

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MAKANA MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa and section 4 of the Public Audit Act of South Africa and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Cash and Cash Equivalents

4. The entity could not provide sufficient appropriate audit evidence to support the reconciling items totalling R9 204 402, between cash and cash equivalents stated in the statement of financial position at R3 903 082 (overdraft) and the cash at banks amount stated on the year-end bank reconciliation at R2 769 182. This is a result of the bank reconciliation not being performed properly and regularly over the years. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligation, completeness, and valuation and allocation of cash and cash equivalents.
5. Prior year Cash and Cash Equivalents was misstated by R19 515 593. These matters were not resolved by the municipality and my opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current and corresponding period figures.

Property, Plant and Equipment

6. I was unable to trace movable tangible capital assets to the value of R9 131 467 to the Asset Register to ensure completeness of assets. Furthermore VAT was not accounted for on additions to Property, Plant and Equipment. This is a result of inadequate asset counts and reconciliation between the asset register and the general ledger and inadequate marking of assets for asset register purposes. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of Property, Plant and Equipment disclosed in note 13 of the financial statements.

Accounts Receivable

7. The entity disclosed an amount of R165 513 075 as trade and other receivables in note 19 and 20 to the financial statements. I could not confirm existence of debtors amounting to R16 368 133 of this balance. Furthermore no supporting documentation was provided to verify the existence of the unpaid conditional grants amounting to R642 804. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence of Accounts Receivable to the value of R17 010 937.
8. Debtors with credit balances amounting to R6 332 826 are incorrectly classified under Accounts Receivable. Furthermore long outstanding debtors amounting to R1 274 847 that are not traceable or recoverable were not written off by the municipality. This is a result of inadequate debtor management system at the municipality. As a result accounts receivable are understated by R5 057 979, accounts payable are understated by R6 332 826 and expenditure is overstated by R1 274 847.
9. The prior year Accounts Receivable was misstated by R4 683 199. The matters reported previously in my prior year report were not resolved by the municipality and my opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current and corresponding period figures.

Accounts Payable

10. There is no supporting documentation or council approval of the write-off of trade payables amounting to R1 377 858. Furthermore no supporting documentation or valid explanations from management relating to other payables amounting to R673 142 and Sundry Debtors: Medical Aid account balance at year end amounting to R617 854. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, and valuation and allocation of accounts payable amounting to R2 668 854.
11. Furthermore invoices relating to the current year were not accrued as a result of not performing creditor reconciliation and Prepaid Electricity suspense that relates to prepaid electricity that has been sold before year end but not yet received is incorrectly classified. As a result Accounts Payable is understated by R726 890 and expenditure and Accounts Receivable are understated by R153 972 and R572 918 respectively.
12. The prior year Accounts Payable was misstated by R4 230 625 as reported in my previous report. This matter was not resolved by the municipality and my opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current and corresponding period figures.

Leave Accrual

13. The municipality's leave accrual is calculated based on leave days that are in the system as at year end. However the daily rate used to calculate the accrual was not accurate and as a result employee costs and the leave accrual are understated by R2 327 985.
14. Furthermore there was no adequate system of control over leave management on which I could rely for the purpose of my audit as employees' leave was not captured timeously and attendance registers and leave forms were not adequately maintained. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, and valuation and allocation of leave accrual amounting to R4 094 673 as disclosed in note 7 of the Annual Financial Statements.

Revenue

15. Supporting documentation could not be obtained for the other revenue recorded in note 26 to the financial statements amounting to R4 376 080. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of revenue of R4 376 080.
16. Furthermore the municipality did not obtain approval for exceeding electricity tariffs set by National Electricity Regulator and there is no proper revenue management system and lack of management review and monitoring resulting in revenue and receivables being overstated by R2 427 611.

Accumulated Surplus

17. The prior year expenditure was overstated by R5 380 485 and I was unable to confirm revenue amounting to R84 124 681 mainly as a result of material scope limitations which resulted in a modification of my opinion in the previous year. These matters were not resolved by the municipality and my opinion on the current period financial statements is also modified because of the possible effect of these matters on the comparability of the current and corresponding period figures.

Irregular Expenditure

18. The Municipal Supply Chain Regulations require the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Payments amounting to R19 850 869 were made in contravention of the supply chain management requirements. The amount was not included in irregular expenditure, disclosed in note 41.3 to the financial statements, resulting in irregular expenditure being understated by R19 850 869.

Unauthorised Expenditure

19. The budgets of a number of votes were exceeded by R24 560 877. As a result unauthorised expenditure disclosed in note 41.1 is understated by R28 797 996 for operating expenditure and overstated by R4 237 119 for capital expenditure. This unauthorised expenditure is as a result of overspending on the individual votes. However the overall budget was not exceeded.

Disclaimer of opinion

20. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

21. As disclosed in note 34.9 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during 2010 in the financial statements of the Makana Municipality at, and for the year ended, 30 June 2009.

Fruitless and wasteful expenditure

22. As disclosed in note 41.1 to the financial statements, fruitless and wasteful expenditure to the amount of R2.7 million was incurred as a result of electricity and water losses above threshold.

Additional matter

I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

23. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations: Municipal Finance Management Act, No 56 of 2003 (MFMA), Municipal Systems Act, No 32 of 2000 (MSA), and financial management (internal control).

Predetermined objectives

Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirements

24. The municipality has not afforded the local community at least 21 days to comment on the final draft of its integrated development plan before it is submitted to the council for adoption as per regulation 15 of Municipal Systems Act (MSA). The local community has been afforded only five days to review and comment on the final draft of the IDP.

25. Contrary to the requirements of regulation 41 of MSA, the municipality has not taken steps to improve performance with regards to those development priorities and objectives where targets are not met.
26. Contrary to the requirements of regulation 9 of MSA, the municipality has not set measurable performance targets with regards to each of its priorities and objectives. The municipality's targets are not well defined to be measurable as the outputs are not clearly defined.
27. Contrary to the requirements of MFMA section 72, the accounting officer of a municipality did not by 25th January of each year assess the performance of the municipality during the first half of the financial year, and submit a report on such assessment to -
- i) the mayor of the municipality;
 - ii) the National Treasury; and
 - iii) the relevant provincial treasury

Usefulness of information

28. The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

29. The key performance indicators do not define or quantify expected level of output, which therefore means that the inputs are not measurable. The examples are:

- For Community and Social Services there were 42 out of 52 indicators that were considered not to be measurable which amounts to 81% of the reported indicators.
- For Basic Services Delivery and Infrastructure Development there were 12 out of 18 indicators that were considered not to be measurable which amounts to 67% of the indicators.

Reliability of information

30. The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit findings relate to the above criteria:

31. The reported indicators were not valid, accurate and complete on the basis of the source information or evidence provided to support the reported indicators relating to Basic Service Delivery and Infrastructure Development. The details are:
 - For Construction of bulk water supply (Reported 100%; Audited: 44%)
 - Eluxolweni (176) construction (Reported 176; Audited: 155)
 - Fingo village (577) construction/fingo (Reported 577; Audited: 273)
 - Upgrading of sugar loaf substation (Reported 100%; Audited: 80%)
32. Sufficient appropriate audit evidence in relation to the following indicators could not be obtained relating to Basic Service Delivery and Infrastructure Development:
 - Seven fountain /Service pending water supply
 - Fort Brown (250) Service/Approved
 - Upgrading Howison's Poort
 - Upgrading of street lights
33. Sufficient appropriate audit evidence in relation to 15 out of 52 (29%) reported indicators for Community Service Delivery could not be obtained.

Compliance with laws and regulations

Municipal Finance Management Act of South Africa, No 56 of 2003 (MFMA)

The financial statements were not prepared in accordance with applicable legislation

34. The financial statements submitted for audit did not comply with section 122(1) of the Municipal Finance Management Act of South Africa, No 56 of 2003 (MFMA). Material misstatements were identified during the audit, certain of these were corrected by management and those that were not are included in the basis for disclaimer opinion paragraphs.

The accounting officer did not adhere to his/her statutory responsibilities

35. Contrary to the requirements of section 167(2) of MFMA, the accounting officer of Makana Municipality did not disclose or recover the irregular expenditure amounting to R58 637 which resulted from the discretionary use of an official vehicle for private purposes which was granted to the Mayor.
36. Contrary to the requirements of section 64(4) of MFMA, the accounting officer did not take all reasonable steps to ensure that all funds collected on behalf of another organ of state are transferred to Department of Transport at least on a weekly basis.
37. Contrary to the requirements of section 66 of MFMA, the accounting officer of a municipality did not report to the council on all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits, in a manner which disclosed such expenditure by type of expenditure, as follows:
 - salaries and wages;

- contributions for pensions and medical aid;
- travel, motor car, accommodation, subsistence and other allowances;
- housing benefits and allowances;
- overtime payments;
- loans and advances; and
- any other type of benefit or allowance related to staff

38. Contrary to the requirements of section 62 (d) of MFMA, the accounting officer did not ensure that the municipality did not take all reasonable steps to ensure that unauthorized, irregular or fruitless and wasteful expenditure and other losses are prevented.

Expenditure was not paid within the parameters set by the applicable legislation

39. Contrary to the requirements of section 65(2)(e) of MFMA, expenditure was not paid within the required 30 days from the receipt of an invoice.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

40. Contrary to the requirements of section 27(2)(g) of SCM Regulations, the specifications for bids were not approved by the accounting officer prior to publication of the invitation of bids
41. Contrary to the requirements of section 17(c) of SCM Regulations, if three quotations were not obtained, the reasons were always reported quarterly to the accounting officer or another officer designated by the accounting officer.
42. Contrary to the requirements of section 36(2) of SCM Regulations, deviations from the procurement processes established by the SCM policy or ratifications of minor breaches were not always reported to the next meeting of the council.
43. Contrary to the requirements of section 13(c) and section 21(c) of SCM Regulations, the municipality did not in all cases determine whether or not the bidder has any conflict of interests in the transaction for which the bid is submitted.
44. Contrary to the requirements of section 18(a) of SCM Regulations, not all the bids were advertised for at least seven days on the website and official notice board of the municipality.
45. Contrary to the requirements of section 36(2) of SCM Regulations, not all the deviations from the procurement processes established by the SCM policy were disclosed in a note to the financial statements.

Expenditure was incurred otherwise than in accordance with sections 15 and 11(3) of the MFMA resulting in unauthorised expenditure

46. Expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality.

Compliance with "Other enabling legislation

Municipal Systems Act of South Africa, No 32 of 2000 (MSA)

47. Contrary to the requirements of section 96 and 97 of the Municipal Systems Act of South Africa, the municipality did not have or did not maintain effective, efficient and transparent systems of internal control as required by legislation for:
- assets and liabilities
 - debtors and revenue
 - creditors and payments
 - guarding against fraud, theft and financial mismanagement

Water Services Act 108 of 1997

48. Contrary to the requirements of section 18 of the Water Services Act 108 of 1997, the municipality did not report on the implementation plan of its development plan for the year within 4 months after the end of each financial year; to the Minister of Water Affairs and Forestry, the Minister for Provincial Affairs and Constitutional Development, the province, and every organisation representing municipalities having jurisdiction in the area of the water services authority.

INTERNAL CONTROL

49. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the Municipal Finance Management Act, No 56 of 2003 (MFMA), Municipal Regulations (Regulations - GNR/GN), Division of Revenue Act, No 12 of 2009 (DoRA, and Municipal Systems Act, No 32 of 2000 (MSA), but not for the purpose of expressing an opinion on the effectiveness of internal control.
50. The matters reported below are limited to the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• Leadership

Quality is not understood by all to be a prerequisite because there are a number of significant findings on internal controls, financial management and reporting on predetermined objectives. Furthermore the misstatements of prior year have not been addressed in the current year.

The accounting officer did not exercise adequate oversight responsibility over reporting and compliance with laws and regulations and internal control because there are a number of findings relating to internal control environment and compliance with laws and regulations. As a result unauthorised, irregular and fruitless and wasteful expenditure was incurred as disclosed in the financial statements and irregular expenditure as reported.

There is not enough action taken to mitigate risk to financial reporting and compliance with legislation as systems are not documented in the policy and procedure manual. In addition there is no compliance checklist or compliance officer to ensure that there is compliance with all laws and regulations.

The accounting officer does not evaluate whether management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities so as to ensure accountability.

- **Financial and performance management**

Quality and reliable financial statements have not been prepared because the entity did not have staff knowledgeable to GRAP reporting framework and performance management requirements. This also refers to knowledge of the controls and related processes. The qualifications reported above are the result.

Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting. As a result the financial statements were subject to material amendments resulting from the audit.

There are no regular stock counts, regular reconciliations between the asset register and the general ledger, no monthly bank reconciliations and no monthly reconciliations between the general ledger and the billing reports.

The record keeping is inadequate as requested information was not always available and supplied without any significant delays.

The IT audit revealed that the general information technology controls are not designed to maintain the integrity of the information systems and the security of the data. Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed as there are material scope limitations relating to revenue as a result of system not coded properly to process to the right accounts.

- **Governance**

Risk identification relating to compliance with laws and regulations and reporting on predetermined objectives is not adequate as a result there are no proper processes in place to ensure that there is compliance with all applicable laws and regulations and reporting on predetermined objectives.

Auditor-General

East London

30 November 2010



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SOUTH AFRICA

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