

Audit Report

Chris Hani District Municipality

For the Year ended 30 June 2011

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE CHRIS HANI DISTRICT MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I was engaged to audit the accompanying financial statements of the Chris Hani District Municipality, which comprise the statement of financial position as at 30 June 2011, and 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 (SA Standards of GRAP) and the requirements of 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), as well as 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 the financial statements based on conducting the audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Inventory

4. The municipality did not have supporting documentation that substantiated the inventory quantities at year-end and there were no adequate controls over inventory management at the local municipalities. The inventory records of the municipality did not allow me to perform alternative tests to obtain the inventory balance at year-end. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation, rights and obligations as well as completeness of consumables, maintenance materials and spare parts to the value of R4,1 million as disclosed in note 2 to the financial statements.
5. The municipality used consultants to value the water inventory at year-end. Upon inspection of the data used by the consultants, I was unable to obtain reliable assumptions regarding the estimates used to arrive at the cost prices. Furthermore, the valuation of the consultants did not reflect all the water reservoirs and storage facilities. I was also unable to obtain assurance over the accuracy of the water quantities at year-end, as management did not have a system to measure water quantities. In addition, the quantities and unit costs were not classified as work in progress and finished goods. As I was unable to confirm or verify this by alternative means, I was unable to determine the amount required to have been disclosed in the financial statements.

6. There was no comparative figure for the inventory balance, as the prior year figure of R6,8 million had been written off. This treatment is not in line with GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. Consequently, the financial statements did not achieve fair presentation as the information presented was not comparable.

Trade receivables from exchange transactions

7. An impairment loss on receivables in trade receivables from exchange transactions was not recognised in accordance with the South African Statement of Generally Accepted Accounting Practice, IAS 39 *Financial Instruments: Recognition and Measurement*. The municipality impaired the full amount for consumer debtors and this did not represent the value of estimated future cash flows as required by IAS 39. A recalculation of the impairment loss using the best estimates available at the time revealed that the impairment loss was overstated by R34,4 million (2010: R126,6 million). As a result, consumer debtors were understated and impairment losses overstated by R34,4 million.
8. An amount of R100,2 million debited to debtors was disclosed in note 38 to the financial statements. The municipality did not have adequate systems and records for processing journals, as the municipality could not provide supporting documentation for the amount disclosed. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the existence, valuation, completeness or rights and obligations of the above-mentioned amount included in the corresponding figures.
9. Prior year trade receivables from exchange transactions were misstated by R37,9 million due to misstatements reported in the report on the financial statements for the year ended 30 June 2010 that were not addressed in the current year. As a result, the corresponding figure was understated by this amount. In addition, the municipality did not provide supporting documentation for debtors amounting to R29,9 million.

Trade and other payables

10. Trade creditors and expenditure were understated by R33,6 million as the municipality did not account for expenditure and accruals relating to water and sanitation services rendered by suppliers at the water service providers.
11. An amount of R118 million credited to creditors was disclosed in note 38 to the financial statements. The municipality did not have adequate systems to maintain records for processing journals, as the municipality could not provide sufficient appropriate audit evidence for the amount disclosed. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the existence, valuation, completeness or rights and obligations of the above-mentioned amount included in the corresponding figures.

Service charges

12. GRAP 9 *Revenue from Exchange Transactions* requires revenue to be recognised in the period in which it was earned. There was no adequate system of internal control over revenue for water, as consumers were billed at incorrect tariffs or were not billed at all. As a result, revenue was understated and consumer debtors were understated by R5,6 million.
13. An amount of R2 million was debited to consumer debtors and credited to revenue from service charges, as disclosed in note 38 to the financial statements. The municipality did not have adequate systems to maintain records for processing journals and could not provide

sufficient appropriate audit evidence for the amount disclosed. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the occurrence, accuracy or classification of the above-mentioned amount included in note 38.

14. Prior year revenue was misstated by R27, 2 million due to misstatements reported in my report on the financial statements for the year ended 30 June 2010 that were not addressed in the current year. As a result, the corresponding figure was understated. In addition, sufficient appropriate evidence was not obtained for revenue transactions amounting to R1,5 million.

Expenditure

15. Expenditure was overstated as value-added tax (VAT) to the value of R5,2 million (2010: R4,9 million) was recognised as expenses in the general ledgers of the water service providers when it should have been allocated to VAT input, or not recognised at all as some suppliers were not registered for VAT.
16. Prior year expenditure was misstated by R14,4 million, due to misstatements reported in my report on the financial statements for the year ended 30 June 2010 that were not addressed in the current year. As a result, the corresponding figure was understated. In addition, the municipality could not provide supporting documentation for payments of R18,3 million and a provision for doubtful debt amounting to R9,5 million.

Other corresponding figures

17. The municipality could not provide sufficient appropriate audit evidence regarding other debtors of R3 million disclosed in note 5 to the financial statements. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the existence, valuation, completeness or rights and obligations of the above-mentioned amount included in the corresponding figures. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole, due to a limitation on the scope of the audit. This matter is one of the matters that gave rise to the limitation and remained unresolved in the current year.
18. An amount of R24,5 million debited to employee costs was disclosed in note 38 to the financial statements. The municipality did not have adequate systems to maintain records for processing journals, as sufficient appropriate audit evidence was not provided for the amount disclosed. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the occurrence, accuracy or classification of the above-mentioned amount included in note 38.

Accumulation of immaterial uncorrected misstatements

19. The financial statements as a whole were materially misstated by R7 million and R8 million, respectively, due to the cumulative effect of various individual immaterial uncorrected misstatements making up the statement of financial position and the statement of financial performance.

Irregular expenditure

20. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose material irregular expenditure that had occurred during the financial year. Irregular expenditure of R33,5 million (2010: R41 million) included in the statement of financial performance was incurred as a result of the contravention of supply chain management (SCM) requirements. This irregular expenditure was not disclosed in note 44 to the financial statements. As a result, irregular expenditure was understated by this amount.

Disclaimer of opinion

21. 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

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

Unauthorised expenditure

23. The municipality disclosed unauthorised expenditure of R152,5 million (2010: R94,3 million) in note 43 to the financial statements.

Additional matter

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

Unaudited supplementary schedules

25. 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

26. 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 ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Usefulness of information

27. 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 verifiable, and targets are specific, measurable and time bound.

The following audit findings relate to the above criteria:

Reported targets not complete when compared to planned targets

28. The reported targets were not complete when compared to the planned targets. The actual achievements with regard to 100% of all planned targets specified for the health and community services programme in the integrated development plan were not included in the report on predetermined objectives submitted for auditing. With regard to the engineering programme, 78% of the planned targets were not complete and could thus not be linked to the integrated development plan.

Reported indicators not complete when compared to planned objectives

29. Hundred per cent of the indicators for the health and community services programme were not documented in the service delivery and budget implementation plan and I was thus unable to determine the consistency between the indicators per the service delivery and budget implementation plan and the indicators per the integrated development plan.

Reported development priorities not complete when compared to planned objectives

30. Sixty-seven per cent of the reported development priorities in the annual performance report for the engineering programme were not consistent with the planned development priorities. With regard to the health and community services programme, none of the development priorities in the annual report were consistent with the planned development priorities.

Reported objectives and indicators not complete when compared to planned objectives and indicators

31. The reported performance against predetermined objectives was not consistent with the approved integrated development plan for all of the objectives of the health and community services programme.

Planned and reported indicators or measures not verifiable

32. For the selected health and community services programme, valid performance management processes and systems that produced actual performance against the planned indicators or measures did not exist for more than 21% of the indicators or measures.

Planned and reported targets not time bound

33. For the selected health and community services programme, 57% of the planned and reported targets were not time bound.

Reliability of information

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

- Validity: Actual reported performance has occurred and pertains to the entity.
- 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.

The following audit findings relate to the above criteria:

Completeness of reported performance against indicators or targets could not be confirmed as inadequate supporting source information was provided

35. Hundred per cent of the measures taken to improve the performance of the health and community services programme were not supported by adequate and reliable corroborating evidence.

Validity of reported performance against indicators could not be confirmed as no supporting source information was provided

36. For the selected programmes, the validity of 64% of the reported targets could not be established, as relevant source documentation could not be provided.

Compliance with laws and regulations

Annual financial statements, performance report and annual report

37. 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 identified by the auditors were not adequately corrected for revenue from service charges, expenditure, creditors, receivables, property, plant and equipment, inventory, reserves and irregular expenditure. The misstatements resulted in the financial statements receiving a disclaimer of audit opinion.
38. The annual performance report did not contain a comparison of the performance of the municipality and of each external service provider with development priorities, objectives and performance indicators set out in the integrated development plan, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

Expenditure management

39. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that recognised expenditure when it was incurred and accounted for the creditors of the municipality, as required by section 65(2)(b) of the MFMA.
40. 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.

Revenue management

41. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
42. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system that recognised revenue when it was earned, as required by section 64(2)(e) of the MFMA.

Procurement and contract management

43. Goods and services with a transaction value between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM Regulation 17(a) and (c).
44. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM Regulations 16(b) and 17(b).
45. Sufficient appropriate audit evidence could not be obtained to verify that bid specifications for the procurement of goods and services through competitive bids had been drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per the requirements of SCM Regulation 27(2)(a).
46. The contract performance measures and the methods whereby they were monitored were insufficient to ensure effective contract management, as per the requirements of section 116(2)(c) of the MFMA.
47. The accounting officer failed to take appropriate action against an official or role player after an investigation justified allegations of fraud, corruption, favouritism, unfair or irregular practice or failure to comply with the SCM policy, as per the requirements of SCM Regulation 38(1)(b).

Asset management

48. 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

49. 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 the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

50. The accounting officer did not exercise the required oversight responsibilities to ensure compliance with laws and regulations as well as internal control. Furthermore, the accounting officer did not properly review financial statements and predetermined objectives prior to submission for auditing, which resulted in the numerous control deficiencies, errors in the financial statements and non-compliance findings detailed above. Policies and procedures were not developed and communicated to staff members in the finance section to ensure that all transactions were accounted for in terms of GRAP requirements.
51. The accounting officer did not exercise oversight over adherence to the SCM Regulations. Non-adherence to these regulations resulted in irregular expenditure. Furthermore, there were no documented policies and procedures to sufficiently communicate tasks for the adequate accounting and identification of irregular expenditure.
52. For predetermined objectives, the documented policy and procedure manuals were not implemented. As a result, significant deficiencies were identified in the performance report on predetermined objectives.

Financial and performance management

53. Reliable financial statements of a high quality were not submitted, as material misstatements were identified in the financial statements submitted for auditing. Proper systems of internal control were not in place to ensure that the municipality accounted for revenue when services were rendered to consumers and for creditors when they were due.
54. The financial controls for water services were not adequately implemented throughout the financial year, as the daily processing of transactions, monthly reconciliation of accounts and continuous reviewing and monitoring of the water sanitation accounts were not adequate to ensure that all transactions were accounted for accurately and completely. Accurate monthly financial reports were not properly reconciled to sub-ledgers or supporting documentation.
55. The accounting officer did not design and implement adequate systems for predetermined objectives, as the documented policy and procedure manuals were not implemented. The monthly performance reports were not reviewed for quality by the internal auditors to ensure that they were reliable and credible. As a result, significant deficiencies were identified in the performance report on predetermined objectives.

Governance

56. The internal audit function and performance audit committee did not fulfil their responsibilities in terms of reviewing the internal processes and procedures of the financial and predetermined objective reporting systems. This is evidenced by the numerous control deficiencies identified in the performance management systems of the municipality, including the errors identified in the annual performance report and the financial statements submitted for auditing.
57. The effectiveness of the internal audit function and audit committee was limited due to inadequate responses to matters reported in the internal audit reports.

Auditor-General

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence