REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON BUFFALO CITY METROPOLITAN MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying consolidated and separate financial statements of the Buffalo City Metropolitan Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2011, and the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and consolidated and separate cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 123 to 213.

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DORA), and for such internal control as management determines necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these consolidated and separate financial statements based on my audit.

4. I conducted my audit in accordance with International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the consolidated and separate financial statements are free from material misstatement.

5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse opinion

Property, plant and equipment

7. The value of infrastructure assets (consisting of electricity, roads, water and wastewater networks) as disclosed in note 14 to the financial statements is R5,5 billion. The municipality did not determine the correct depreciated replacement costs for certain of these infrastructure assets in accordance with Directive 7: *The Application of Deemed Cost on the Adoption of Standards of GRAP*. It also incorrectly classified certain infrastructure assets as repairs and maintenance expenditure and work in progress as infrastructure assets. Consequently, there is an understatement of infrastructure assets, work in progress and accumulated surplus of R297,3 million, R112,4 million and R337,3 million respectively and an overstatement of repairs and maintenance of R72,3 million.

8. In addition to the above there was a limitation imposed on the scope of my work regarding infrastructure assets. Sufficient appropriate audit evidence could not be provided to substantiate the fixed rate per square meter that was used to value bridges included in note 14 at R513,5 million or to verify the existence of infrastructure assets of R160,3 million. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the existence and valuation of infrastructure assets included in property, plant and equipment disclosed in the statement of financial position and in note 14 to the financial statements.

9. Buildings to the value of R742,2 million for which the municipality earns rental income and which meet the definition of investment properties as defined by GRAP 16: *Investment property* are incorrectly classified as property, plant and equipment. As a result, buildings in note 14 are overstated and investment property is understated by R742,2 million.

10. Land valued at R401,9 million, which is registered in the name of the municipality and does meet the recognition criteria of GRAP 17: *Property, plant and equipment*, was incorrectly omitted from property, plant and equipment as disclosed in note 14 to the financial statements. The municipality also incorrectly included other land and buildings of R131,4 million that is not registered in its name. Discrepancies between the fixed asset register, valuation roll and the Registrar of Deeds records resulted in an amount of R107,6 million being excluded from the land disclosure in note 14 to the financial statements. Overall, this resulted in an understatement of both land, as disclosed in note 14, and the revaluation reserve, as disclosed in note 23, by R 424,4million and R378,1 million respectively and an overstatement of R46,4 million of buildings as disclosed in note 14.

11. An amount of R207,4 million is disclosed as movable assets in note 14 to the financial statements (this consists of plant and equipment, furniture and fittings, motor vehicles and office equipment). The disclosure is understated by R34,5 million as the asset register which supports the financial statements is not complete and movable assets that should therefore have been recognised in terms of GRAP 17 have not been included in note 14 to the financial statements.

Investment property

12. The municipality used the fair value model as described in GRAP 16 to value investment properties. However, the size and value per square metre of a number of properties was incorrectly captured in their financial records resulting in an understatement of R391,1 million. In addition the land register supporting the financial statements disclosure incorrectly included investment properties of R13,2 million that are not owned by the municipality, and excluded properties of R67,5 million that are owned by the municipality. Consequently investment property, as disclosed in note 12, and accumulated surplus as per the statement of changes in net assets are understated by R445,4 million.

Irregular expenditure

13. Irregular expenditure of R227,2 million is disclosed in note 53 to the financial statements. This disclosure is understated by R122,1 million as a result of expenditure incurred in contravention of the supply chain management requirements, but not disclosed by the municipality as required by section 125(2) of the MFMA.

14. In addition the municipality could not provide sufficient appropriate audit evidence to confirm that the supply chain requirements were adhered to for goods and services of R315,7 million (2010: R400 million) procured during the financial year, or to support amounts totalling R204,3 million disclosed in note 53. The records of the municipality did not permit the application of alternative procedures. Consequently, I was unable to obtain sufficient appropriate evidence to satisfy myself as to the completeness, occurrence and accuracy of irregular expenditure as disclosed in note 53.

Commitments

15. The municipality does not have an adequate contract management system in place for the identification, recognition and measurement of capital commitments as required by GRAP 17. The municipality did a manual calculation of commitments outstanding at year-end. Errors in the calculation resulted in an overstatement of commitments, as disclosed in note 44 to the financial statements, by R215 million.

Inventory

16. There were numerous discrepancies in the records used to support the disclosure of consumable stores inventory (consisting of maintenance parts, fuel and general stores inventory as per note 5 to the financial statements). Consequently inventory disclosed in note 5 and included in the statement of financial position, is understated by R35,5 million and expenditure disclosed in the statement of financial performance is overstated by the same amount.

17. The value of housing inventory, as disclosed in note 5, does not include numerous properties owned by the municipality. In addition, the disclosed value did not include all costs required by GRAP 12: *Inventories*. As a result, housing inventory, as disclosed in note 5 and included in inventory in the statement of financial position, is understated by R50,9 million and accumulated surplus, as disclosed in the statement of changes in net assets, is overstated by R50,9 million.

18. Unsold water inventory of R2,2 million is disclosed in note 5 to the financial statements. The municipality did not account for the unsold water contained in certain reservoirs that it owns as it did not determine their holding capacity. The municipality's records did not permit me to perform alternate procedures. As a result, I was not able to obtain sufficient

appropriate evidence to confirm the completeness and valuation of water inventory included in note 5 and in the statement of financial position.

Property rates revenue

19. As a result of under-billing and the delayed implementation of the supplementary valuation roll, which is used as the basis for calculating property rates, the related rates revenue as disclosed in note 27 and in the statement of financial performance, is understated by R28,7 million. Receivables from non-exchange transactions as disclosed in the statement of financial position are understated by the same amount.

Service charges revenue

20. Due to inaccurate record keeping the municipality did not bill certain electricity, water and sewerage services that were rendered during the financial year and as a result service charges revenue, as disclosed in note 28 to the financial statements and in the statement of financial performance, is understated by R19,3 million. Receivables from exchange transactions, as disclosed in the statement of financial position, are understated by the same amount.

Aggregation/accumulation of immaterial uncorrected misstatements

21. The following immaterial uncorrected misstatements were identified which are collectively material in respect of the statement of financial position:
    - Capital input VAT was not accounted for and the prior year error was not corrected, resulting in the VAT receivable as disclosed in note 8 to the financial statements being understated by R4,1 million.
    - Intangible assets, as disclosed in note 11, are understated by R3,8 million due to the municipality not including all software purchased.
    - Bank accounts in the name of the municipality were not accounted for. As a result cash and bank, as disclosed in note 4, is understated by R2,1 million.
    - Payables, as disclosed in note 20 to the financial statements, is overstated by R3,1 million as a result of computation errors.
    - Fire levy charges of R3,5 million were not billed. This resulted in the understatement of revenue and receivables from non-exchange transactions, as disclosed in note 7.
    - Accumulated surplus is understated by R5,4 million, as a result of the errors listed above.

22. Further to the above misstatements, supplier statements were not provided in support of trade payables and accruals at year-end. I was therefore unable to obtain sufficient appropriate audit evidence in respect of payables of R8,2 million included in note 20 to the financial statements. I was unable to confirm or verify the balance by alternative means.

Other comparative figures

23. The municipality could not provide sufficient appropriate audit evidence regarding the following comparative amounts:
    - expenditure, as included in the statement of financial performance, of R1,4 billion.
    - employee cost (overtime), as disclosed in note 32, of R50,8 million.

24. I was unable to confirm or verify these amounts by alternative means and, as a result, could not confirm the occurrence and accuracy of the above-mentioned amounts included in the comparative figures.

Adverse opinion

25. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the consolidated and separate financial position of the Buffalo City Metropolitan Municipality and its subsidiaries as at 30 June 2011 and their consolidated and separate financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DORA.

Emphasis of matters

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

Restatement of corresponding figures

26. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 30 June 2011 in the financial statements of the Buffalo City Metropolitan Municipality.

Unauthorised expenditure

27. Disclosed in note 51 is unauthorised expenditure of R8,1 million incurred as a result of directorates exceeding their approved budgets.

Material losses/impairments

28. Disclosed in note 7 to the financial statements are impairments of R178,9 million that were recognised in respect of trade and other receivables from non-exchange transactions. Disclosed in note 6 to the financial statements are impairments of R353 million that were recognised in respect of trade and other receivables from exchange transactions.

29. Disclosed in note 55 to the financial statements are water and electricity distribution and technical losses of R168,5 million, which have not been recovered from consumer debtors.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

30. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages 218 to 226 and material non-compliance with laws and regulations applicable to the municipality and its subsidiaries.

Predetermined objectives

Presentation of information

31. The following criterion is relevant to the findings below:
    - Performance against predetermined objectives is reported in accordance with section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

Audit findings:

Reasons for major variances between planned and actual reported targets were not explained in the report on predetermined objectives

- Measures taken to improve performance were not provided in the performance report, as required in terms of section 46(1)(c) of the MSA. Of the total number of indicators and targets, 100% did not have measures taken to improve performance in the annual performance report.

Usefulness of information

32. The following criteria are relevant to the findings below:
    - Consistency: Objectives, indicators and targets are consistent between planning and reporting documents.
    - Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets.
    - Measurability: Indicators are well defined and/or verifiable, and targets are specific, and/or measurable and/or time bound.

Audit findings:

Reasons for major variances between planned and actual reported targets were not provided in the report on predetermined objectives

- Fifty percent (50%) of the indicators in the IDP could not be agreed to the reported indicators in the annual performance report.

Reported indicators are not consistent when compared with the planned indicators

- Seventy-three percent (73%) of reported indicators were not consistent or not complete when compared with planned indicators.

Reported targets are not consistent when compared with the planned targets

- Ninety-one percent (91%) of reported targets were not consistent or not complete when compared with planned targets.

Other information reported is not consistent when compared with the annual performance report

- Eighty-one percent (81%) of other information provided in the annual performance report is materially inconsistent when compared to the audited annual performance.

Development objectives, indicators and targets not linked directly to the strategic objectives

- Planned development objectives, indicators and targets are not relevant to the mandate and/or objectives of the municipality. Furthermore, it did not have a five-year strategic development priorities/objectives in place. As a result that all (100%) of the development objectives, indicators and targets were not linked directly to the strategic objectives/mandate of the municipality.

No clear and logical link between reported development objectives, indicators and targets

- A clear and logical link does not exist between reported development objectives, indicators and targets for 50% of the development objectives.

Planned and reported indicators are not well defined

- Thirty-three percent (33%) of the indicators were not well defined.

Planned and reported indicators are not verifiable

- Forty-three percent (43%) of the audited indicators were not verifiable.

Planned and reported indicators are not measurable

- Twenty-eight percent (28%) of the selected targets for testing were not measurable.

Planned and reported indicators are not time bound

- Ninety percent (90%) of the selected targets for testing were not time bound.

Reliability of information

33. The following criteria are relevant to the findings below:
    - Validity: Actual reported performance has occurred and pertains to the municipality.
    - Accuracy: Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately.
    - Completeness: All actual results and events that should have been recorded have been included in the annual performance report.

Audit findings:

Measures taken to improve performance were not supported by adequate and reliable corroborating evidence

- No measures were taken to improve performance.

Reported performance against indicators is not valid, accurate and complete when compared to source information

- For the selected development objective, 94% of the reported indicators were not valid, accurate and complete based on the source information or evidence provided.

Reasons for major variances between planned and actual reported targets were not supported by sufficient appropriate evidence

- For the selected objectives, 94% of the reported targets with major variances were not explained.

Sufficient appropriate evidence was not submitted to support reported indicators

- Adequate documentation was not provided for 94% of the indicators for the selected development objective.

Compliance with laws and regulations

Budget

34. The municipality incurred expenditure in excess of the limits provided for in the votes within the approved budget. This is in contravention of section 15 of the MFMA. As a result, unauthorised expenditure of R8,1 million was disclosed in note 53.

35. The municipality did not submit to the council the third and fourth quarter reports on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

36. The accounting officer did not timeously submit the monthly budget statements to the mayor and the provincial treasury, as required by section 71(1) of the MFMA.

Annual financial statements and annual report

37. The accounting officer did not make public the council's oversight report on the 2009-10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

38. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA. Material misstatements of revenue and disclosure items identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving an adverse audit opinion.

Audit committee

39. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

40. The audit committee did not function as required by section 166 of the MFMA as it did not consist of at least three persons with appropriate experience and the audit committee did not review the annual financial statements.

Procurement and contract management

41. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of between R10 000 and R200 000 were procured by means of obtaining written price quotations from at least three different prospective providers as per the requirements of supply chain management (SCM) regulation 17(a) and (c).

42. Quotations were accepted from prospective providers who are not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).

43. Awards were made to providers based on criteria which differed from those stipulated in the original bid documents and which were not stipulated in the original bid documents as per the requirements of SCM regulation 21(b) and/or 28(1).

44. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days as per the requirements of SCM regulations 22(1) and 22(2).

45. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials, as required by SCM regulation 27(3).

46. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services, as per the requirements of SCM regulation 28(2).

47. Awards were made to providers whose tax matters had not been declared by the South African Revenue Services to be in order, as required by SCM regulation 43.

48. Awards were made to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state, as per the requirements of municipal SCM regulation 13(c).

49. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2001 (Act No. 5 of 2011) (PPPF) and SCM regulation 28(1)(a).

50. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPF and its regulations.

51. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

52. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA.

53. Awards were made to providers who are persons in service of the municipality in contravention of SCM regulation 44. Furthermore, the providers failed to declare that they were in the service of the municipality, as required by SCM regulation 13(c).

54. Awards were made to providers who are persons in service of other state institutions in contravention of the requirements of SCM regulations 44. Furthermore, the providers failed to declare that they were in the service of the state, as required by SCM regulation 13(c).

55. Persons in service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e)/the code of conduct for staff members issued in terms of the MSA.

56. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).

57. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year, as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

58. Sufficient appropriate audit evidence could not be obtained that contracts and quotations to the value of R315,7 million were procured in accordance with legislative requirements and the SCM policy.

Human resource management

59. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, as required by sections 57(1)(b) and

57(2)(a) of the MSA.

60. The municipal manager did not provide job descriptions for some posts in the staff establishment, as required by section 66(1)(b) of the MSA.

61. The municipal manager did not sign an annual performance agreement for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the MSA.

Expenditure management

62. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

63. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.

64. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.

65. The municipality did not always report to the South African Police Service the cases of alleged irregular expenditure that constituted a criminal offence/theft and fraud, as required by section 32(6) of the MFMA.

66. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised expenditure when it was incurred/accounted for creditors of the municipality/accounted for payments made by the municipality, as required by section 65(2)(b) of the MFMA.

Revenue management

67. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned/accounted for debtors, as required by section 64(2)(e) of the MFMA.

Transfer and conditional grants

68. The municipality did not always submit quarterly reports to the transferring national officer on non-financial performance in respect of the allocation received, as required by section 11(2)(c) of DORA.

69. The accounting officer did not evaluate the performance of the municipality in respect of programmes funded or partially funded by a schedule 4 allocation within two months after the end of the financial year, as required by section 11(6) of DORA.

Asset management

70. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality, as required by section 63(2)(a) of the MFMA.

71. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register), as required by section 63(2)(c) of the MFMA.

Financial misconduct

72. Investigations were not always conducted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

73. Disciplinary proceedings were not always instituted against all officials of the municipality, when investigations warranted such a step, as required by section 171(4)(b) of the MFMA.

INTERNAL CONTROL

74. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

75. On 21 May 2011, the Buffalo City Municipality was bestowed metropolitan status. The newly elected council took office on 31 May 2011, but did not convene a meeting of the finance committee before September 2011 to consider important processes, such as the frequent approval of bad debt write offs, the consideration of irregular expenditure and the authorisation and approval of disposals and lease agreements.

76. The permanent filling of key leadership positions remains a challenge. For the third consecutive year, the critical positions of city manager and chief financial officer remained vacant at year-end. The suspension of three directors was only lifted in June 2011 and the cases against these individuals have not yet been finalised. Key leadership vacancies have directly contributed towards the weakening of the general control environment of the municipality during the past three years.

77. General delegations were only approved by the council during May 2011. The municipality therefore operated without approved delegations for most of the financial year and no sub-delegations to lower ranks were in place at year-end. This had a severe impact on the operational and organisational efficiency of the municipality and is visible in the slow decision-making processes across all directorates.

78. Although an audit intervention plan was approved by the council, the leadership did not report to the council on the progress made with regard to the implementation and progress made with regard to the plan. No formal leadership structures were in place to monitor, report and enhance the plan as and when required.

79. Although there was an improvement in the flow of information during the audit process, this was mainly as a result of the acting city manager's intervention. This reactive approach does not address the root cause of poor financial discipline and reporting.

Financial and performance management

80. The silo effect as reported in the past continues to undermine general financial and performance management processes and activities at the municipality. Directorates and sections are inwardly focused instead of supporting the overall financial and performance

management objectives of the municipality. As a result, improvement projects have yielded minimal results. Management's lack of focus on the municipality's performance management system is symptomatic of the culture of non-performance and is further evidenced by the total disregard for compliance governing this critical area.

81. The majority of reported material findings relate to either inadequate or non-existent managerial monitoring and review of financial and performance management processes, activities and tasks. The reactive response to audit findings remains an area of concern and limited proactive strategies have emerged since the previous audit report. The inability to submit audit evidence in support of SCM compliance and predetermined objectives remains an area of concern.

82. The strategic and operational leadership normally associated with the position of chief financial officer is lacking and the high turnover of acting chief financial officers over the past 36 months further destabilised financial and performance efforts and interventions. Incumbents also did not receive the prerequisite level of support to execute their legislative responsibilities.

83. The disregard for approved financial policies and procedures, specifically the municipality's SCM policy, is an area of concern. Staff at the SCM unit are not capacitated to fulfil and execute their duties and responsibilities. This has resulted in an excessive amount of irregular expenditure for the fourth consecutive financial year not being fully disclosed in the financial statements.

84. The lack of segregation of duties between the procurement and payment functions at the SCM unit has contributed towards the weakening of the control environment. The municipality again did not introduce an appropriate system to detect, monitor, report and discipline staff who failed to observe the municipality's SCM policy.

85. The pervasiveness of findings is indicative of officials not understanding the stringent reporting requirements prescribed by the GRAP reporting framework and insufficient capacity within the finance division.

86. Management did not incorporate the full capacity of available information technology systems and tools to assist with the financial and performance management transformation of the municipality. Insufficient care to produce, interrogate and act on available exception reports bear testimony to this.

87. Senior management did not always supervise and monitor basic accounting disciplines such as daily record keeping and the preparation of reliable monthly management accounts that are reconciled to the general ledger and are supported by appropriate schedules that had been reconciled to the underlying accounting records.

88. Formal controls over IT systems remain a concern and aspects reported in the past relating to security management and user access control have still not been addressed.

Governance

89. Since December 2010 the audit committee operated without the statutory number of three independent members. This impacted on the efficiency of the committee and on 30 June 2011 the acting chairperson also resigned. The remaining member resigned in August and, as a result, the committee did not meet to discuss the financial statements prior to its presentation for auditing. Subsequently, a five-member audit committee has been approved by the council.

90. During the year under review, the audit committee only considered SCM and predetermined objective reports and together with the failure to address significant risk areas, such as information technology risks and GRAP implementation issues, this limited that the effectiveness of the audit committee in these matters. There is insufficient capacity for internal audit to deal with complex matters and insufficient efforts were made by the leadership or those charged with governance to address this shortcoming.

91. The fraud prevention plan was last reviewed in 2003. The significance of not reviewing the plan is evident by the numerous fraud cases uncovered by management subsequent to the last review performed.

92. The leadership is now considering internal audit reports on a weekly basis, however, the full impact of this has not filtered through to the general control environment.

93. Although the oversight committee considered the annual report, the impact of their oversight activities was again not visible through noticeable improvements in the general control environment.

OTHER REPORTS

Investigations

94. The investigation in respect of allegations leveled against a former acting municipal manager was concluded after year-end and a number of officials and councillors were implicated in the report. At the time of reporting, the council was still in the process of assessing and implementing the findings and recommendations of the report. Irregular expenditure of R75,1 million in respect of this matter has been included in paragraph 13 above.

Auditor-General

East London
14 December 2011

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence