

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON NDLAMBE LOCAL MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I have audited the accompanying financial statements of Ndlambe Local Municipality (the municipality), which comprise the statement of financial position as at 30 June 2011, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information 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 Municipal Finance Management Act, 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 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 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 financial statements are free from material misstatement.

5. An audit involves performing procedures to obtain audit evidence for the amounts and

disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

246

186 238.

Basis for qualified opinion

Unspent conditional grants and receipts

7. Supporting documentation, including a grant register and reconciliations, could not be provided by the municipality for the unspent conditional grants and receipts (balance of R19 231 211) disclosed in note 10 to the financial statements. As a result, I could not obtain sufficient appropriate audit evidence for the completeness, existence, valuation and rights and obligations assertions, which has resulted in a qualification due to a material limitation of scope. The municipality's records did not permit the application of alternative audit procedures regarding this balance.

Revenue – Government grants and subsidies

8. Included in the revenue stream for government grants and subsidies of R92 171 805, disclosed in note 14 to the financial statements, is an amount of R4 508 628 for which supporting documentation and calculations could not be provided by the municipality. As a result, I could not obtain sufficient appropriate audit evidence for the occurrence, accuracy, completeness, cut off and classification assertions, which has resulted in a qualification due

to a material limitation of scope.

Opinion

9. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Ndlambe Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with GRAP and the requirements of the MFMA.

Emphasis of matters

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

Restatement of corresponding figures

11. Various errors were identified, which had a material impact on corresponding figures of the financial statements. These were not identified by the municipality initially and as such were not disclosed in the initial financial statements submitted for audit. Subsequent adjustments were made, the effects of which have been disclosed in note 43.

Unauthorised, irregular as well as fruitless and wasteful expenditure

12. Unauthorised expenditure with a value of R23 625 401 was identified during the audit. This

related to overspending on votes and was not identified by the municipality as being unauthorised or disclosed in the initial financial statements submitted for audit in note 38. Subsequent adjustments were made to correct this disclosure.

13. Irregular expenditure of R33 580 831 was identified during the audit as a result of various types of supply chain management (SCM) policy contraventions, however, this was not disclosed in note 39 to the initial annual financial statements submitted for audit.

Subsequent adjustments were made to correct this disclosure.

14. Fruitless and wasteful expenditure of R111 994 was identified during the audit. This expenditure, mainly attributable to interest on outstanding audit fees, was not identified as fruitless and wasteful by the municipality or disclosed in the initial financial statements

submitted for audit. Subsequent adjustments were made, the effects of which have been
247

disclosed in note 44 to the financial statements.

Material underspending of the budget

15. As disclosed in note 47 to the financial statements, the municipality has materially underspent the capital budget to the amount of R20 655 334. Specific underspending has occurred within the operating budget. As a consequence, the municipality has not achieved its operating objectives related to the repairs and maintenance of its assets, FMG: operating expenses and general expenditure with underspending of R7 405 090; R1 948 893 and R3 830 026 respectively. Due to the inaccurate record keeping related to capital expenditure, management could not indicate which planned capital projects were not completed during the year.

Significant losses

16. The municipality incurred material losses during the year for the impairment of its receivable balances. The loss recognised in the current financial year amounted to R17 357 808 while R16 223 678 of the opening provision was written off as irrecoverable. These are reflected in note 4 to the annual financial statements.

17. As reported in prior periods, water distribution losses are not monitored by the municipality, as there are no bulk water meters at the purification works to monitor the amount of water supplied to the municipality.

18. Electricity distribution losses were not monitored throughout the financial year.

Additional matters

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

20. 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 12 to 84 and material non-compliance with

laws and regulations applicable to Ndlambe Local Municipality.

Predetermined objectives

Presentation of information

21. The following criterion is relevant to the finding 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).

248

Audit finding

22. Measures taken to improve performance were not provided in the performance report

(presentation)

Measures taken to improve performance were not provided in the performance report, as required in terms of section 46(1)(c) of the MSA. In total, 85% of the reported targets had no details of the measures taken to improve performance.

Usefulness of information

23. The following criteria are relevant to the findings below:

Consistency: Objectives, indicators and targets are consistent between planning and reporting documents.

Measurability: Indicators are well-defined and/or verifiable, and targets are specific, and/or measurable and/or time bound.

Audit findings

24. Reported objectives and objectives are not complete when compared with the planned objectives and indicators (consistency)

The actual achievements relating to 77% of all planned objectives and 61% of targets specified in the integrated development plan (IDP) for the year under review, were not included in the report on predetermined objectives submitted for audit purposes.

25. Planned and reported targets are not specific, measurable or time bound

(measurability)

For the selected key performance area (KPA) of basic service delivery, 47% of targets were not specific in clearly identifying the nature and the required level of performance.

In addition, for this selected KPA, 49% of targets were not measurable in identifying the required performance.

Furthermore, for the KPA mentioned above, 63% of targets were not time bound in specifying the time period or deadline for delivery.

Compliance with laws and regulations

Strategic and performance management

26. The accounting officer of the municipality did not, by 25 January, assess the performance

of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA. The assessment was reviewed by the municipal manager on 1 February 2011.

27. No evidence could be obtained to prove that the accounting officer submitted the mid-year

assessment report to the mayor, the National Treasury, and the provincial treasury by 25 January as required by section 72(1)(b) of the MFMA.

249

Budget

28. The municipality incurred expenditure in excess of the limits of the amounts provided for in

the votes in the approved budget, in contravention of section 15 of the MFMA. This resulted in unauthorised expenditure to the value of R23 625 401 as reported in paragraph 12 above.

Annual financial statements and annual performance report

29. 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 property, plant and equipment, current assets and liabilities, revenue, expenditure and disclosure items identified by the auditors, were subsequently corrected. Material limitations in scope relating to the unspent government grants and government grant revenue balances resulted in the financial statements receiving a qualified audit opinion.

30. The performance report for the financial year under review was not prepared as required by

section 46 of the MSA read with section 121(3)(c) of the MFMA. Findings in this regard are covered in detail in this report under the heading *predetermined objectives*.

Audit committee

31. The audit committee did not function as required by section 166 of the MFMA, in that:

it did not advise the council of the municipality on matters relating to internal financial control and internal audits, risk management, accounting policies, performance management, effective governance, compliance with applicable legislation and performance evaluation

it did not review the annual financial statements prior to submission for audit

it did not advise the council, the accounting officer and management of the municipality on matters relating to SCM.

32. The municipality did not utilise a performance audit committee, nor was the existing audit committee utilised as the performance audit committee as required by regulation 14(2)(a) of the Municipal Planning and Performance Management Regulations, 2001.

33. In the absence of an audit committee performing the function of the performance audit committee, the following requirements of regulations 14(3)(a) and 14(4)(a) of the Municipal Planning and Performance Management Regulations, 2001, were not adhered to:

Meet at least twice during the financial year

Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality

Review the municipality's performance management system and make recommendations in this regard to the council of the municipality

Submit an auditor's report to the council regarding the performance management

system at least twice during the financial year.

250

Internal audit

34. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:

it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review

it did not report to the audit committee on the implementation of the internal audit plan

it did not advise the accounting officer or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.

35. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.

36. The municipality did not develop and implement mechanisms, systems and processes for

auditing the results of performance measurement as part of its internal audit processes, as required by section 45(1)(a) of the MSA read with regulation 14(1)(a) of the Municipal Planning and Performance Management Regulations, 2001, and the following assessments and reviews/audits were not conducted:

Assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA, as required by regulation 14(1)(b)(i) and (ii) of the Municipal Planning and Performance Management Regulations, 2001.

Assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators, as required by regulation 14(1)(b)(iii).

37. Audit the performance measurements on a continuous basis and/or did not submit quarterly

reports on their audits to the municipal manager and the performance audit committee, as required by regulation 14(1)(c) of the Municipal Planning and Performance Management Regulations, 2001.

Procurement and contract management

38. Awards were made to providers based on criteria that were not stipulated in the original bid

documents as per the requirements of SCM regulation 21(b) and/or 28(1).

39. 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, 2000 (Act No. 5 of 2000) and SCM regulation 28(1)(a). These, and the below SCM related compliance findings, are addressed in paragraph 13 above.

40. Awards were made to suppliers based on preference points that were not allocated and/or

calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.

41. Awards were made to suppliers that did not score the highest points in the evaluation process as per the requirements of section 2(1)(f) of the Preferential Procurement Policy Framework Act.

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

251

43. The contract performance measures and methods whereby suppliers are monitored, were

insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA.

44. 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 regulations 14(1)(a)(ii) and 14(2).

45. The accounting officer failed to implement measures for combating the abuse of the SCM

system as per the requirements of SCM regulation 38(1) because awards were made to suppliers who did not provide or had not been requested to confirm that they had not: during the past five years, failed to perform satisfactorily on a previous contract with the municipality or municipal entity or other organ of state committed a corrupt or fraudulent act in competing for the contract abused the SCM system been convicted of fraud or corruption during the past five years.

Human resources management

46. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review within the required timeframes, as required by sections 57(1)(b) and 57(2)(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Expenditure management

47. 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 and accounted for creditors of the municipality, as required by section 65(2)(b) of the MFMA.

48. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as

well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Transfers and conditional grants

49. The municipality did not submit quarterly reports to the transferring national officer on nonfinancial

performance in respect of the allocation received for various conditional grants, as required by section 11(2)(c) of DoRA.

50. 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.

Revenue management

51. 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, as required by section 64(2)(e) of the MFMA.

252

Asset management

52. 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.

INTERNAL CONTROL

53. 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 qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

54. The accounting officer did not provide oversight responsibility over financial reporting, compliance and the related internal controls, implement effective human resources management or ensure the execution of internal control objectives. This is evidenced by the following:

Many of the findings reported on in the prior year audit have not been addressed adequately during the current financial year, including the qualification relating to grant expenditure and liabilities, and the prior year qualification relating to commitments.

The findings reported on in the prior year audit relating to contraventions of the SCM

policy have also not been addressed during the current financial year, with a 100% error rate identified in the testing of tenders and over 500 SCM deviation applications having been approved during the current financial year.

Various laws and regulations have not been complied with (material cases have been highlighted above).

The process to identify and disclose related parties and transactions with them is inadequate.

Financial and performance management

55. Accurate record keeping and the effective maintenance of controls relating to the processing and reconciliation of transactions, were not implemented during the current financial year. As a result of this, accurate information was not available to support financial and performance reporting, including the preparation of the annual financial statements.

This was evidenced by the fact that many material adjustments were required to correct the annual financial statements in order to ensure their fair presentation. Quarterly performance reports were not prepared and submitted for review. In addition, significant non-compliance with laws and regulations, specifically related to SCM, occurred, which indicates insufficient monitoring and review.

253

Governance

56. Adequate risk management activities and the promotion of accountability have not been implemented during the current financial year. This was evidenced by the following:

The annual financial statements were not provided to the audit committee for review prior to submission for audit

The performance audit committee did not exist and the audit committee did not take over this responsibility in the absence of a performance audit committee

Internal audit did not evaluate performance information and report on it on a quarterly basis

There is no internal audit plan

Risk assessment procedures were only performed and reviewed after financial yearend.

In addition, the audit committee has not functioned as envisaged by the MFMA, mainly as a result of challenges experienced with the information flow to and from the committee.

Port Elizabeth

30 November 2011

254