,6,7,8,9,10,11,12,13,14, 15,16,17,18,19 and 20.</b> |
| To determine whether the qualification of financial statement of municipalities is caused by the unethical practices by municipal officials.                                                                                                                         | <b>10, 11, 12, 18, 19, 20 and 21.</b>                     |
| To determine whether the qualification of municipal financial statements is caused by unaccountability of municipal officials.                                                                                                                                       | <b>19, 10, 10, 12 and 24.</b>                             |
| To determine whether the qualification of financial statements of municipalities is caused by the audit committee, the internal audit function or the financial department not meeting the minimum qualification and competency requirements prescribed by the MFMA. | <b>1, 2, 3, 25, 26, 27, 28, 29, 30, 31, and 32.</b>       |

### **3.10 Summary**

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

## **Chapter 4: Data presentation, analysis and interpretation**

### **4.1 Introduction**

This chapter presents the analyses and interpretation of the data. Data is presented in accordance with the respondents' responses to the electronically administered questionnaire. The data is analysed quantitatively and presented using tables and graphs. The questionnaires were distributed electronically and respondents submitted the completed questionnaires electronically. The population comprised nine managers, eight accountants and the Auditor-General which gave a total of eighteen respondents. All the members of the sample participated in this study; therefore the study had a 100% participation rate. The responses of the participants are discussed in the following sections.

### **4.2 Quantitative data analysis**

In this study data is analysed based on the respondents' answers to the electronically administered questionnaires (refer to Annexure A for questionnaire).

#### **Section A: Biographical data analysis**

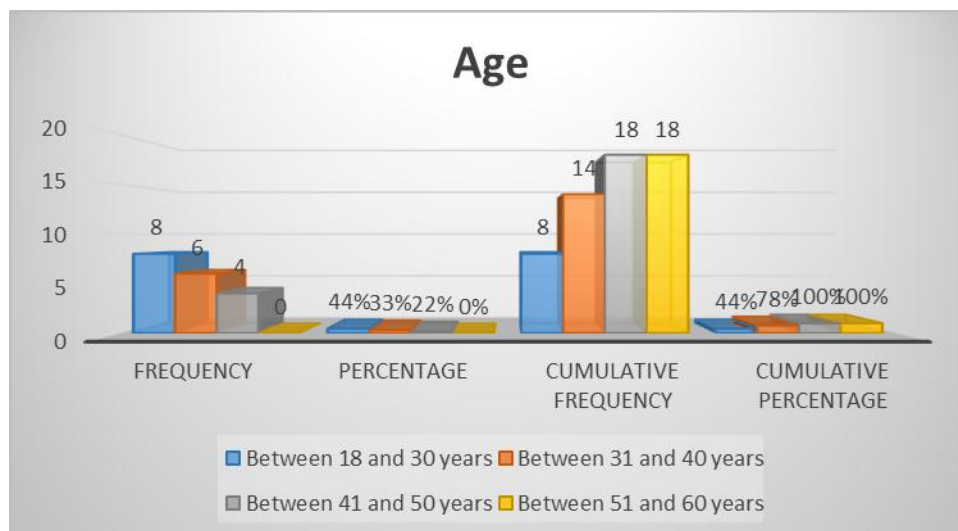
Question 1: What is the age of the respondent?

**Table 4.1: Respondents age**

| Age groups              | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------------|-----------|------------|----------------------|-----------------------|
| Between 18 and 30 years | 8         | 44%        | 8                    | 44%                   |
| Between 31 and 40 years | 6         | 33%        | 14                   | 78%                   |
| Between 41 and 50 years | 4         | 22%        | 18                   | 100%                  |
| Between 51 and 60 years | 0         | 0%         | 18                   | 100%                  |

The results in Table 4.1 show that 44 per cent of the respondents are between the ages of 18 and 30, while 33 per cent are between 31 and 40 years. Only 22 percent of the

respondents are aged between 41 and 50 years, and none of them were between the ages of 51 and 60 years. Verhaegen and Salthouse (1997), in their analyses of 91 organisations, concluded that the cognitive abilities reasoning, speed and episodic memory decline significantly before 50 years of age and more thereafter (Bratsberg *et al.*, 2003). They concluded in their studies that older researchers publish less than younger ones in leading journals, and that the rate of decline is the same for top researchers as among others. Kutscher and Walker (1960) provided some evidence that mail sorters and office workers kept productivity quite stable at higher ages, while factory workers' productivity fell after the age of 55. Warr (1994) in his study concluded that the decreased cognitive abilities of older workers can lead to lower productivity, unless their longer experience and higher levels of job knowledge outweigh the decline in mental abilities. From the above-mentioned analysis, this study could not determine a direct relationship between the continuous qualification of Mafikeng Local Municipality's financial statement and the age of the managers in the finance department. These results are represented graphically in Figure 4.1.



**Figure 4.1: Respondents age**

Question 2: Highest qualifications?

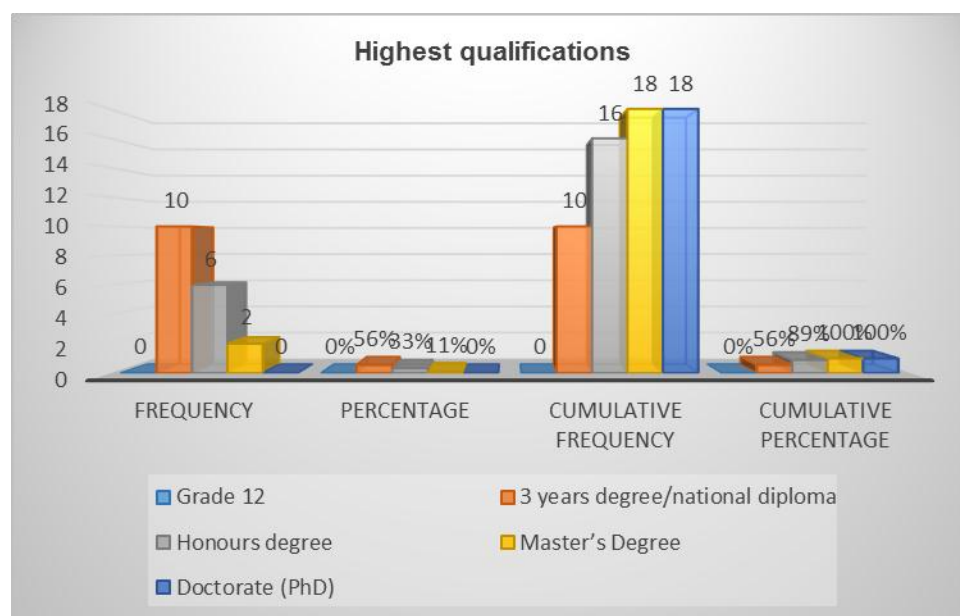
**Table 2.2: Respondent's qualification level**

| Qualification level            | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|--------------------------------|-----------|------------|----------------------|-----------------------|
| Grade 12                       | 0         | 0%         | 0                    | 0%                    |
| 3 year degree/national diploma | 10        | 56%        | 10                   | 56%                   |
| Honours degree                 | 6         | 33%        | 16                   | 89%                   |
| Master's Degree                | 2         | 11%        | 18                   | 100%                  |
| Doctorate (PhD)                | 0         | 0%         | 18                   | 100%                  |

Table 2.2 indicates that the respondents' highest academic and professional qualification acquired is a three-year bachelor's degree or national diploma. This means that 56 per cent of the respondents have completed a three-year bachelor's degree or national diploma qualification. There are 33 per cent of the respondents with an Honours degree and only 11 per cent with Master's or equivalent qualifications. This implies that managers and accountants in the finance department meet the educational requirement as mandated by National Treasury (2007), which require that managers in the finance department of municipalities must have at least National Qualifications Framework level 6, translated as a three-year bachelor's degree or a national diploma or a certificate in municipal financial management qualification, approved by the South African Qualifications Authority.

Section 119 of the MFMA (2003) further makes this requirement compulsory and stipulates that a municipality and a municipal entity must provide resources or opportunities for the training of officials to meet the prescribed competency levels. On the other hand, Hoyer and Lincourt (1998) stated in their studies that accelerating technological progress can increase the importance of being able to learn and to adjust to new ways of working, while a lengthy work experience may become less important. From the analysis of the above requests this study could not confirm whether the continued qualification of Mafikeng Local Municipality's financial statements is as a

result of the officials preparing the financial statements not meeting the minimum educational qualification. This is illustrated graphically in Figure 4.2.



**Figure 4.2: Respondent's qualification level**

Question 3: Period of service as a manager or accountant in the finance department?

**Table 2.3: Respondent's duration on service.**

| Period of service   | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|---------------------|-----------|------------|----------------------|-----------------------|
| Less than 12 months | 2         | 11%        | 2                    | 11%                   |
| 1–2 years           | 6         | 33%        | 8                    | 44%                   |
| 4–5 years           | 0         | 0%         | 8                    | 44%                   |
| 5–10 years          | 8         | 44%        | 16                   | 89%                   |
| More than 10        | 2         | 11%        | 18                   | 100%                  |

Table 4.3 shows that 44 per cent of the respondents from the sample have between 5 to 10 years of working experience in the finance department, 33 per cent have between 1 and 2 years of experience and 11 per cent have less than 1 and more than 10 years of

working experience as managers or accountants in the finance department. In accordance with the Auditor-General national report for local government for the municipal financial year ending 2011, officials in key positions at more than 70% of the municipalities do not have the minimum competencies and skills required to perform their jobs AGSA (2012). National Treasury (2007) recommended a minimum of five years' working experience for middle management in the finance department of municipalities. Warr (1994), in his study identified that work experience can increase efficiency and productive abilities of employees. From the above analysed results, it can be concluded that not all managers in Mafikeng Local Municipality's finance department meets the minimum working experience level as recommended by National Treasury. This is illustrated graphically in Figure 4.3.



Figure 2.3: Respondent's duration on service

## Section B: Factors that prevent the municipality from obtaining unqualified audit opinions

Question 4: The financial statement of the municipality is prepared by the finance department of the municipality (not by external consultants)?

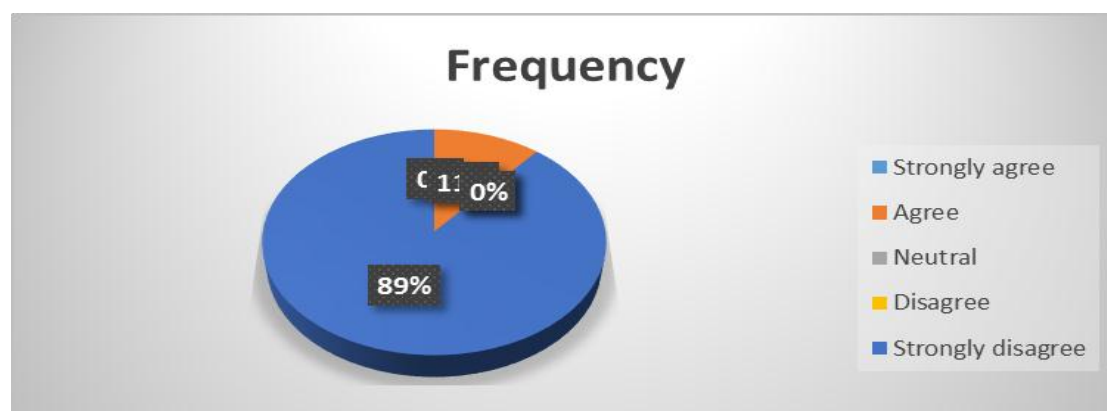
**Table 4.4: Responsibility of financial statement preparation**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 0         | 0%         | 2                    | 11%                   |
| Disagree          | 0         | 0%         | 2                    | 11%                   |
| Strongly disagree | 16        | 89%        | 18                   | 100%                  |

The results in Table 4.4 show that 89 per cent of the respondents strongly disagree that the financial statements of the municipality are prepared by the financial department of the municipality and only eleven per cent agreed. This implies that the financial statements of the municipality are being prepared by an external consultancy, and this is in contravention with the recommendations of section 60.1 of the MFMA (2013) which gave responsibility of the financial statement preparation to the accounting officer of the municipality and not to any private consultant. In accordance with Section 57 1 (a) of the local government municipal Finance Management acts as the chief financial officers of municipalities and must enter into a performance contract with the municipality and one of the terms of this contract is the annual preparation of consolidated performance and financial statements of the municipality in accordance with a recommended framework.

AGSA (2012) identified in the local government audit for municipalities for the year end 2011 that in more than 70% of the municipalities in South Africa, their municipal officials do not have the minimum competencies and skills required to perform their jobs. Benoit *et al* (1998) in their studies of assessing the risks of outsourcing critical functions identified that outsourcing critical functions can have negative consequences to organisation like escalating costs, diminishing service levels and loss of experience. From the analyses of these results, the studies confirmed that the financial department of Mafikeng Local Municipality is not preparing their financial statement as

recommended by (MFMA, 2003), and this is one of the reasons for the continuous qualification of the financial statement. This is illustrated graphically in Figure 4.5.



**Figure 4.4: Responsibility of financial statement preparation.**

Question 5: Supporting proofs of all line items disclosed in the financial statement are filed and provided to the auditors upon request?

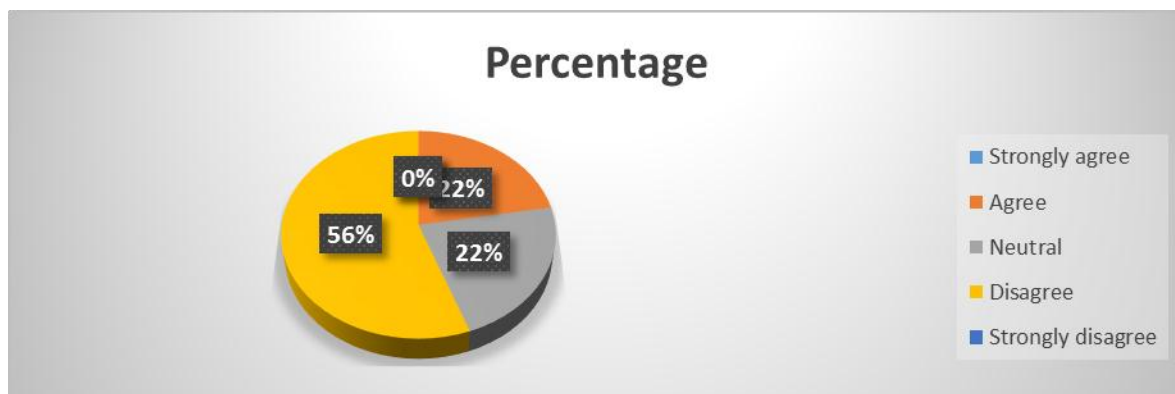
**Table 4.5: Effective filing of supporting documentations**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 4         | 22%        | 4                    | 22%                   |
| Neutral           | 4         | 22%        | 8                    | 44%                   |
| Disagree          | 10        | 56%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

The results summarised in Table 4.5 shows that 55 per cent of the respondents disagree that supporting proofs of all line items disclosed in the financial statement are filed and submitted to the auditors upon request, 22 per cent of them were neutral and only 22 per cent agreed that supporting proofs were adequately filed and provided to auditors upon request. This result correlates with the findings from the Institute of

Internal Auditing (IIA, 2014) that stated that 91% of the 319 municipalities and municipal entities nationally, financial statements were qualified because of insufficient, inadequate audit evidence to justify the disclosures in their financial statements. Also in the AGSA (2012) audit report for Mafikeng Local Municipality for the year ending 2013 the municipality did not provide supporting proof to justify adjustments relating to property plant and equipment amounting to R 446 870 064 disclosed in the statement of financial position.

In accordance with the AGSA report for the municipal financial year ending 2011 for Mpumalanga Province sixteen municipalities' financial statements was qualified because of the unavailability of adequate and reliable supporting documentation to support material disclosures in their financial statements. These results imply that line items disclosed in the financial statement do not have adequate proofs to confirm their existence or occurrence depending whether it's an account balance or a class of transaction. The study confirms that the continuous qualification of the financial statement of Mafikeng Local Municipality can be attributed to unavailability of supporting proofs to confirm line items disclosed in the financial statement. This is illustrated graphically in Figure 4.5.



**Figure 4.5: Effective filing of supporting documentations.**

Question 6: The Auditor-General always qualifies the municipality financial statements because of a lack of supporting documents?

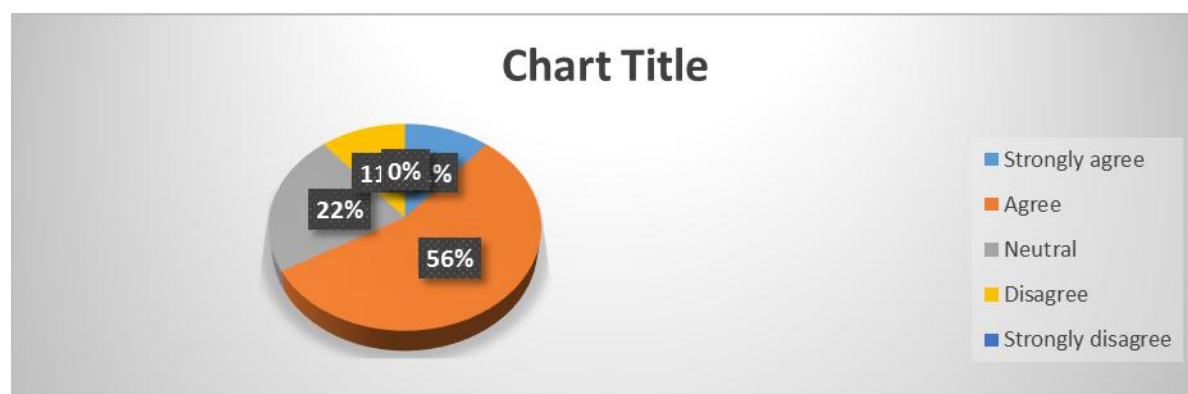
**Table4.6: Unavailability of supporting documentations**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 2         | 11%        | 2                    | 11%                   |
| Agree             | 10        | 56%        | 12                   | 67%                   |
| Neutral           | 4         | 22%        | 16                   | 89%                   |
| Disagree          | 2         | 11%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

Results in Table 4.6 show that 55 per cent of the respondents agree and eleven per cent strongly agree that the Auditor-General qualifies the financial statement because of lack of supporting proofs to confirm the line items in the financial statement, 22 per cent of them were neutral and only eleven per cent disagreed. This result correlates with the findings of AGSA in their annual audit report for municipal financial year ending 2011 for Mpumalanga Province that sixteen municipalities' financial statements were qualified because of the unavailability of adequate and reliable supporting documentation to support material disclosures in their financial statement.

In the AGSA national report for the municipal financial year ending 2013 the AG stated that more than 63% of municipality's nationally financial statements were qualified because of unavailability of supporting documentations. The Institute of internal Auditing (IIA, 2014), averred that 91% of the 319 municipalities and municipal entities nationally had their financial statements qualified because of insufficient, inadequate audit evidence to justify the disclosures in their financial statements. In the municipal financial year ending 2013 the Auditor-General qualified Mafikeng Local Municipality financial statements because of a lack of supporting documentation to justify debtors disclosed in the statement of financial position amounting to R92 576 514. (AGSA, 2014) The study confirms that the continuous qualification of the financial statements of Mafikeng Local

Municipality can be attributed to unavailability of supporting proofs to confirm line items disclosed in the financial statements. This is illustrated graphically in Figure 4.6.



**Figure 4.6: Unavailability of supporting documentations**

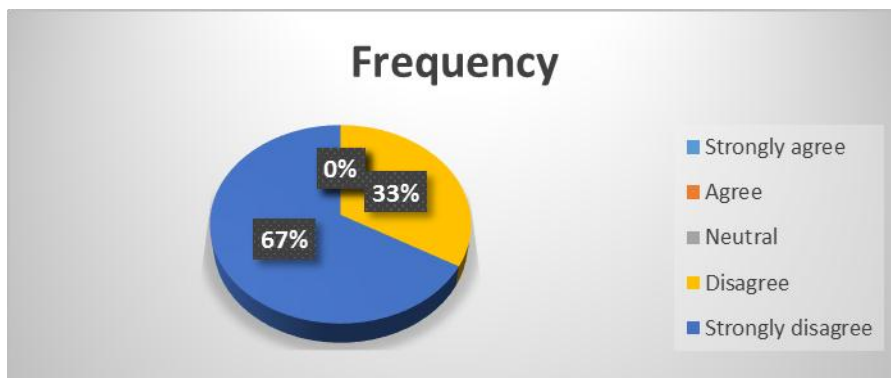
Question 7: The municipality has a fully staffed internal audit function?

**Table 4.7: Composition of the internal audit department.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 0         | 0%         | 0                    | 0%                    |
| Disagree          | 6         | 33%        | 6                    | 33%                   |
| Strongly disagree | 12        | 67%        | 18                   | 100%                  |

Table 4.7 shows that 67 per cent of the respondents strongly disagree and 33 per cent disagree that the municipality has a fully staffed internal audit function. In accordance with the MFMA (2003) all municipalities should have an internal audit function which must prepare a risk-based audit programme for each year, advise the accounting officer and report to the audit committee on its plan about matters relating to Internal audit, internal control and accounting procedures. Mculu (2008) argued that the role of the

internal auditors is to plan each audit before the start of the audit process, collect, analyse, interpret, and document information to support the audit results. National Treasury (2009) also stated that with objectively and adequately resources and staffing, an Internal Audit Activity should be in a position to provide management with much of the assurance it requires regarding the effectiveness of the system of internal control risk management and governance processes. The Institute of Internal Audit South Africa (IIA, 2015) also alluded to the fact that to ensure that professional audit services are provided to municipalities an assessment of internal audit, functions needs to be revised at least every three years to ensure compliance with the internal audit standards. From the results analysed above the studies confirmed that Mafikeng Local Municipality does not have a fully staffed internal audit function to provide management with assurance on the systems of internal control and risk management which will consequently affect the quality of the financial statement and subsequently the audit opinion. This is illustrated graphically in Figure 4.7.



**Figure 4.7: Composition of the internal audit department.**

Question 8: The internal audit function takes responsibility for the implementation of the approved post-audit action plan?

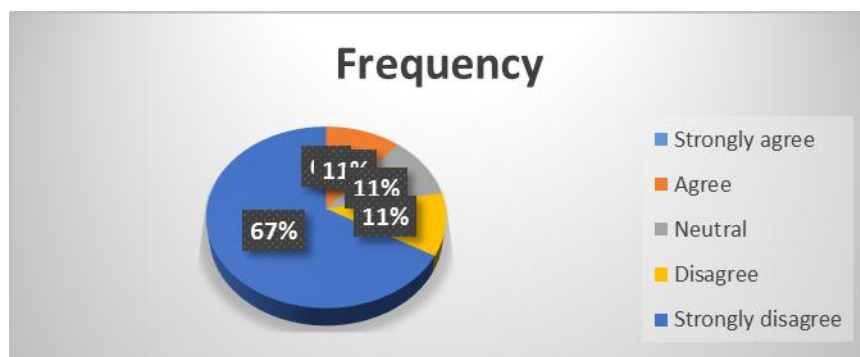
**Table4.8: Responsibility for the implementation of the post audit action plan**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 2         | 11%        | 4                    | 22%                   |
| Disagree          | 2         | 11%        | 6                    | 33%                   |
| Strongly disagree | 12        | 67%        | 18                   | 100%                  |

The results in Table 4.8 indicate that 67 per cent of the respondents strongly disagreed and eleven per cent disagreed that internal audit functions do not take responsibility for the implementation of the post audit action plan. Diamond (2002) in his study of the coordination role between the internal and the external audit functions recommends that there should be proper coordination between the external and internal audit functions to ensure adequate audit coverage and to minimize duplication of functions.

They should have access to each other's plans and programmes and have periodic meetings to discuss matters of mutual interest. In accordance with the MFMA (2003) the internal audit function must prepare a risk-based audit programme for each year and will perform such other duties as may be assigned by the accounting officer relating to audit processes. Mculu (2008) argued that the role of the internal auditors is to properly plan and take responsibility for the audit process and make adequate follow-ups to establish whether appropriate action has been taken on reported findings. In accordance with IIASA (IIA, 2015), internal auditing is 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.

This analysis correlates with the previous analysis which confirmed that the municipality does not have a fully staffed internal audit function. From this analysis, the study confirmed that the absence of a fully staffed internal audit function has limited its ability to fully perform its functions, and it's one of the reasons for the continuous qualification of Mafikeng Local Municipality's financial statements. This is illustrated graphically in Figure 4.8.



**Figure 4.8: Responsibility for the implementation of the post audit action plan.**

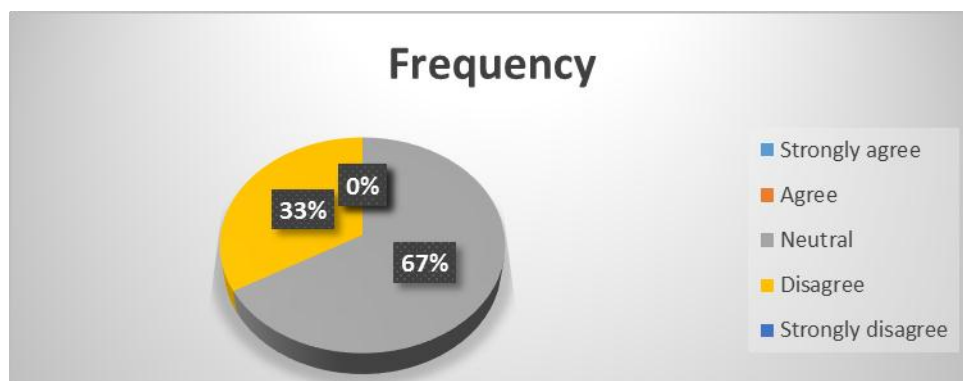
Question 9: Managers in the finance department adhere to recommendations in the post audit action plan?

**Table 4.9: Adherences to the Recommendations in the Post Audit Action Plan.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 12        | 67%        | 12                   | 67%                   |
| Disagree          | 6         | 33%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

The results summarised in Table 4.9 shows that 67 per cent of the respondents were neutral, 33 per cent disagreed that managers in the finance department do not adhere to the recommendations in the post-audit action plan. This implies that more than 67 per

cent of managers and accountants do not know if they adhere to recommendations in the post audit action plan and 33 per cent do not adhere. From this response, the researcher could not analyse the results because more than 50 per cent of the responses were neutral. This study could not determine whether the qualification of the municipality is as a result of non-compliance with the requirements of the post-audit action plan. This is illustrated graphically in Figure 4.9.



**Figure 4.9: Adherences to the recommendations in the post audit action plan**

Question 10: Officials in the finance department carry out their functions free from political influence?

**Table4.10: Political influence in the financial department.**

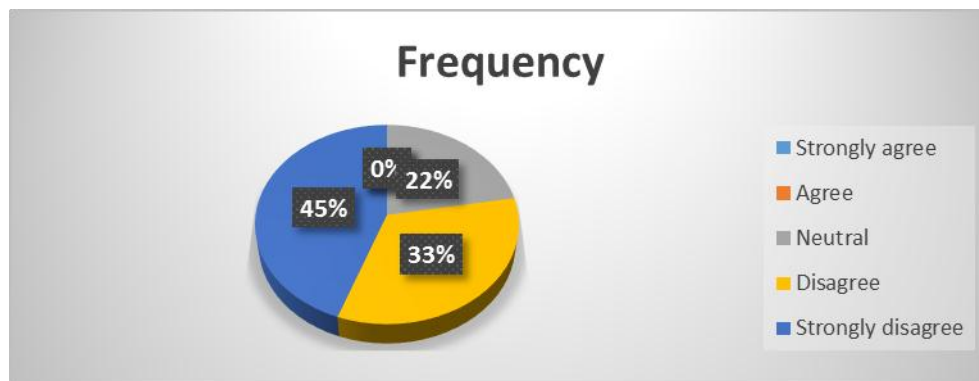
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 4         | 22%        | 4                    | 22%                   |
| Disagree          | 6         | 33%        | 10                   | 56%                   |
| Strongly disagree | 8         | 44%        | 18                   | 100%                  |

Table 4.10 reflects that 44 per cent of the respondents strongly agreed and 33 per cent disagreed that officials in the financial department of the municipality do not carry out

their functions without political interference. 22 per cent of them were neutral, and this implies that over 77 per cent of managers and accountants believe that their administrative decisions have been politically influenced.

In accordance with Rotich *et al.* (2005) the introduction of political pluralism in Kenya has led to political jostling for power across the country which peaks at the local authorities. The councillors get elected or nominated to local authorities through their allied political parties and will usually pursue the interests of their parties to the detriment of the municipality when voting or making decisions in council. Joseph *et al.* (2007) in their study identified that almost 27% of the CEOs in a sample of 790 newly partially privatized firms in China are former or current government bureaucrats. Firms with politically connected CEOs underperform those without being politically connected CEOs by almost 18% based on three-year post-IPO (Initial Public Offerings) stock returns and have poorer three-year post-IPO earnings growth, sales growth, and change in returns on sales.

The negative effects of the CEOs' political ties also show up in the first-day stock return. Also, firms led by politically connected CEOs are more likely to appoint other bureaucrats to the board of directors rather than directors with relevant professional backgrounds. In accordance with South African Government News Agency (2015) the Local Government department in the North West is to take over financial control of five local municipalities because of political influence in the running of the financial affairs of these municipalities which has led to high levels of irregular, fruitless and wasteful expenditures in these municipalities. From the above analysed response, this study confirmed that political influence in the management of the financial affairs in Mafikeng Local Municipality is one of the reasons for continuous qualification of Mafikeng Local Municipality financial statements. This is illustrated graphically in Figure 4.10.



**Figure 4.10: Political influence in the financial department**

Question 11: The council overrides administrative decisions taken by management without reasonable justification?

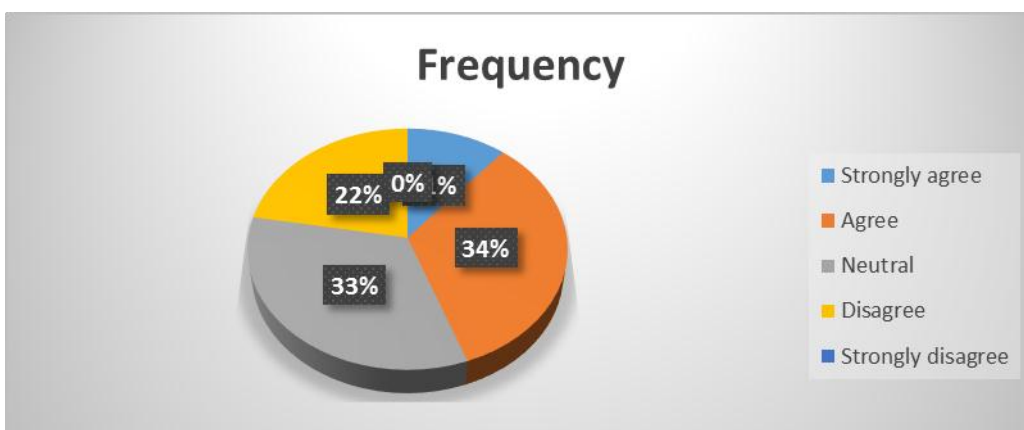
**Table4/11: Overriding of administrative decisions by council**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 2         | 11%        | 2                    | 11%                   |
| Agree             | 6         | 33%        | 8                    | 44%                   |
| Neutral           | 6         | 33%        | 14                   | 78%                   |
| Disagree          | 4         | 22%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

Table 4.11 shows that 33 per cent of the respondents agreed and eleven per cent strongly agreed that council overrides administrative decisions taking by management without reasonable justification. 33 per cent were neutral and 22 per cent disagreed. Joseph *et al.* (2007) in their studies identified that almost 27% of the CEOs in a sample of 790 newly partially privatized firms in China are former or current government bureaucrats. Firms with politically connected CEOs underperform those without politically connected CEOs by almost 18% based on three-year post-IPO (Initial Public

Offerings) stock returns and have poorer three-year post-IPO earnings growth, sales growth, and change in returns on sales. The negative effect of the CEO's political ties also shows up in the first-day stock return. Also, firms led by politically connected CEOs are more likely to appoint other bureaucrats to the board of directors rather than directors with relevant professional backgrounds.

In accordance with South African Government News Agency (2015), the local government department in the North West is to take over financial control of five local municipalities because of political influence in the running of the financial affairs of these municipalities which has led to high level of irregular fruitless and wasteful expenditures in these municipalities. In accordance with AGSA (2013) for the audit of Mafikeng Local Municipality, Section 125(2) (d) (I) of the MFMA requires the municipality to disclose particulars of irregular expenditure. The municipality made statements in contravention of the supply chain management requirements which were not included in irregular expenditure disclosed in note 43, resulting in irregular expenditure being understated by R2 782 173. From the above analysis, this study could not confirm whether the continuous qualification of Mafikeng Local Municipality's financial statements is as a result of council overriding of managements decisions. This is illustrated graphically in Figure 4.11.



**Figure 4.11: Overriding of administrative decisions by council.**

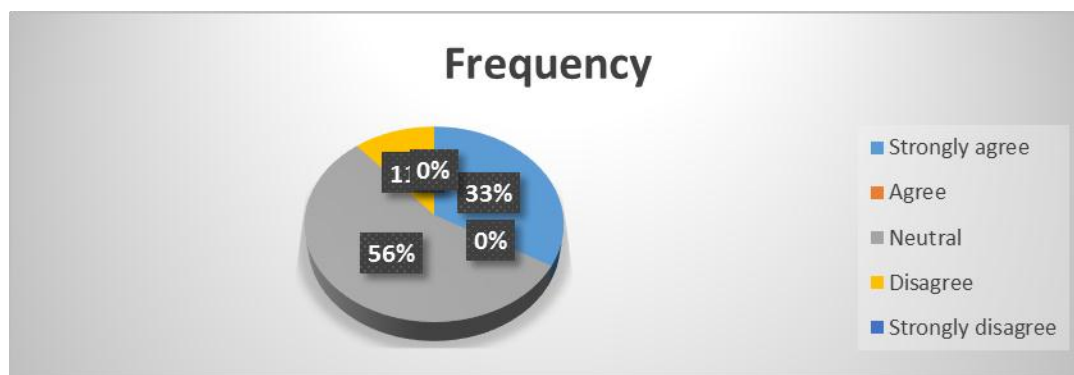
Question 12: The municipality has a policy which prohibits management of the finance department from doing business with the municipality in their personal capacity?

**Table4.12: Restraint of trade policy.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 6         | 33%        | 6                    | 33%                   |
| Agree             | 0         | 0%         | 6                    | 33%                   |
| Neutral           | 10        | 56%        | 16                   | 89%                   |
| Disagree          | 2         | 11%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

Table 4.12 shows that 56 per cent of the respondents were neutral, 33 per cent agreed that the municipality has a policy to restrict managers in the finance department from doing business with the municipality in their personal capacity. In accordance with Arwinge (2013) in order for institutions to meet their operational and profitability targets and transmit management policies throughout the organization they need to put in place and effective and efficient internal control systems (Visser, 2011). Policies are formalised directives and procedures issued to employees by the management of a public institution that describe in detail how certain activities must be performed. These policies are mainly in the form of a written document or manual and serve as the basis for internal control. In accordance with MFMA (2003), the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of internal control that will draft and implement policies and procedures. From the analysis of the above results, this study could not confirm whether qualification of the Mafikeng Local Municipality is as a result of the municipality not having financial policies.

This is illustrated graphically in Figure 4.12.



**Figure 4.12: Restraint of trade policy**

Question 13: The audit committee charter provides sufficient authority for the audit committee to perform its oversight responsibilities of financial statement review?

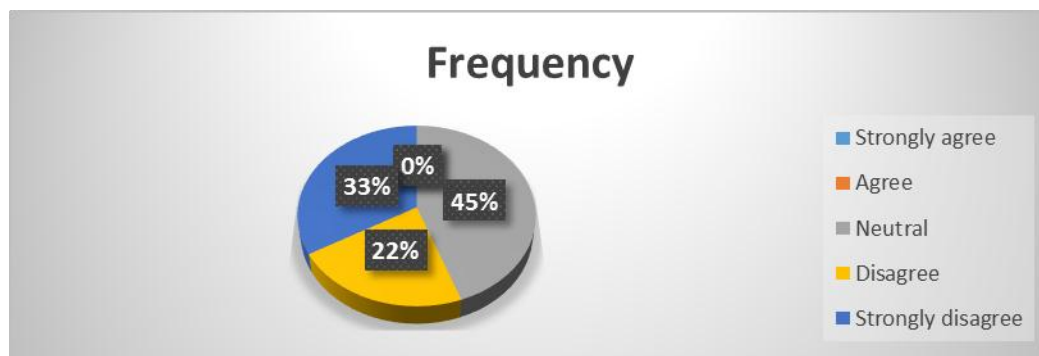
**Table 4.13: Authority of the Audit Committee**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 8         | 44%        | 8                    | 44%                   |
| Disagree          | 4         | 22%        | 12                   | 67%                   |
| Strongly disagree | 6         | 33%        | 18                   | 100%                  |

The responses summarised in Table 4.13 show that 33 per cent of the respondents strongly disagreed and 22 per cent disagreed that sufficient authority is provided for the audit committee to perform its oversight responsibilities of financial statement review. 44 per cent of the respondents were neutral. Benjamin (2008) in his study concluded that for an audit committee to effectively perform its financial and control oversight roles it is essential that the committee be provided with all the relevant information and facts in an open, honest and transparent manner for this to be effective it is important that the independence and scope of the audit committee be embedded in the audit committee charter.

In accordance with Deloitte (2014), the audit committee should have oversight responsibilities on the effectiveness of financial statement preparation. In accordance with the MFMA (2003), each municipality and each municipal entity must have an audit committee which must review the annual financial statements to provide the council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation.

Klein (2006) stated that the audit committee's primary function is to oversee the financial reporting processes of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit process, and internal accounting controls. From the analysis of this result this study has confirmed that a lack of authority from the audit committee charter to the audit committee to perform its oversight responsibilities of financial statement review is one of the reasons for the continuous qualification of the financial statements of Mafikeng Local Municipality. This is illustrated graphically in Figure 4.13.



**Figure 4.13: Authority of the Audit Committee**

Question 14: The audit committee reviews the financial statement after preparation before it is submitted to the Auditor-General for auditing?

**Table4.14: Responsibility of financial statement review**

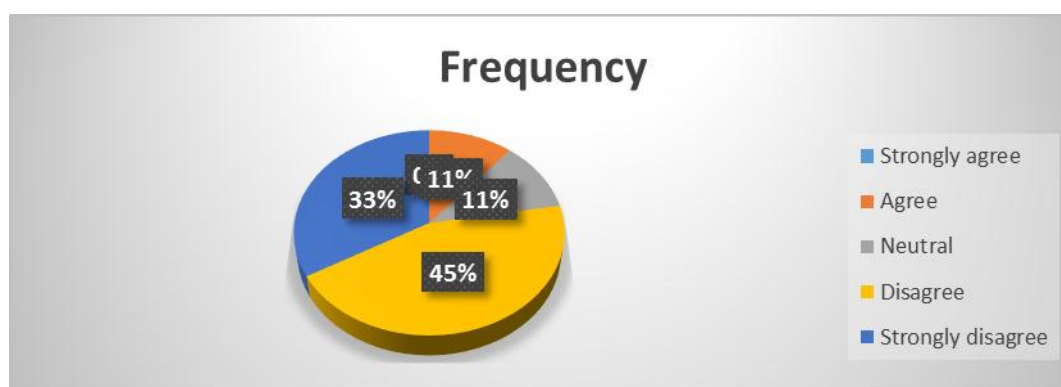
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 2         | 11%        | 4                    | 22%                   |
| Disagree          | 8         | 44%        | 12                   | 67%                   |
| Strongly disagree | 6         | 33%        | 18                   | 100%                  |

Table 4.14 shows that 44 per cent of the respondents disagreed and 33 per cent strongly disagreed that the audit committee of council review the financial statement after preparation, before it is submitted to the Auditor-General for audit. Eleven per cent were neutral and eleven per cent agreed. This implies that more than 77 per cent of the respondents admitted that the audit committee did not perform their oversight responsibility of financial statement review before submitting for audit.

In accordance with MFMA (2003), each municipality and each municipal entity must have an audit committee which must review the annual financial statements to provide the council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation.

In accordance with PWC (2005), although the audit committee can take up numerous additional responsibilities the central reason for the existence of the committee is to oversee the integration of the financial statements. Klein (2006) also stated that the audit committee's primary function is to oversee the financial reporting processes of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit

process, and internal accounting controls (IIA, 2015), as an oversight structure, an audit committee also provides a valuable benefit, as it results in a greater focus on controls and risk management, as well as financial reporting. An audit committee should also promote the integrity and effectiveness of audit activities. An audit committee as a mediator between the external audit and the organisation ensures that the audit results that are recommended in the form of corrective actions are implemented. From the analysed responses this study confirmed that the continuous qualification of Mafikeng Local Municipality's financial statements is as a result of the audit committee not performing its oversight functions of financial statement review. This is illustrated graphically in Figure 4.14.



**Figure 4.14: Responsibility of financial statement review**

Question 15: The audit committee discusses the scope of the internal and external audit regularly (this includes issues of concern raised during the audit engagement, the financial statements and management's letter on completion of the external audit, as well as reviews of management responses to audit findings).

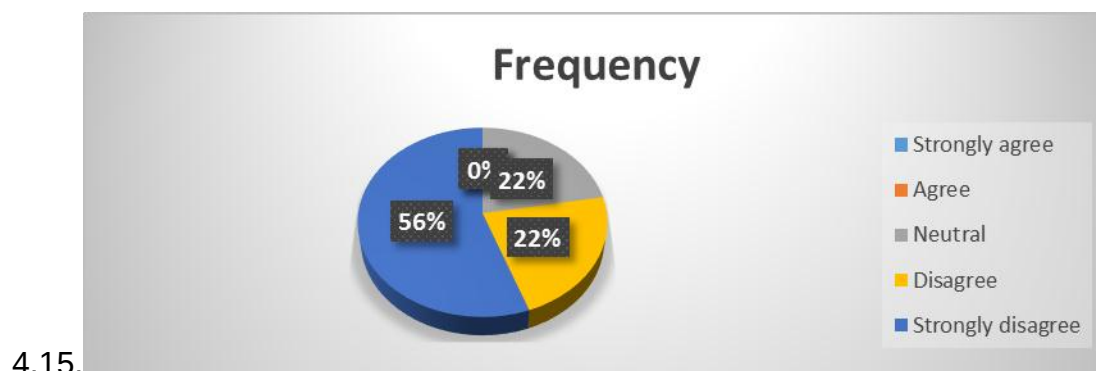
**Table4.15: Monitoring the scope of internal and external auditors**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 4         | 22%        | 4                    | 22%                   |
| Disagree          | 4         | 22%        | 8                    | 44%                   |
| Strongly disagree | 10        | 56%        | 18                   | 100%                  |

The results in Table 4.15 show that 56 per cent of the respondents strongly disagreed and 22 per cent disagreed and 22 per cent were neutral. In accordance with Klein (2006) the audit committee's primary function is to oversee the financial reporting processes of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit process, and internal accounting controls. In accordance with ICAEW (2003) the audit committee has a very important role to play in strengthening the external audit's independence and to ensure that they can perform they work objectively and without interference or pressure from management. This oversight role should significantly increase the quality of the audit opinion and contribute in ensuring financial reporting that is accurate, credible and reliable.

MFMA (2003) stated that in terms of the requirements of the MFMA, each municipality and each municipal entity must have an audit committee: an audit committee is an independent advisory body which must advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to. Internal financial control and internal audits, risk management, accounting policies and coordinate the external and internal audit processes. From the analysis of this response this study has confirmed that one of the

reasons for the continuous qualification of Mafikeng Local Municipality's financial statement is its task of the audit committee not performing its responsibility of external audit coordination. This is graphically illustrated in Figure



**Figure 4.15: Monitoring the scope of internal and external auditors.**

Question 16: The audit committee maintains a productive relationship with management?

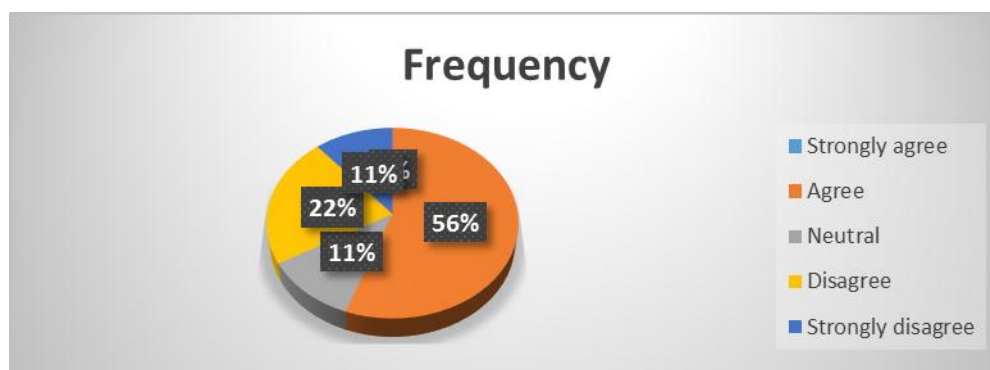
**Table4.16: Relationship between the Audit Committee and management**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 10        | 56%        | 10                   | 56%                   |
| Neutral           | 2         | 11%        | 12                   | 67%                   |
| Disagree          | 4         | 22%        | 16                   | 89%                   |
| Strongly disagree | 2         | 11%        | 18                   | 100%                  |

Table 4.16 shows that 56 per cent of the respondents agreed, 22 per cent disagreed, eleven per cent was neutral and eleven per cent strongly disagreed that there is a productive relationship between the audit committee and management. In accordance with Smith (2003) the reasons for forming an audit committee is that, while all directors have the duty to act in the interests of the company, this committee has a particular role

acting independently from the executives, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control. In accordance with the MFMA (2003) each municipality and each municipal entity must have an audit committee: an audit committee is an independent advisory body which must advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to Internal financial control and internal audits.

PWC (2005) stated that although the audit committee can take up numerous additional responsibilities the central reason for the existence of the committee is to oversee the integration of the financial statement. In accordance with Klein (2006) the audit committee's primary function is to oversee the financial reporting process of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit processes and internal accounting controls. From the analysis of this result this study confirmed that the qualification of Mafikeng Local Municipality is not as a result of lack of communication between the audit committee and management. This is illustrated graphically in Figure 4.16.



**Figure 3: Relationship between the Audit Committee and management**

Question 17: The audit committee communicates openly with management?

**Table4.17: Communication between management and the Audit Committee**

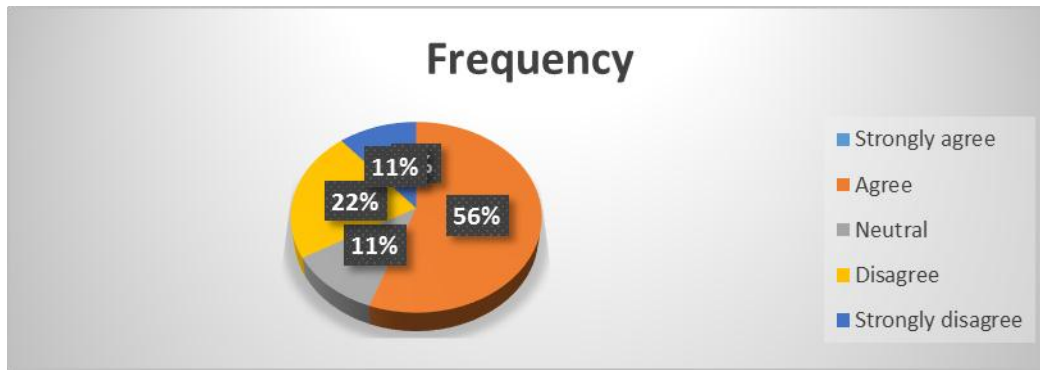
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 10        | 56%        | 10                   | 56%                   |
| Neutral           | 2         | 11%        | 12                   | 67%                   |
| Disagree          | 4         | 22%        | 16                   | 89%                   |
| Strongly disagree | 2         | 11%        | 18                   | 100%                  |

Table 4.17 shows that 56 per cent of the sample agreed that the audit committee communicated openly with management, 22 per cent disagreed, eleven per cent were neutral and eleven per cent strongly disagreed. in accordance with Smith (2003) the reason for forming an audit committee, is while all directors have the duty to act in the interests of the company, this committee has a particular role acting independently from the executives, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control.

In accordance with the MFMA (2003), each municipality and each municipal entity must have an audit committee: an audit committee is an independent advisory body which must advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to Internal financial control and internal audits.

PWC (2005) felt that although the audit committee can take up numerous additional responsibilities the central reason for the existence of the committee is to oversee the integration of the financial statement.in accordance with Klein (2006) the audit committee's primary function is to oversee the financial reporting process of the firm. It achieves this goal by meeting regularly with the firm's outside auditors and internal financial managers to review the corporation's financial statements, audit process, and

internal accounting controls. From the analysis of this result this study confirmed that the qualification of Mafikeng Local Municipality is not as a result of lack of communication between the audit committee and management. This is illustrated graphically in Figure 4.17.



**Figure 4.17: Communication between management and the Audit Committee.**

### **SECTION C: Ethics and accountability of municipal officials**

Question 18: The municipality has an ethical code of conduct and the code outlines penalties to unethical behaviours?

**Table 4.18: Effectiveness of the municipal code of conduct.**

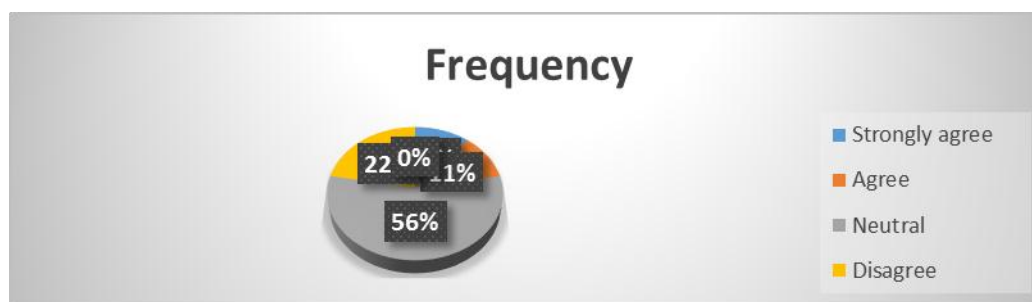
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 2         | 11%        | 2                    | 11%                   |
| Agree             | 2         | 11%        | 4                    | 22%                   |
| Neutral           | 10        | 56%        | 14                   | 78%                   |
| Disagree          | 4         | 22%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

The results in Table 4.18 show that 56 per cent of the respondents were neutral, 22 per cent disagreed, eleven per cent agreed and eleven per cent strongly agreed that the

municipality has an ethical code of conduct and the code outlines penalties to unethical behaviours. It implies that more than 56% of managers and accountants in the finance department do not know whether the municipality has an ethical code of conduct. In accordance with Edwards (2008) one can argue that sound ethical behaviour and accountability of public administration are prerequisites to and underpin public trust as a keystone to good government. Attention should be focused by municipalities on the legislative framework on ethical professionalism and accountability (PSC, 2008) the PSC conducted a study of 25 national and provincial bodies to evaluate the consistency of sanctions imposed for misconduct in the public service. The following listed catalogue of unethical conduct was identified:

- Inappropriate or unacceptable behaviours,
- Gross dereliction of duty,
- Fraud,
- Unauthorised absences,
- Contravention of policies or procedures,
- Financial Misconduct,
- Misuse of state property; and
- Corruption (Edwards, 2007).

The concept of ethics has been broadened to include not only the characteristics of the good person and theoretical knowledge, but it refers also to best practice. In general, ethics refers to a set of moral principles or values that directs the behaviour of municipal officials in terms of what is wrong and what is right. From the analysis of this response this study could not confirm whether the continuous qualification of Mafikeng Local Municipality's financial statement is influenced by lack of an ethical code of conduct. This is illustrated graphically in Figure 4.18.



**Figure 4.18: Effectiveness of the municipal code of conduct.**

Question 19: The municipality has a policy which deals with accountability of its officials and it states penalties to unaccountable officials?

**Table4.19: Effectiveness of municipal policy on accountability of its officials.**

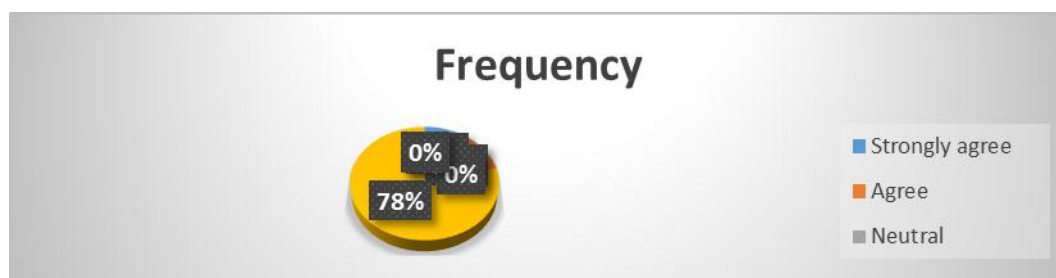
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 2         | 11%        | 2                    | 11%                   |
| Agree             | 2         | 11%        | 4                    | 22%                   |
| Neutral           | 0         | 0%         | 4                    | 22%                   |
| Disagree          | 14        | 78%        | 18                   | 100%                  |
| Strongly disagree | 0         | 0%         | 18                   | 100%                  |

Table 4.19 shows that 78 per cent of the respondents disagreed, only eleven per cent agreed and eleven per cent strongly agreed that the municipality has a policy which deals with accountability of its official and it states penalties to unaccountable officials. This implies that more than 78 per cent of the respondents are of the view that the municipality does not have a policy which deals with the accountability of its officials.

Ababio (2007) defined accountability as the answerability for performance and the obligation that public officers have to give a satisfactory explanation to the public concerning the authority and recourses entrusted to them. Section 171 (4) of the MFMA

(2003) states that a municipality must investigate allegations of financial misconduct against the accounting officer, the chief financial officer, a senior manager or other official of the municipality unless those allegations are frivolous, vexatious, speculative or obviously unfounded. If the investigation warrants such a step, an institution should instigate disciplinary proceedings against the accounting officer, chief financial officer or that senior manager or other official. Edwards (2008) also averred that sound accountability of public administration is a prerequisite of good governance.

This is demonstrated graphically in Figure 4.19.



**Figure 4: Effectiveness of municipal policy on accountability of its officials.**

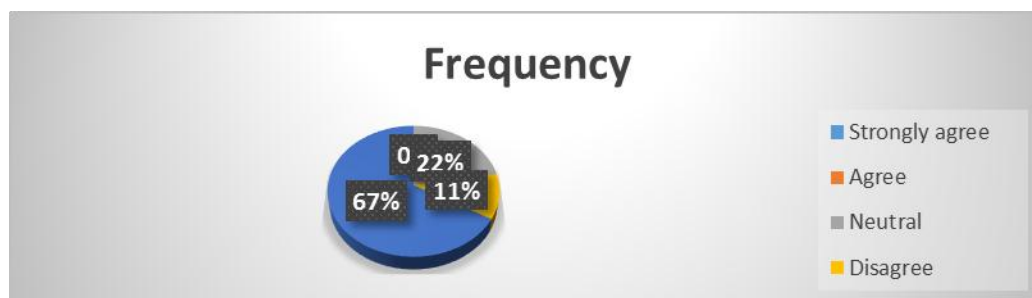
Question 20: In the past 5 years the municipality has recovered all the fruitless and wasteful expenditures disclosed in their financial statements from the guilty municipal officials?

**Table 4.20: Recoverability of fruitless and wasteful expenditures.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             |           | 0%         | 0                    | 0%                    |
| Neutral           | 4         | 22%        | 4                    | 22%                   |
| Disagree          | 2         | 11%        | 6                    | 33%                   |
| Strongly disagree | 12        | 67%        | 18                   | 100%                  |

Table 4.20 shows that 67 per cent of the respondents strongly disagreed, eleven per cent disagreed that in the past five years the municipality has recovered all the fruitless and wasteful expenditures disclosed in their financial statements from the guilty municipal officials, only 22 per cent were neutral. This correlates with South African Government News Agency (2015) which stated that five municipalities in the North West Province will be placed under administration because of the high level of irregular fruitless and wasteful expenditures. Section 171 (4) of the MFMA (2003), states that a municipality must investigate allegations of financial misconduct against the accounting officer, the chief financial officer, a senior manager or other official of the municipality unless those allegations are frivolous, vexatious, speculative or obviously unfounded. If the investigation warrants such a step, disciplinary proceedings should be instituted against the accounting officer, chief financial officer or that senior manager or other official. AGSA (2013) As disclosed in note 42 to the financial statements, for Mafikeng Local Municipality fruitless and wasteful expenditure of R97 087 was incurred in the current year and fruitless and wasteful expenditure in respect of prior years of R5 270 237 had not yet been dealt with in accordance with Section 32 of the MFMA.

Section 32(d) MFMA (2003) states that any political office-bearer or official of a municipality who deliberately or negligently made or authorised a fruitless and wasteful expenditure is liable for that expenditure. The analysis in this study confirms that the continuous qualification of Mafikeng Local Municipality's financial statements is because of a lack of accountability by municipal officials. This is illustrated graphically in Figure 4.20.



**Figure 4.20: Recoverability of fruitless and wasteful expenditures.**

Question 21: Officials of the municipality carry out the financial statement preparation duties with a recommended level of professionalism?

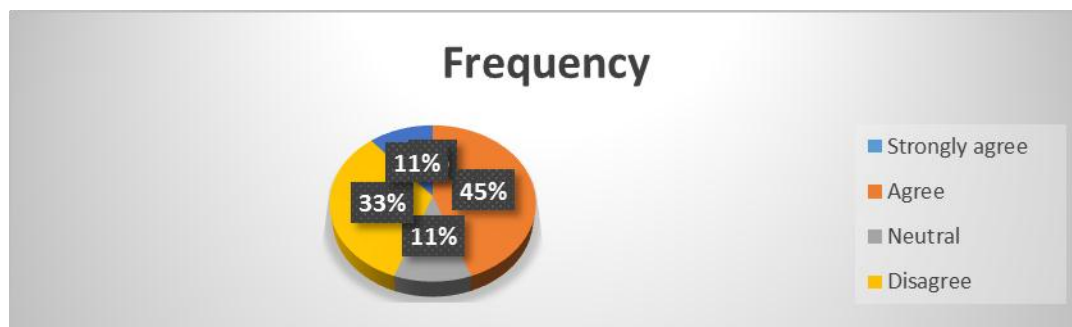
**Table 4.21: Professionalism of municipal officials.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 8         | 44%        | 8                    | 44%                   |
| Neutral           | 2         | 11%        | 10                   | 56%                   |
| Disagree          | 6         | 33%        | 16                   | 89%                   |
| Strongly disagree | 2         | 11%        | 18                   | 100%                  |

Table 4.21 shows that 44 per cent of the respondents agreed that the officials of the municipality carry out the financial statement preparation duties with a recommended level of professionalism, 33 per cent disagreed, eleven per cent strongly disagreed and eleven per cent were neutral. In accordance with Section 61 of the MFMA (2003), the accounting officer of a municipality must act with fidelity, honesty, integrity, professionalism and in the best interests of the municipality in managing its financial affairs. The concepts of ethics, professionalism and accountability form part of the fundamental principles of municipal administration and need to be exposed and practised by the leaders within the municipalities and by all municipal office-bearers and municipal officials. One can argue that sound ethical behaviour and accountability of public administration are prerequisites to and underpin public trust as a keystone to good government. Attention should be focused by municipalities on the legislative framework on ethics professionalism and accountability (Edwards, 2008).

In agreement with Mafunisa (2000) professionalism is an ongoing process of development, an important aspect of professionalism in the public sector is that public officials must have specific expertise or competency to be able to do execute their official duties. From the analysis of this response this study could not confirm whether

the continuous qualification of Mafikeng Local Municipality's financial statements is as a result of lack of professionalism of municipal officials. This is illustrated graphically in Figure 4.21.



**Figure 4.21: Professionalism of municipal officials.**

Question 22: The municipality has a fully-fledged internal control department which is in charge of the internal control system?

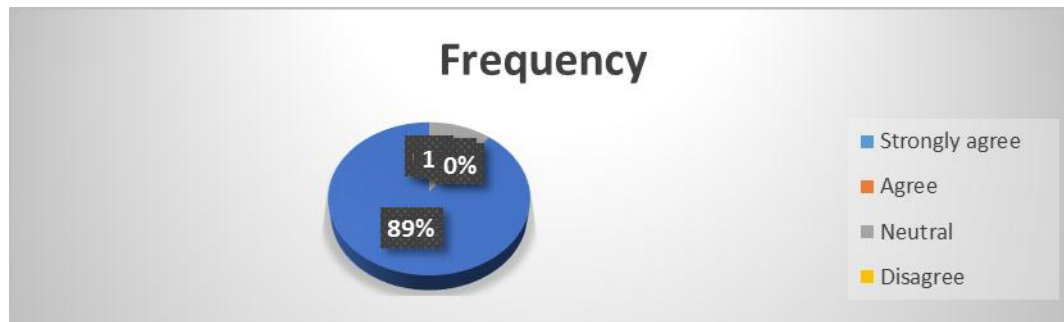
**Table 4.22: Responsibility of the Internal Control Department.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 2         | 11%        | 2                    | 11%                   |
| Disagree          | 0         | 0%         | 2                    | 11%                   |
| Strongly disagree | 16        | 89%        | 18                   | 100%                  |

Table 4.22 shows that 89 per cent of the respondents strongly disagreed that the municipality has a fully-fledged internal control department which is in charge of the internal control system (MFMA, 2003). In accordance with Section 36 of the MFMA, the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to

ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. In accordance with COSO (2013) internal control is the most valuable tool used to manage financial activities of any municipality. The responsibility of internal control is to identify, mitigate and manage control risks that may hamper achievement of the municipality's objectives to effectively, efficiently and economically manage financial and related resources. The 2012/13 Auditor-General's Report shows that the spheres of government in South Africa are struggling to monitor public financial resources. Some employees take advantage of poor internal control systems to commit fraud and corruption by misusing public funds that are budgeted for service delivery. From this analysis, this study confirmed that non-existence of an internal control department in Mafikeng Local Municipality is one of the factors that reduce the quality of its financial statements and consequently the audit opinion.

This is illustrated graphically in Figure 4.22.



**Figure 4.22: Responsibility of the Internal Control Department.**

Question 23: The municipality's policies and procedures are reviewed on an annual basis by the internal control department?

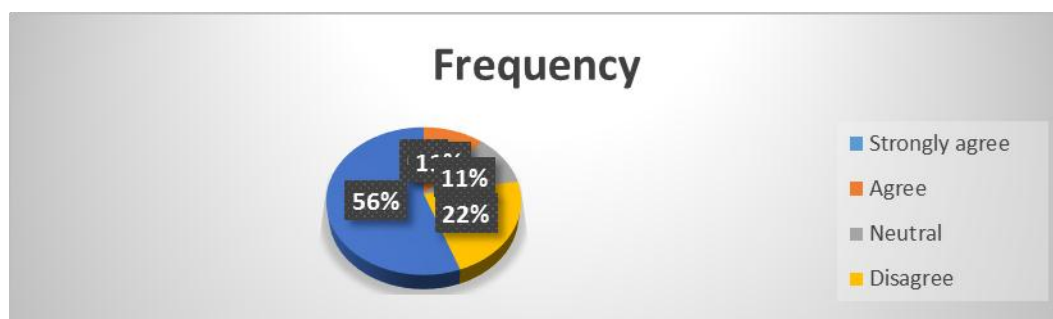
**Table 4.23: Annual Review of Municipal Policies**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 2         | 11%        | 4                    | 22%                   |
| Disagree          | 4         | 22%        | 8                    | 44%                   |
| Strongly disagree | 10        | 56%        | 18                   | 100%                  |

Table 4.23 shows that 56 per cent of the respondents strongly disagreed, 22 per cent disagreed that the municipality's policies and procedures are reviewed on an annual basis by the internal control department, in accordance with Section 78 MFMA (2003). Each senior manager of a municipality and each official of a municipality exercising financial management responsibilities must take all reasonable steps within their respective areas of responsibility to ensure that the system of financial management and internal control established for the municipality is carried out diligently.

In accordance with Visser and Erasmus (2008), there are certain means that exist which public managers can ensure that internal control is applied; these means include organisational structure; organization policies, administrative and operational procedures; personnel matters; accounting; budgeting; reporting; internal review; and strategic planning as well as internal auditing. This means that when applied, there should be periodic reviews. Only eleven per cent agreed and eleven per cent neutral. This implies that more than 68 percent of the respondents are of the view that the municipality does not review their policies annually.

This is illustrated graphically in Figure 4.23.



**Figure 4.23: Annual review of municipal policies.**

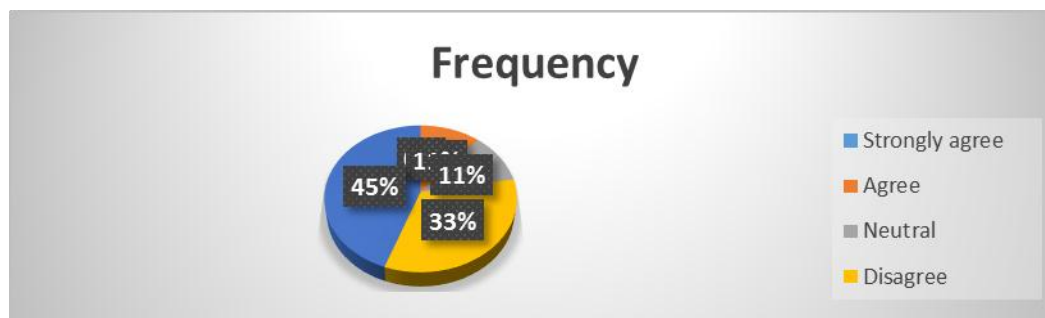
Question 24: The municipality complies fully with MFMA in the implementation of its internal control functions?

**Table 4.24: Compliance with the MFMA**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 2         | 11%        | 4                    | 22%                   |
| Disagree          | 6         | 33%        | 10                   | 56%                   |
| Strongly disagree | 8         | 44%        | 18                   | 100%                  |

Table 4.24 shows that 44 per cent of the respondents strongly disagreed, 33 per cent disagree that the municipality complies fully with MFMA in the implementation of its internal control functions. This response is contrary with Section 36 of MFMA (2003) that alludes that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial, risk management and internal control. In accordance with Cahill (2006), the systems of internal control involve the financial and administrative

checks and balances that are designed and supported to ensure that the goals, objectives and responsibilities of the institution are realised. Finally, in accordance with COSO (2013) internal control operates as the most valuable tool used to manage financial activities of any municipality. The responsibility of internal control is to identify, mitigate and manage and control risks that may hamper achievement of the municipality's objectives to effectively, efficiently and economically manage financial and related resources. From the above analysis noncompliance with the MFMA is one of the factors that affects the quality of the financial statement of Mafikeng Local Municipality and consequently the audit opinion. Only eleven per cent agreed and eleven per cent was neutral. This is illustrated graphically in Figure 4.24



**Figure 4.24: Compliance with the MFMA.**

#### **SECTION D: Education and professional experience of management in the Financial Department and Audit Committee**

Question 25: The finance department comprises of employees with relevant qualifications?

**Table 4.25: Relevance of qualifications for officials in the finance department**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 0         | 0%         | 2                    | 11%                   |
| Disagree          | 2         | 11%        | 4                    | 22%                   |
| Strongly disagree | 14        | 78%        | 18                   | 100%                  |

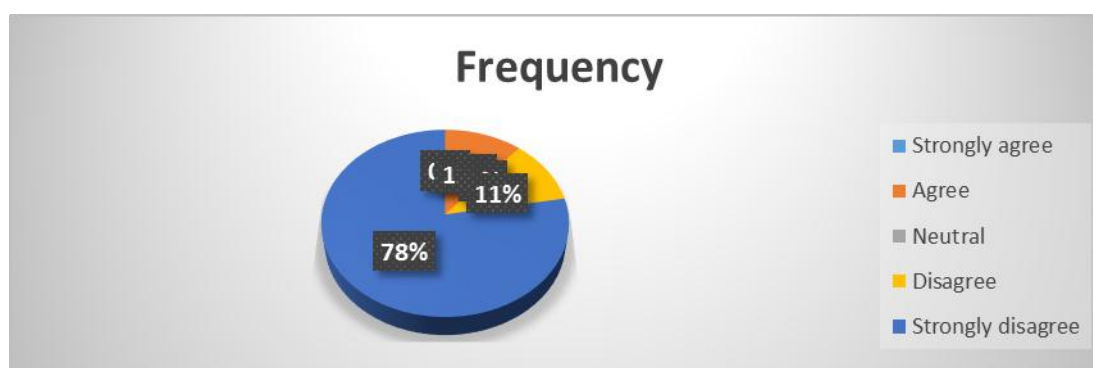
Table 4.25 shows that 78 per cent of the respondents strongly disagreed and eleven per cent disagreed that the finance department comprises employees with relevant qualifications. Only eleven per cent agreed, and from this response, it implies that more than 89 per cent of the respondents are of the view that employees in the finance department do not have the relevant qualifications.

In accordance with the National Treasury (2007) senior managers of low capacity municipalities and medium municipalities with an annual budget of a value below R500 million for the current financial year must have at least a National Qualifications Framework level 6, translated as a three-year bachelor's degree or a national diploma or a certificate in municipal financial management qualification, approved by the South African Qualifications (National Treasury, 2007). Sections 107 and 119 of the MFMA specifically contain enabling provisions requiring all officials who manage, supervise and operate within the financial management and supply chain management departments, to meet minimum competency requirement levels.

In accordance with the National Treasury (2007a?) guidelines for minimum requirements for municipal managers, the minimum requirement for municipal manager's transitional provisions contained in the guideline regulations requires managers had up to 1 January 2013 to meet the minimum competency levels, and new employees would also benefit from this transitional period. Municipalities will be required

to develop appropriate strategies to assess staff competencies, provide suitable resources and opportunities for staff training and development. Furthermore, they must ensure that the attainment of competencies is included as a performance target in the official's, performance agreement.

In accordance with AGSA (2011), more than 70 per cent of officials in municipalities do not have the minimum competencies and skills and educational required for their jobs and this has led to the low quality of financial statements prepared by the officials. This is illustrated graphically in Figure 4.25.



**Figure 4.25: Relevance of qualifications for officials in the finance department**

Question 26: All managers in the finance department have at least the minimum education level as recommended in the MFMA (a Bachelor's degree in finance)?

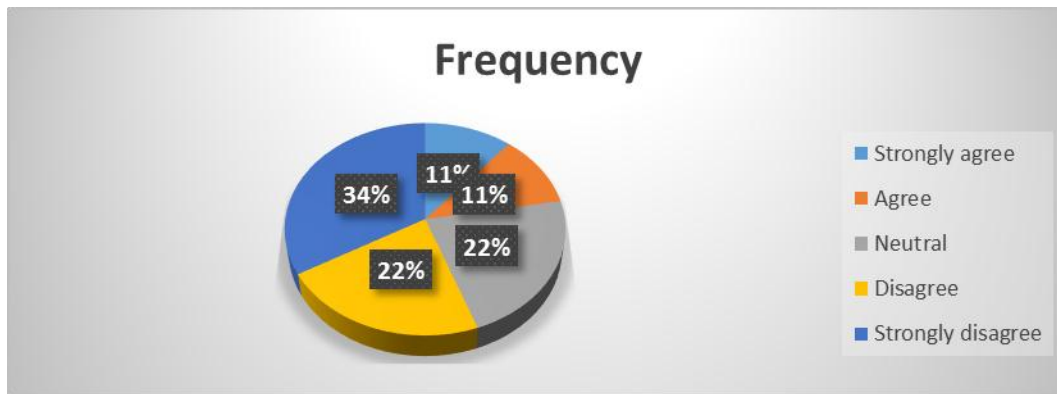
**Table 4.26: Compliance with MFMA minimum qualification requirement**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 2         | 11%        | 2                    | 11%                   |
| Agree             | 2         | 22%        | 4                    | 22%                   |
| Neutral           | 4         | 33%        | 8                    | 44%                   |
| Disagree          | 4         | 22%        | 12                   | 67%                   |
| Strongly disagree | 6         | 11%        | 18                   | 100%                  |

Table 4.26 shows that 33 per cent of the respondents strongly disagreed and eleven per cent disagreed that all managers in the finance department have at least the minimum education level as recommended by the MFMA. Only 22 per cent agreed, eleven per cent strongly agreed and 33 per cent were neutral. In accordance with the National Treasury (2007), senior managers of low capacity municipalities and medium municipalities with an annual budget of a value below R500 million for the current financial year must have at least a National Qualifications Framework level 7, translated as a three-year bachelor's degree or a national diploma or a certificate in municipal financial management qualification, approved by the South African Qualifications Authority.

In the municipal financial audit report for the Limpopo Province for the year ending 2012, although the Province has commenced with a process to appoint competent chief financial officers, there is still a critical shortage of skills and competencies at 72% (87% in 2010–11) of the municipalities. The lack of skills resulted in significant reliance (R51 million) on the use of consultants in the preparation of financial statements in 72% of the municipalities (AGSA, 2013). In accordance with the Auditor-General national report for local government for the municipal financial year ending 2011, officials in key positions at more than 70% of the municipalities do not have the minimum competencies and skills required to perform their jobs. While a lack of dedicated capacity is at the root of the weaknesses in service delivery reporting, the skills gap is most pronounced in the financial discipline.

The analysis in this study could not confirm whether the continuous qualification of Mafikeng Local Municipality's financial statements is as a result of its officials not complying with the minimum educational requirement. This is illustrated graphically in Figure 4.26.



**Figure 4.26: Compliance with MFMA minimum qualification requirement.**

Question 27: Managers in the finance department individually and combined possess relevant experience as mandated by the MFMA to be able to prepare the annual financial statement free of material misstatements?

**Table 4. 27: Compliance with MFMA collective education requirement.**

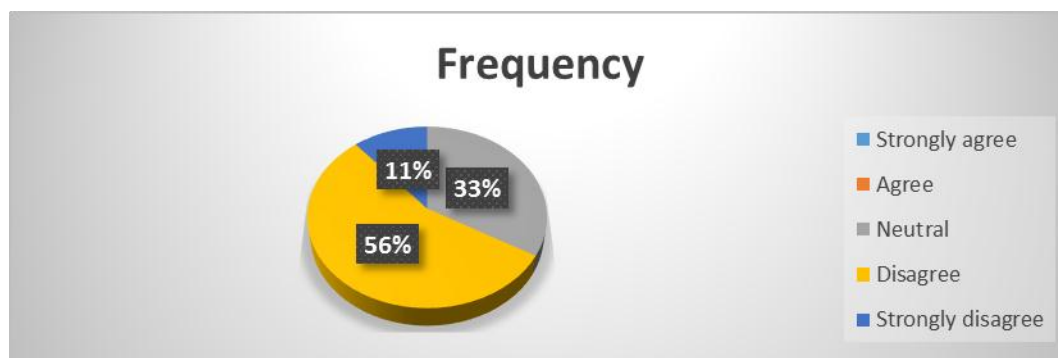
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    |           | 0%         | 0                    | 0%                    |
| Agree             |           | 0%         | 0                    | 0%                    |
| Neutral           | 6         | 33%        | 6                    | 33%                   |
| Disagree          | 10        | 56%        | 16                   | 89%                   |
| Strongly disagree | 2         | 11%        | 18                   | 100%                  |

Table 4.27 shows that 56 per cent of the respondents disagreed and eleven per cent strongly disagreed that managers in the finance department individually and combined possess relevant experience as mandated by the MFMA to be able to prepare the annual financial statements free of material misstatements.

Sections 107 and 119 of the MFMA (2003) specifically contain enabling provisions requiring all officials who manage, supervise and operate within the financial management and supply chain management disciplines, to meet minimum competency

requirement levels. Section 119 further makes this requirement compulsory and stipulates that a municipality and a municipal entity must provide resources or opportunities for the training of officials to meet the prescribed competency levels. This section also gives responsibility to the National Treasury or a provincial treasury to assist municipalities and municipal entities in the training of their officials (AGSA, 2012). In accordance with the Auditor-General for Northern Cape Province for the municipal financial year ending 2012, municipalities' audit opinions were again disclaimed. These municipalities have been disclaimed since 2009–10 mainly due to a lack of consequences for poor performance (AGSA, 2012). In the municipal financial audit report for the Limpopo Province for the year ending 2012, although the Province has commenced with a process to appoint competent chief financial officers, there is still a critical shortage of skills and competencies at 72% (87% in 2010-11) of the municipalities. The lack of skills resulted in significant reliance (R51 million) on the use of consultants in the preparation of financial statements at 72% of the municipalities (AGSA, 2013). 33 per cent of the respondents were neutral; this implies that more than 67 per cent of the respondents are of the view that managers in the finance department do not possess the relevant experience to prepare annual financial statements free from material misstatements.

From the above analysis this study confirms that one of the factors that have led to the continuous qualification of Mafikeng Local Municipality financial statements is because managers in the finance department do not have the relevant experience in financial statement preparation. This is illustrated graphically in Figure 4.27.



**Figure 4.27: Compliance with MFMA collective education requirement**

Question 28: All employees in the finance department have an understanding of what is required of them in relation to the financial statement preparation in accordance with the Municipal Finance Management Act?

**Table 4.28: Municipal officials understanding of the MFMA.**

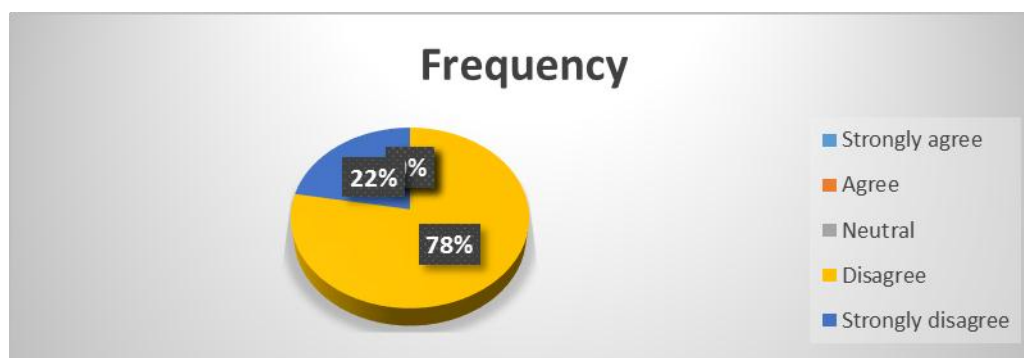
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 0         | 0%         | 0                    | 0%                    |
| Disagree          | 14        | 78%        | 14                   | 78%                   |
| Strongly disagree | 4         | 22%        | 18                   | 100%                  |

Table 4.28 shows that 78 per cent of the respondents disagree and 22 per cent strongly disagree that all employees in the finance department have an understanding of what is required of them in relations with the financial statement preparation in accordance with the Municipal Finance Management Act. This implies that 100 per cent of the respondents believe that not everyone in the finance department knows what is expected of them in relation to financial statement preparation.

In accordance with the Auditor-General for Northern Cape Province for the municipal finance year ending 2012 municipalities' audit opinions were again disclaimed. These municipalities have been disclaimed since 2009-10 mainly due to a lack of consequences for poor performance (AGSA, 2012). In the municipal financial audit report for the Limpopo Province year ending 2012, although the Province has commenced with a process to appoint competent chief financial officers, there is still a critical shortage of skills and competencies at 72% (87% in 2010–11) of the municipalities. The lack of skills resulted in a significant reliance (R51 million) on the use

of consultants in the preparation of financial statements at 72% of the municipalities (AGSA, 2013).

From the analyses of the results above this study confirmed that this is one of the factors influencing the quality of the financial statements and consequently the audit opinion. This is illustrated graphically in Figure 4.28.



**Figure 4.28: Municipal officials understanding of the MFMA.**

Question 29: Is the internal audit function of the municipality fully staffed with competent staff and it functions as intended by the MFMA?

**Table 4.29: Staffing of the Internal Audit Function.**

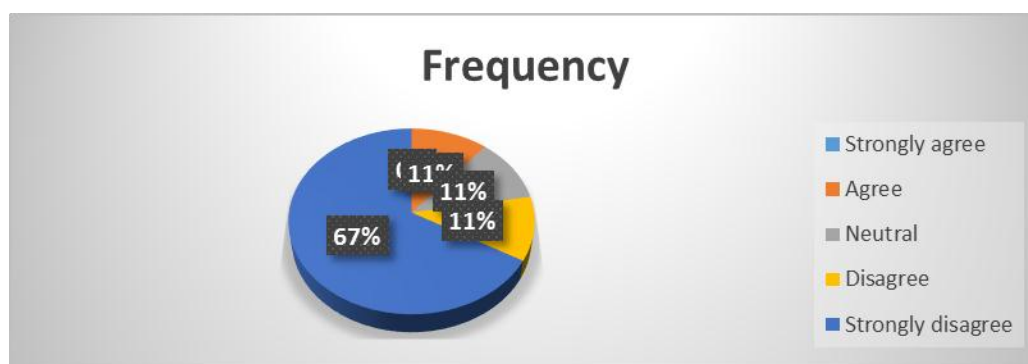
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 2         | 11%        | 2                    | 11%                   |
| Neutral           | 2         | 11%        | 4                    | 22%                   |
| Disagree          | 2         | 11%        | 6                    | 33%                   |
| Strongly disagree | 12        | 67%        | 18                   | 100%                  |

Table 4.29 shows that 67 per cent of the respondents strongly disagreed and eleven per cent disagreed that the internal audit function of the municipality was fully staffed with

competent staff and it functions as intended by the MFMA. This implies that the municipality does not comply with the requirements of the MFMA (2003) which recommends that all municipalities should have a fully-staffed internal audit function.

Diamond (2002) in his study of the coordination role between the internal and the external audit functions recommended that there should be proper coordination between the external and internal audit functions to enshroud adequate audit coverage and to minimize duplication of functions. Finally, in accordance with the National Treasury's internal Audit Framework (2009) an Internal Audit Activity is an important component of internal control, risk management and corporate governance and provides the necessary assurance and advisory services to a municipality. Internal Audit Activity is one of the most significant management tools and can provide value-added services to a municipality. When objectively and adequately resourced, an Internal Audit Activity should be in a position to provide management with much of the assurance it requires regarding the effectiveness of the system of internal control risk management and governance processes. The Internal Audit Activity must be well-planned, organised, staffed, trained, directed and monitored. Only eleven per cent agreed and eleven per cent was neutral; this implies that more than 78 per cent of the participants are of the view that the internal audit function is understaffed and underperforming.

The analysis in this study confirms that one of the factors that affect the quality of the financial statements of Mafikeng Local Municipality is the lack of a fully-staffed internal audit function. This is illustrated graphically in Figure 4.30.



**Figure 4.5: Staffing of the Internal Audit Function.**

Question 30: The audit committee comprises of members with relevant qualifications and competence as recommended by the MFMA?

**Table 4.30: Composition of Member in the Audit Committee**

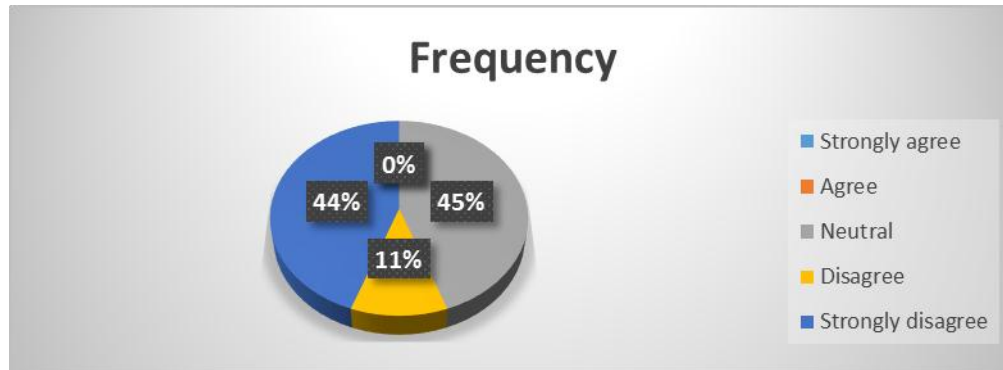
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 8         | 44%        | 8                    | 44%                   |
| Disagree          | 2         | 11%        | 10                   | 56%                   |
| Strongly disagree | 8         | 44%        | 18                   | 100%                  |

Table 4.30 shows that 44 per cent of the respondents strongly disagreed and eleven per cent disagreed that the audit committee comprises members with relevant qualifications as recommended by the MFMA. This implies that the municipality does not comply with the minimum qualification requirements of MFMA. Section 166 of the MFMA (2003) provides for a minimum requirement for the composition of an audit committee. The audit committee must comprise at least three (3) persons with relevant educational qualifications and experience in financial statement preparation and should consist of a majority of members who are not employees of the municipality or municipal entity MFMA (2003). National Treasury (2012) also stipulated that, in determining suitable candidates for an audit committee and maintaining a balanced composition, the accounting officer should seek to appoint members from different areas of expertise to enhance the audit committee's overall knowledge of the municipality or entity and the ability to discharge its obligations and provide appropriate recommendations to the council.

44 per cent of the respondents were neutral; from the above analysed results this study confirmed that the continuous qualification of Mafikeng Local Municipality's financial

statements is as a result of the audit committee not meeting the minimum requirement of having members with relevant qualifications.

This is illustrated graphically in Figure 4.30.



**Figure 4.30: Composition of member in the Audit Committee.**

Question 31: Do the audit committee members have sufficient experience in financial reporting as recommended by the MFMA?

**Table 4.31: Experience of the Audit Committee on financial statement review.**

| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 4         | 22%        | 4                    | 22%                   |
| Disagree          | 10        | 56%        | 14                   | 78%                   |
| Strongly disagree | 4         | 22%        | 18                   | 100%                  |

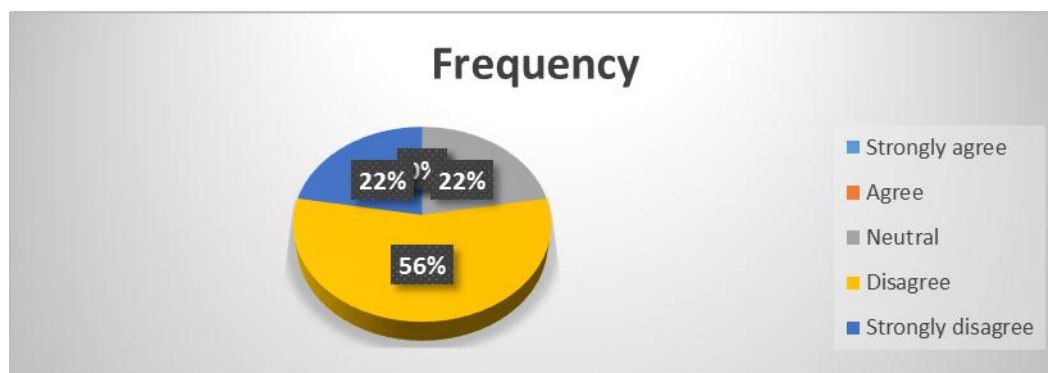
The results in Table 4.31 shows that 56 per cent of the respondents disagreed and 22 per cent strongly disagreed that the experience possessed by the audit committee members is sufficient for financial reporting as recommended. MFMA (2003) the audit

committee must comprise at least three members with relevant financial statement preparation experience. National Treasury (2012) also stipulated that, in determining suitable candidates for an audit committee and maintaining a balanced composition, the accounting officer should seek to appoint members from different areas of expertise to enhance the audit committee's overall knowledge of the municipality or entity and the ability to discharge its obligations and provide appropriate recommendations to the council. The appointed members should collectively possess the following skills and experience:

- Private and public sector experience;
- An understanding of service delivery priorities;
- Good governance and/or financial management experience;
- An understanding of the role of council and councillors;
- An understanding of the operations of the organisation;
- Familiarity with risk management practices;
- An understanding of internal controls;
- An understanding of major accounting practices and public sector reporting requirements;
- An understanding of public sector reforms;
- Familiarity with legislation applicable to municipalities;
- An understanding of the roles and responsibilities of internal and external auditors;
- An understanding of the treatment of allegations and investigations; and
- An understanding of the performance management system.
- Table 4.32 provides further guidance on the skills National Treasury (2012).

22 per cent were neutral; this implies that more than 78 per cent of the respondents are of the view that the audit committee members do not have the recommended

experience on financial statement review as recommended by the MFMA (2003). From these analyses this study confirmed that the lack of experience on financial statements review by audit committee members is one of the factors affecting the quality of the financial statements and consequently the audit opinion of the financial statements. This is illustrated graphically in Figure 4.31.



**Figure 4.31: Experience of the Audit Committee on financial statement review.**

Question: 32: The employees in the internal control department have sufficient experience and are competent in performing their functions?

**Table 4.32: Competency of officials in the Internal Control Department.**

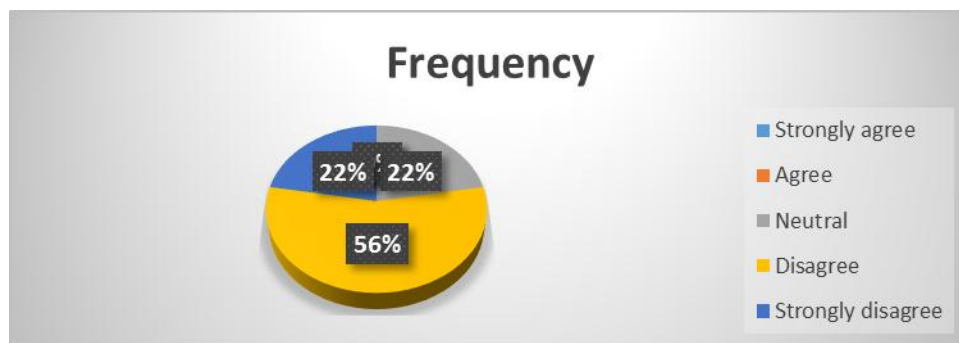
| Responses         | Frequency | Percentage | Cumulative Frequency | Cumulative Percentage |
|-------------------|-----------|------------|----------------------|-----------------------|
| Strongly agree    | 0         | 0%         | 0                    | 0%                    |
| Agree             | 0         | 0%         | 0                    | 0%                    |
| Neutral           | 4         | 22%        | 4                    | 22%                   |
| Disagree          | 10        | 56%        | 14                   | 78%                   |
| Strongly disagree | 4         | 22%        | 18                   | 100%                  |

Table 4.32 shows that 56 per cent of the respondents from this sample disagreed and 22 per cent strongly disagreed that the employees of the internal control department

have sufficient experience and are competent in performing their function. Only 22 per cent were neutral and this implies that more than 78 per cent of the respondents are of the view that employees in the internal control unit do not have sufficient experience and are not competent in performing their functions.

In accordance with Section 62 of the MFMA (2003), the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. In accordance with COSO (2013) internal control operates as the most valuable tool used to manage financial activities of any municipality. The responsibility of internal control is to identify, mitigate and manage control risks that may hamper achievement of the municipality's objectives to effectively, efficiently and economically manage financial and related resources. Auditor-General's Report shows that the spheres of government in South Africa are struggling to monitor public financial resources (AGSA, 2012). Some employees take advantage of poor internal control systems to commit fraud and corruption by misusing public funds that are budgeted for service delivery. This response correlates with the previously analysed responses that confirmed that Mafikeng Local Municipality does not have an internal control function as recommended by Section 62 of the MFMA (2003).

From the above analysed response, the study confirms that one of the reasons for the continuous qualification of Mafikeng Local Municipality's financial statement is the lack of an internal control unit. This is also illustrated graphically in Figure 4.32.



**Figure 4.32: Competency of officials in the Internal Control Department.**

### **4.3 Summary**

In this chapter data was collected from each electronically administered questionnaire was analysed through determining proportionate representation (percentages) represented in tables and graphs. From the analyses it was discovered that most of the managers in the finance department of Mafikeng Local Municipality have the minimum level of educational qualification as recommended by the MFMA, but they do not have the relevant education and experience for financial statement preparation. Employees in the financial department of the municipality are unethical and unaccountable for their actions. The internal audit function and the internal control department of the municipality do not meet the minimum standards of experience and professionalism as recommended by the MFMA. The audit committee does not perform its functions of maintaining the overall quality of the financial statement as recommended by the MFMA and its members do not have the relevant financial statements review experience as recommended. In the next chapter the analysed data is assessed and recommendations are made.

## **Chapter 5: Conclusions and recommendations**

### **5.1 Introduction**

The purpose of this study was to investigate the causes of qualified audit opinions in municipalities, with a case study being done of Mafikeng Local Municipality in the North West Province. In the previous chapter an analysis of responses from the respondents on the purpose of this study was done. In this chapter, a summary of the previous chapters will be given, the realisation of objectives will also be discussed, detailed discussions of the findings are undertaken and a conclusion with recommendations to the municipality on minimising the possibilities of their financial statements from being qualified by the Auditor-General.

### **5.2 Summary of chapters**

Chapter 1: In this chapter the topic was introduced and a general orientation of the research project was indicated, in which the problem statement, aims, objectives, significance of the study, the research questions, ethical considerations or issues and limitations of the study were discussed.

Chapter 2: In this chapter, the literature applied to the study was reviewed to establish the basic principles to be considered in both the organisation and planning of the research project. Based on the fact that the researcher presented a variety of views from different authors, legislation and acts of government regarding the research problem under study; it was easy to confront the problem head-on with deeper knowledge, insight and understanding of the background. The researcher was able to plan, carry out the research project and deal with the problem within the constitutional and regulative frameworks including the MFMA, the Auditor-General Manuals and the GAAP.

Chapter 3: In this chapter the research design and methodology were presented and the procedure followed in acquiring data was presented. The sampling and the applicable data analysis methods were indicated.

Chapter 4: presented the analysis of data from the respondents' answers in the questionnaire. Data was quantitatively analysed with the use of graphs and tables for

each of the research questions in the questionnaire and thereafter findings were presented.

Now in Chapter 5, the interpretation of the data analysis is imperative to formulation the recommendations to the municipality.

### **5.3 Realisation of the research objectives**

The first objective of this study is to determine factors that influence the financial statement of municipality to be qualified by the Auditor-General. Different factors previously alluded to by different authors like the AGSA, the IIA, PWC and the National Treasury were reviewed from the literature and discussed. The results from the respondents were analysed to determine if these findings from literature could be confirmed in practice.

The second objective was to determine whether the qualification of financial statement of municipalities is caused by unethical practices by municipal officials. Opinions from other researchers indicated that unethical practices may lead to ineffective preparation of the financial statement and consequently its qualification by the Auditor-General. These were confirmed in the analysis of the responses to the questionnaire under section C of the analyses.

The third objective was to determine whether the qualification of municipal financial statements is caused by unaccountability of municipal officials. Other authors' opinions were analysed on how unaccountability of municipal officials may lead to ineffective preparation of the financial statements and consequently its qualification by the Auditor-General. This was confirmed by the analysis of the responses to the researcher's questionnaire under section C of the analyses.

The fourth objective was to determine whether the qualification of financial statement of municipalities is caused by the audit committee, the internal audit function or the financial department not meeting the minimum qualification and competency requirements prescribed by the MFMA. The literature of other authors was reviewed and analysed on how non-compliance with the minimum qualification and experience requirement has influenced qualification of financial statements of municipalities. It was

confirmed in chapter 4 where the responses from the researcher's questionnaire were analysed under section D of the analyses.

## **5.4 Findings, conclusion and recommendation**

The findings in this study are based on the research questions that have been outlined in Chapter 1 as follows:

Main questions

- What are the factors that prevent municipalities from obtaining unqualified audit opinions?

Sub-questions

- Are the municipality officials ethical in carrying out their financial reporting functions?
- Are the municipality officials accountable for their actions in carrying out their financial reporting functions?
- Do the audit committee, internal audit function and financial department of municipalities meet the minimum educational qualification and experience as recommended by the MFMA?

The researcher addressed these research questions by investigating the causes of qualified audit opinions in Mafikeng Local Municipality in the North West Province..

### **5.4.1 Factors that prevent the municipality from obtaining unqualified audit opinions**

The financial department of Mafikeng Local Municipality does not prepare its financial statements as recommended by the MFMA — they sub-contract this function to a private consultancy, and this is one of the factors contributing to the continuous qualification of the financial statements because this leads to continuous reliance on consultancy and not improving the financial statement preparation experience of the officials in the financial department.

Supporting proofs of all line items disclosed in the financial statement are not properly filed and provided to the auditors upon request. This study confirmed that one of the reasons of continuous qualification of Mafikeng local municipalities financial statements is due to the negligence of the officials in the financial department of the municipality, in running their day-to-day financial activities leading to not being diligent in proper filing and re-provision of documentary proofs of transactions and account balances recorded in the financial statements.

The municipality prepares a post-audit action plan where all the unresolved findings of the past audit are discussed and recommendations on how to resolve them are made, but the recommendations from the action plan are not put into practice because the financial statements are being prepared by private consultants and not the municipal officials who prepared the audit action plan.

Mafikeng Local Municipality does not have a fully staffed internal audit function. This study confirmed that one of the factors that influence the continuous qualification of Mafikeng Local Municipality is the lack of a fully-staffed internal audit function to manage the external audit processes.

The audit committee charter does not provide sufficient authority for the audit committee to perform its oversight responsibilities of financial statement review and this study has confirmed that one of the reasons of the continuous qualification of Mafikeng Local Municipality financial statement is because of the audit committee not performing its oversight responsibilities of financial statement review and the overall responsibility of quality control of the financial statements.

#### **5.4.2 Ethics and accountability of municipal officials**

The municipality does not have a policy which deals with accountability of its officials and which states penalties to unaccountable officials. This study confirmed that in the past five years, Mafikeng Local Municipality has not charged any of its officials for the recovery of fruitless and wasteful expenditure recorded in the financial statements.

Mafikeng Local Municipality does not have a fully-fledged internal control department which is in charge of the internal control system. This study confirmed that one of the

reasons for the continuous qualification of Mafikeng Local Municipality's financial statements is because of lack of a fully-staffed internal control function to manage the activities of the internal control system.

The officials in the financial department of Mafikeng Local Municipality do not know whether the municipality has financial policies that deal with the ethical behaviour of municipal officials and accountability of municipal officials, because of the absence of an internal control and internal audit function which was supposed to manage and control the internal control system of the municipality, and this has led to unaccountability by officials in the financial department, and consequently non-compliance with the MFMA.

#### **5.4.3 Education and professional experience of management in the financial department and Audit Committee**

This study determined that the repeated qualifications of Mafikeng Local Municipality's financial statements can be firstly be attributed to the fact that the officials of the financial department of Mafikeng Local Municipality do not have the relevant recommended educational qualifications as recommended by the MFMA.

Secondly, the officials do not have the experience in preparation of financial statements as recommended by the MFMA, which explains the outsourcing of the financial statement preparation to an external consultancy.

Thirdly, officials in the internal audit function of the Mafikeng Local Municipality do not have the relevant educational qualifications as recommended by the MFMA, nor do they have the recommended financial statement monitoring experience as recommended by the MFMA. This confirms the need for outsourcing of the financial statement preparation to external consultancies.

Finally, members of the Audit Committee of the Council of Mafikeng Local Municipality do not have the relevant recommended educational qualifications as recommended by the MFMA, and recommended financial statement review experience as recommended by the MFMA and this reaffirms the outsourcing of the financial statement preparation and review functions to an external consultancy.

## **5.5 Recommendations**

Based on the results from this study and the analyses of these results, the following recommendations are made to improve the quality of financial statement prepared by the Mafikeng Local Municipality and subsequently reducing the possibility of receiving another qualified audit report.

The financial department of the municipality should have a culture of taking responsibility by preparing the financial statements of the municipality and not sub-contracting this function to a private consultancy. In this way the employees in the financial department will learn and acquire experience on financial statement preparation.

Employees in the financial department should be diligent in their day-to-day financial activities by properly recording all financial transactions and doing accurate safe-keeping of supporting proof of transactions recorded to be provided upon request by the auditors.

This study also recommends that the council should appoint a fully-staffed internal audit function which should be responsible for monitoring and maintenance of the overall financial reporting control and subsequently adding value to the overall value chain of financial reporting.

This study recommends that only people with relevant qualifications and recommended experience are appointed to the Audit Committee and that the Audit Committee should perform their oversight responsibility of financial statement review and overall responsibility of the quality of the financial statement as recommended by the MFMA.

This study recommends that the Mafikeng Local Municipality Council should appoint a fully-staffed internal control function which will be in charge of the overall implementation of the municipality's internal control system.

Finally, this study recommends that the human resource department of the municipality review their recruitment strategies to include minimum educational and professional experience requirements for managers in the financial department of the municipality

and only recruit employees with relevant education and experience in the financial department, the internal audit function and internal control departments.

## **5.6 Conclusion**

In conclusion, this study has identified that the repeated qualification of Mafikeng Local Municipality's financial statement for the past five years resulted from a lack of the following key functions:

- ✚ The financial statements of the municipality are not prepared by the financial department of the municipality.
- ✚ Management in the financial department does not have relevant financial statement preparation experience.
- ✚ The municipality does not provide supporting proof of line items disclosed in the financial statement upon request by the Auditor-General.
- ✚ The municipality does not have a fully-staffed internal audit function.
- ✚ The audit committee of council does not perform their oversight responsibility of financial statement review and overall responsibility of financial statement quality
- ✚ Members of the audit committee do not have the relevant educational qualifications and financial statement review experience.
- ✚ The municipality does not have a fully-staffed internal control function.

From this study it can be concluded that the type of audit opinion provided by the Auditor-General depends on the quality of the financial statement submitted for audit, the quality of the financial statements depends on the educational, professional experience and dedication of officials preparing the financial statement, compliance with acts and legislative requirement on municipal financial statement preparation and also compliance with policies and procedures of the municipality.

All the objectives that were outlined in Chapter 1 have been realised. Findings and recommendations were made to improve the quality of financial statements of the Mafikeng Local Municipality and consequently having a more favourable audit opinion of the financial statements of the Mafikeng Local Municipality in future.



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## QUESTIONNAIRE

The researcher is a Masters candidate at North-West University. The purpose of the questionnaire is merely academic to fulfil the requirements for a Master's degree; recommendations will also assist the Municipality in improving its possibility of obtaining an unqualified opinion from the auditor general.

I wish to assure you that all information received will remain confidential and that your participation will remain anonymous. Your contribution to this study is extremely important to ensure the success of the project.

Please do not write your name on this questionnaire.

### SECTION A: **Biographical Data**

Complete the following by indicating with an (X) the statement applicable to you.

#### (1) Age

|                         |  |
|-------------------------|--|
| Between 18 and 30 years |  |
| Between 31 and 40 years |  |
| Between 41 and 50 years |  |
| Between 51 and 60 years |  |

#### (2) Highest qualifications

|                                               |  |
|-----------------------------------------------|--|
| Grade 12                                      |  |
| Grade 12 plus 3 years degree/national diploma |  |
| Honours degree                                |  |
| Master's Degree                               |  |
| Doctorate (PhD)                               |  |

#### (3) Period of service as a Manger or accountant in the Finance department

|                     |  |
|---------------------|--|
| Less than 12 months |  |
| 1 – 2 years         |  |
| 4-5 years           |  |
| 5-10 years          |  |
| More than 10        |  |

**SECTION B: Factors that prevents the municipality from obtaining unqualified audit opinions**

| Cross one of the six categories from <i>Strongly disagree (1)</i> to <i>Strongly agree (5)</i> for each statement as it applies to you: |                                                                                                                                                           |                     |            |              |               |                        |
|-----------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|------------|--------------|---------------|------------------------|
| Statements                                                                                                                              |                                                                                                                                                           | Strongly agree<br>1 | Agree<br>2 | Neutral<br>3 | Disagree<br>4 | Strongly disagree<br>5 |
| 4                                                                                                                                       | The financial statement of the municipality is prepared by the finance department of the municipality. (not by external consultancy)                      |                     |            |              |               |                        |
| 5                                                                                                                                       | Supporting proves of all line items disclosed in the financial statement are filed and provided to the auditors upon request                              |                     |            |              |               |                        |
| 6                                                                                                                                       | The Auditor general always qualifies the municipalities financial statements because of lake of supporting documents                                      |                     |            |              |               |                        |
| 7                                                                                                                                       | The municipality has a fully staffed internal audit function                                                                                              |                     |            |              |               |                        |
| 8                                                                                                                                       | The internal audit function tacks responsibility for the implementation of the approved post audit action plan.                                           |                     |            |              |               |                        |
| 9                                                                                                                                       | Managers in the finance department adhere to recommendations in the post audit action plan                                                                |                     |            |              |               |                        |
| 10                                                                                                                                      | Officials in the finance department carries out their functions free from political influence.                                                            |                     |            |              |               |                        |
| 11                                                                                                                                      | The council overrides administrative decisions taken by management without reasonable justifications                                                      |                     |            |              |               |                        |
| 12                                                                                                                                      | The municipality has a police which prohibits management of the finance department from doing business with the municipality in their personal capacity.  |                     |            |              |               |                        |
| 13                                                                                                                                      | The audit committee charter provides sufficient authority for the audit committee to perform its oversight responsibilities of financial statement review |                     |            |              |               |                        |
| 14                                                                                                                                      | The audit committee reviews the financial                                                                                                                 |                     |            |              |               |                        |

|    |                                                                                                                                                                                                                                                                                                               |  |  |  |  |  |
|----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--|--|--|--|
|    | statement after preparation before it's submitted to the Auditor General for audit                                                                                                                                                                                                                            |  |  |  |  |  |
| 15 | The audit committee discusses the scope of the internal and external audit regularly (This include issues of concern raised during the audit engagement, the financial statements and management's letter on completion of the external audit, as well as reviews of management responses to audit findings). |  |  |  |  |  |
| 16 | The audit committee maintains a productive relationship with management.                                                                                                                                                                                                                                      |  |  |  |  |  |
| 17 | The audit committee has open lines of communication with management.                                                                                                                                                                                                                                          |  |  |  |  |  |

### SECTION C: Ethics and accountability of municipal officials

| Cross one of the six categories from <i>Strongly disagree (1)</i> to <i>Strongly agree (5)</i> for each statement as it applies to you: |                                                                                                                                                                          |                |       |         |          |                   |
|-----------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------|-------|---------|----------|-------------------|
| Statements                                                                                                                              |                                                                                                                                                                          | Strongly agree | Agree | Neutral | Disagree | Strongly disagree |
|                                                                                                                                         |                                                                                                                                                                          | 1              | 2     | 3       | 4        | 5                 |
| 18                                                                                                                                      | The municipality has an ethical code of conduct and the code outlines penalties to unethical behaviors                                                                   |                |       |         |          |                   |
| 19                                                                                                                                      | The municipality has a policy which deals with accountability of its official and it states penalties to unaccountable officials.                                        |                |       |         |          |                   |
| 20                                                                                                                                      | In the past 5 years the municipality has recovered all the fruitless and wasteful expenditures disclosed in their financial statement from the guilty municipal official |                |       |         |          |                   |
| 21                                                                                                                                      | Officials of the municipality carry out the financial statement preparation duties with a recommended level of professionalism.                                          |                |       |         |          |                   |
| 22                                                                                                                                      | The municipality has a fully fleshed internal control department which is in charge of the internal control system                                                       |                |       |         |          |                   |
| 23                                                                                                                                      | The municipality's Policies and procedures are reviewed on an annual basis by the internal control department.                                                           |                |       |         |          |                   |
| 24                                                                                                                                      | The Municipality complies fully with MFMA in the implementation of its internal control functions.                                                                       |                |       |         |          |                   |
|                                                                                                                                         |                                                                                                                                                                          |                |       |         |          |                   |

### SECTION D: Education and Professional Experience of Management in the Financial Department and Audit Committee

| Cross one of the six categories from <i>Strongly disagree (1)</i> to <i>Strongly agree (5)</i> for each statement as it applies to you: |                                                                                                                                                                                                          |                     |            |              |               |                        |
|-----------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|------------|--------------|---------------|------------------------|
| Statements                                                                                                                              |                                                                                                                                                                                                          | Strongly agree<br>1 | Agree<br>2 | Neutral<br>3 | Disagree<br>4 | Strongly disagree<br>5 |
| 25                                                                                                                                      | The finance department comprises of employees with relevant qualifications.                                                                                                                              |                     |            |              |               |                        |
| 26                                                                                                                                      | All managers in the finance department have at least the minimum education level as recommended in the MFMA. (A Bachelor's degree in finance)                                                            |                     |            |              |               |                        |
| 27                                                                                                                                      | Managers in the finance department individually and combined poses relevant experience as mandated by the MFMA to be able to prepare the annual financial statement free of material misstatements.      |                     |            |              |               |                        |
| 28                                                                                                                                      | All employees in the finance department have an understanding of what is required of them in relations with the financial statement preparation in accordance with the Municipal Finance Management act. |                     |            |              |               |                        |
| 29                                                                                                                                      | The internal audit function of the municipality is fully staffed with competent staff and its functions as intend by the MFMA                                                                            |                     |            |              |               |                        |
| 30                                                                                                                                      | The audit committee comprises of members with relevant qualifications and competency as recommended by the MFMA                                                                                          |                     |            |              |               |                        |
| 31                                                                                                                                      | The audit committee members have sufficient experience in financial reporting as recommended by the MFMA                                                                                                 |                     |            |              |               |                        |
| 32                                                                                                                                      | The employees of the internal control department have sufficient experience and are competent in performing their function.                                                                              |                     |            |              |               |                        |

## *Declaration*

*This is to declare that I, Annette L Combrink, accredited language editor and translator of the South African Translators' Institute, have language-edited the mini-dissertation by*

*by*

**Ngomba Mbua**

*with the title*

**Investigating the causes of qualified audit opinions in municipalities: A case study of Mafikeng Local Municipality in the North West Province.**



*Prof Annette L Combrink*

*Accredited translator and language editor*

*South African Translators' Institute*

*Membership No. 1000356*

*Date: 3 May 2016*

**Graduate School of Business and  
Government Leadership (GSB&GL)**  
Private Bag x 2946, Mmabatho  
South Africa, 2735  
Tel: 018-389 2437 Fax: 018-389 2335  
Email: Gradschool@nwu.ac.za

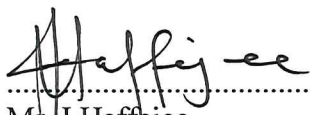
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**Permission to conduct research –Mr ME Ngomba-MBA Student**

This letter serves to introduce Mr ME Ngomba who is presently a registered student for Master in Business Administration (MBA) programme at the Graduate School of Business and Government Leadership of the North West University. He is conducting a research project on **“Investigating the causes of qualified audit opinions in municipalities: A case study of Mafikeng Local Municipality in the North West Province”** towards a partial fulfillment of his MBA programme.

In this regard, your office is requested to afford him full co-operation to conduct this research. In particular, Mr ME Ngomba requires permission to access information, data or even to distribute questionnaires.

Your cooperation will be highly appreciated.

  
.....  
Mr. I Haffjee  
Research Unit

