A case of a South African Municipality's Audit Opinion, Audit Implementation Plan, and Service Delivery

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ABSTRACT

Purpose: This study aimed to establish the perceptions of employees of a municipality in South Africa on how audit opinions are crafted into the audit implementation plan, and how such opinions affect service delivery.

Design/Methodology/Approach: The study adopted a quantitative approach using a questionnaire as a data collection instrument. A case study approach was used, with the questionnaire administered to only one municipality that had had an audit opinion in the past three years.

Findings: The study found that some staff were not aware of the existence of the Audit Implementation Plan in the municipality. However, the respondents acknowledged the implications of audit opinions for the municipality’s budget and service delivery. Furthermore, employees showed positive attitudes towards the effects of audit opinions on the municipality’s operations.

Implications/Originality/Value: The findings have implications for public governance and monitoring of audit implementation plans by municipalities.

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Introduction
Debate continues on the role of auditing within the public governance framework as scholars and practitioners seek lasting solutions to the principal-agent problem. This problem is a trade-off where owners of businesses or providers of capital employ agents to manage the business on their behalf in terms of a contract signed between the two parties (Truong and Trück, 2016). Auditing costs form part of the agency costs incurred by organizations in a bid to mitigate the agency
problem (Falkman and Tagesson, 2008). The need for public sector audits is gaining momentum as municipalities have a constitutional mandate to improve the lives of South African citizens (Scholtz, 2014).

Chapter 9, S188 of the Constitution of South Africa requires all municipal entities and government departments to undergo an annual audit performed by the Auditor General of South Africa (AGSA) (South African Government, 2013). The purpose of an audit is to report on an entity’s financial statements, detailing whether they are free from material misstatements due to fraud or error with the overall aim of ensuring that such statements are credible (Kachelmeier, Schmidt and Valentine, 2017). The AGSA thus reports on the accounts, financial statements and financial management of municipal entities.

According to the International Standards of Auditing (ISA), the external auditor may issue an unmodified or a modified opinion. An unmodified opinion is issued when the auditor has obtained sufficiently appropriate evidence that the financial statements are free from material misstatements and fairly present the affairs of an entity. A modified opinion is issued when this is not the case. An auditor may issue different modified opinions. A qualified audit opinion may be issued after the auditor has obtained sufficiently appropriate evidence that there are material misstatements but that these are not pervasive to the financial statements, or when the auditor fails to obtain sufficiently appropriate audit evidence. An adverse opinion arises when the auditor has obtained sufficient appropriate evidence to conclude that misstatements are material and pervasive to the financial statements. Finally, a disclaimer of audit opinion is issued when the auditor is unable to establish appropriate audit evidence to support the financial information contained in the financial statements; undetected misstatements could thus be both material and pervasive to the financial statements (IAASB, 2016).

The findings from the audit are reported to the auditee, resulting in the preparation of the Audit Implementation Plan (AIP). This plan communicates how the organization will address the audit findings. The study sought to establish the perceptions of employees of a municipality on how audit findings and the implementation plan are communicated to them by management. It also aimed to determine employees’ perceptions on how audit findings influence municipalities’ financing strategies and ultimately service delivery.

The following section reviews existing literature on audit opinions, the AIP and service delivery.

**Literature Review**

Various scholars have investigated how audit opinions affect performance; however, the implementation of audit plans in the public sector remains under-researched. According to Zulu (2006), there are no consequences for a lack of systems and controls within municipalities as oversight is inadequate and problematic due to lack of policies and procedures. Cenciarelli, Greco and Allegrini (2018) state that, audit reports are an essential tool in predicting bankruptcy and should be considered by all the stakeholders in an entity. Andersson and Nilsson (2011) note that, provided the government defines relevant performance measures, audits include a review of a municipality’s performance. However, most audit reports focus on financial results. The consequences of audit opinions include higher costs of borrowing and debt covenants as lenders consider such opinions as a reflection of increased risk (Chen, He, Ma and Stice, 2016; Menon and Williams, 2016; Baylis, Burnap, Clatworthy, Gad and Pong, 2017).

Consequently, audit qualification results in information asymmetry and uncertainty in the entity’s financial statements (Abad, Sánchez-Ballesta and Yagüe, 2017). According to Abad et al., information asymmetry further results in higher adverse selection risk – a situation where sellers have more information than buyers. Therefore, the audit opinion results in incremental
informational value (incremental information content) for other stakeholders in the entity (Geiger and Kumas, 2018; Tahinakis and Samarinas, 2016). In addition, audit opinions and credit ratings have been found to be positively related, suggesting that the outcome of an audit is a predictor of the entity’s credit score (Cha, Hwang and Yeo, 2016). Pressure from financial analysts who monitor the entity’s performance enhances audit quality. This approach is, however, not applicable to the public sector (Chen, Ding, Hou and Johan, 2016). Audit report modifications (opinions) have a positive relationship with the entity’s liquidity, and loss in the current and previous year (Moalla, 2017). This has implications for how auditors view the operations of an organization in preparing the audit report.

It is the auditor’s responsibility to evaluate the entity and ascertain without doubt that it is able to continue to operate as a going concern (AICPA, 2017). Audits generally lead to feedback for improvement and it is thus important to consider how such feedback is provided (Ivers, Jamtvedt, Flottorp, Young, Odgaard-Jensen, French, and Oxman, 2012). Two types of audit are used for municipalities or government entities, namely, a performance audit and an audit of the financial statements. A performance audit measures predetermined objectives against the execution of such objectives. “Performance in the public sector is guided and assessed by multiple, equally important standards of effectiveness, efficiency and equity” (Van der Waldt, 2004: p. 68). A common focus of public sector performance is its concern with office bearers’ use of taxpayers’ funds allocated to a municipality and the municipality’s mandate to ensure that the policies adopted fulfill public objectives and needs. Performance management is primarily a tool to improve service delivery. It matters in municipalities because it addresses maladministration, waste, inefficiencies and a lack of productivity and enables municipalities to deliver on their promises to citizens (Fourie et al., 2011). The auditing function and the reports thereof play an important role in the agency and management control of an entity (Cordery and Hay, 2016).

An AIP is a document developed by a municipality in response to an audit opinion for a specific financial period. The AIP is a working document or tool that municipalities formulate in response to the findings of the external auditors (Auditor General South Africa). This report is an internal document that the municipality presents to the audit committee to state how the audit findings will be addressed. The audit findings are identified and monitored through a detailed review of the external auditor’s report for a specific financial year. This document can also be defined as an action plan to address the audit findings. Implementation plans are therefore required to action the recommendations arising from the audit (Wang, Norris, Bero, 2015). Kluger and Denisi (1996) state that feedback may have negative effects on performance if the auditee does not fully understand the audit findings. Moreover, Ivers et al. (2014) note that the likelihood of the items in the AIP being addressed depends on the extent to which recipients of the findings feel that they are able to manage them and that it is not a tick-box exercise. Badara and Saidin (2014) and De Lange et al. (2015) note that most municipalities struggle to apply the King IV recommendations with regard to governance, including monitoring and control.

While it is recognized that the public sector plays an integral role in economic growth, Fourie and Poggenpoel (2016) argue that public sector management has been ineffective, despite the adoption of sound policies. They argue that this is mainly due to the failure to implement policies. Moreover, public sector management finds it difficult to implement methods that are driven or derived from the private sector, as these sectors have different objectives. South Africa’s Constitution states that local government’s primary task is to deliver services to communities. Such delivery should be in line with the National Development Plan (NDP). Hay and Cordery (2016) found that auditing does not have a direct impact on the bottom line due to the fact that only management that is directly involved in the audit gains useful information from this process.

The following section discusses the methodology employed to conduct this study.
Methodology
The study adopted a quantitative approach, with a questionnaire as the research instrument. The study population was the 54 municipalities in existence as at 1 April 2017 in KwaZulu-Natal Province, South Africa. Cluster sampling was used initially to categorize the municipalities in terms of audit opinions for the financial year 2013/2014. Thereafter, convenience sampling was applied to select Mpofana Municipality as a case study. A questionnaire was designed to collect data. Seventy-nine employees in the administration and management of the municipality were selected to participate in the study. The questionnaire consisted of two sections, with one dealing with the participants’ biographical information and the other addressing AIPs and service delivery. The second section contained closed-ended questions coded using five Likert scales, ranging from, “strongly disagree”, to “disagree”, “neutral”, “agree” and “strongly agree”. A pilot study was conducted to test reliability. The data was coded and captured onto SPSS Version 25 for analysis.

Findings
Seventy-nine questionnaires were distributed, of which 52 were returned, representing a 66 percent response rate. The majority of the respondents (71 percent) possessed at least a diploma, while 12 percent and 16 percent had matric and a certificate, respectively. Seventy-nine percent of the respondents were at administrator level and 12 percent were at senior management level, including directors. Thirty-nine percent of the respondents had been employed by the municipality for at least five years while 28 percent indicated that they had occupied their posts for less than a year. The following section presents the results from 17 questions, with nine relating to the effects of an AIP on the operations of Mpofana Local Municipality with a Cronbach’s Alpha of 0.870 and eight on the impact of audit opinions on service delivery in this municipality with a Cronbach’s Alpha of 0.899.

Employee Participation in the AIP
The respondents were asked to respond to questions on a Likert scale ranging from strongly disagree to strongly agree. The summary results with descriptive statistics are provided in the table below.

**Table 1: Employee Participation in the AIP**

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<tr>
<td>5.</td>
<td>I am aware of the Audit Implementation Plan (AIP) prepared by Mpofana Local Municipality.</td>
<td>7.8</td>
<td>9.8</td>
<td>17.6</td>
<td>35.3</td>
<td>29.4</td>
<td>3.69</td>
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<td>6.</td>
<td>My team is involved in the formulation of the AIP for Mpofana Local Municipality.</td>
<td>14.0</td>
<td>18.0</td>
<td>22.0</td>
<td>24.0</td>
<td>22.0</td>
<td>3.22</td>
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<tr>
<td>7.</td>
<td>The external auditor’s report/findings inform the issues that are included in the AIP.</td>
<td>5.9</td>
<td>11.8</td>
<td>33.3</td>
<td>29.4</td>
<td>19.6</td>
<td>3.45</td>
</tr>
<tr>
<td>8.</td>
<td>The AIP is presented to the audit committee on a regular basis.</td>
<td>7.8</td>
<td>19.6</td>
<td>29.4</td>
<td>35.3</td>
<td>7.8</td>
<td>3.16</td>
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<td>9.</td>
<td>Between financial years, there is comparability and follow up of matters included in the prior year’s AIP. E.g., matters in the AIP 2014 are analyzed for completion in the 2015 AIP.</td>
<td>8.0</td>
<td>12.0</td>
<td>24.0</td>
<td>40.0</td>
<td>16.0</td>
<td>3.44</td>
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*Source: Researcher’s computation using SPSS version 25.*

The majority of the respondents (64.7 percent) agreed that they were aware of the AIP prepared by
Mpofana Local Municipality. This assertion is supported by a strong mean of 3.69. In the same vein, 46 percent of the respondents indicated that their teams are involved in the formulation of the municipality’s AIP. Thirty-two percent indicated that they were not involved in the formulation of the AIP, while 22 percent remained neutral. The majority of the respondents agreed that the external auditor’s report/findings inform the issues that are included in the AIP and follow up issues are also included in the subsequent year’s AIP, but a smaller proportion noted that the AIP is presented to the audit committee on a regular basis. This is indicated by a lower mean of 3.16 and standard deviation of 1.084 for question 8. The high number of respondents indicating that they are not involved in AIP is in line with Badara and Saidin (2014) and De Lange et al.’s (2015) finding that most municipalities struggle to uphold good governance.

**Employee Perceptions on the impact of the AIP process on the Municipality’s operations**

The table below summarizes the findings on employee perceptions of the impact of the AIP process on the municipality’s operations.

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagreed</th>
<th>Disagree</th>
<th>Uncertain</th>
<th>Agree</th>
<th>Strongly agree</th>
<th>Mean</th>
<th>Standard Deviation</th>
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<tr>
<td>10. I feel that the AIP process leads to reduced effectiveness of the municipality’s operations.</td>
<td>8.0</td>
<td>32.0</td>
<td>26.0</td>
<td>30.0</td>
<td>4.0</td>
<td>2.90</td>
<td>1.055</td>
</tr>
<tr>
<td>11. I feel that the AIP process results in the effective management of the municipality (improved controls and implementation of standards and procedures).</td>
<td>10.0</td>
<td>16.0</td>
<td>26.0</td>
<td>38.0</td>
<td>10.0</td>
<td>3.22</td>
<td>1.148</td>
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<tr>
<td>12. The municipality has made changes to the internal controls as a result of the implementation of the AIP.</td>
<td>10.0</td>
<td>8.0</td>
<td>34.0</td>
<td>36.0</td>
<td>12.0</td>
<td>3.32</td>
<td>1.115</td>
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<tr>
<td>13. As an employee of the municipality, I feel the AIP process negatively affects my morale at work.</td>
<td>18.0</td>
<td>22.0</td>
<td>26.0</td>
<td>18.0</td>
<td>16.0</td>
<td>2.92</td>
<td>1.338</td>
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Source: Researcher’s computation using SPSS version 25.

Thirty-four percent of the respondents agreed that the AIP process resulted in reduced effectiveness of the municipality’s operations, while 40 percent disagreed with the statement and 26 percent remained neutral. The mean of 2.90 suggests that employees of Mpofana Municipality do not feel that the AIP process affects its operations. Furthermore, 48 percent of the respondents indicated that the AIP process results in effective management of the municipality. However, 26 percent remained neutral in relation to this issue. The majority of the respondents agreed that the municipality has made changes to internal controls as a result of the implementation of the AIP (question 12). Many disagreed with the statement that the AIP negatively affects their morale at work. This is supported by a low mean of 2.92, although the standard deviation is high at 1.338. While the AIP is a valuable management tool, municipalities lack proper governance practices in terms of monitoring and control (De Lange et al., 2015). The table below shows the perceptions of the respondents on how audit opinions affect municipal finances.
Table 3: Audit Opinions and municipal finances

<table>
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<tr>
<td>14. During the budgeting process, the municipality allocates resources towards addressing audit findings that led to a negative audit opinion.</td>
<td>2.0</td>
<td>8.2</td>
<td>28.6</td>
<td>46.9</td>
<td>14.3</td>
<td>3.63</td>
<td>0.906</td>
</tr>
<tr>
<td>15. The audit opinion from the AGSA has an influence on the grants allocated to the municipality.</td>
<td>8.2</td>
<td>8.2</td>
<td>28.6</td>
<td>40.8</td>
<td>14.3</td>
<td>3.45</td>
<td>1.100</td>
</tr>
<tr>
<td>16. I am aware that, as per section 139(1) of the Constitution, municipalities may be placed under administration by the Department of Co-operative Governance and Traditional Affairs (COGTA) on the basis of the audit opinion and findings.</td>
<td>6.0</td>
<td>10.0</td>
<td>10.0</td>
<td>46.0</td>
<td>28.0</td>
<td>3.80</td>
<td>1.143</td>
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</table>

Source: Researcher’s computation using SPSS version 25.

The table shows that 61.2 percent of the respondents agreed that during the budgeting process, the municipality allocates resources to address audit findings that led to a negative audit opinion, with a mean of 3.63. This shows that employees believe that the budget process is influenced by the audit outcome. The results also show that the AGSA’s audit opinion influences the grants allocated to the municipality, with 55 percent of the respondents agreeing with this statement and a mean of 3.45. In the same vein, the majority of the respondents (74 percent) indicated that they understand the provisions of the Constitution on placing municipalities under administration. This suggests that the respondents are aware of the policies and regulations governing municipalities and are also aware of the action that COGTA may take with regard to a municipality being placed under administration (Tshishonga, 2016). The consequences of audit opinions as a reflection of increased risk are understood by the employees in line with the articulations by Chen, He, Ma and Stice (2016), Menon and Williams (2016) and Baylis, Burnap, Clatworthy, Gad and Pong (2017). The following table shows the responses relating to the question posed on governance.

Table 4: Audit Opinions and governance

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<tbody>
<tr>
<td>17. The external audit process has a negative impact on the municipality’s ability to deliver services to its stakeholders.</td>
<td>8.0</td>
<td>10.0</td>
<td>24.0</td>
<td>38.0</td>
<td>20.0</td>
<td>3.52</td>
<td>1.165</td>
</tr>
</tbody>
</table>

Source: Researcher’s computation using SPSS version 25.

This question sought to establish perceptions on the impact of external audit processes on the municipality’s ability to deliver services to its stakeholders. The majority of the respondents (58 percent) indicated that the process has a negative impact on such ability. These results are contrary to those of Hay and Cordery (2016) who found that auditing does not have a direct impact on the bottom line due to the fact that management that is directly involved in the audit gains useful...
information from this process.

Conclusion
The study’s results indicate that audit findings are communicated to relevant parties within the municipality, although some respondents did not take part in the formulation of the AIP. The study respondents indicated that the AIP process does not have a negative impact on the municipality’s operations. Identifying items to include in the AIP has resulted in a review of internal controls. However, the respondents felt that monitoring, in the form of regular reporting on progress on the AIP items and follow-up, including implementation and feedback to the audit committee is lacking; this indicates a lack of or poor governance practices. A municipality or government organization’s main objectives differ from those of a typical for-profit company. A municipality’s main purpose is to serve the communities that reside in its area of jurisdiction through service delivery. The majority of the respondents agreed that the audit opinion influences how the budget process is undertaken as well as the grants issued to the municipality in order to serve the community. They were also aware of the duties of the government department in relation to administration of municipalities. The majority of the respondents felt that the results of an audit do not assist in fulfilling the municipality’s main objective, i.e., service delivery. This highlights that, regardless of the audit opinion issued to a municipality by its external auditors (AGSA), its operations, specifically delivering services to its customers, will remain business as usual. It suggests a disconnect in the process as auditors perform an audit to report on whether the financial statements fairly present the operations, financial position and financial performance of a municipality.

This study was based on a single municipality in South Africa. Further research should be done on a larger sample of municipalities to gain broader insights on employees’ perceptions of audit opinions in South Africa.

Declaration of Interest
The authors report no conflicts of interest regarding this piece of research paper. Only the authors are responsible for the content and writing of this paper. Therefore, we have no conflicts of interests to disclose.

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Validation: Bomi Cyril Nomlala and Mabutho Sibanda
Visualisation: Bomi Cyril Nomlala
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