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

**Introduction**

1. I have audited the financial statements of the Maletswai Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

**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, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is 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. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about 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.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

**Basis for qualified opinion**

**Property, plant and equipment**

6. The municipality did not have systems and processes to prepare an accurate and complete fixed asset register. This resulted in incorrect values disclosed for land and buildings and for infrastructure assets, due to duplication, misclassification and omission of assets, inaccurate recording of disposals, and property not owned by the municipality being recognised. Consequently both property, plant and equipment in note 10 and the accumulated surplus in the statement of changes in net assets are overstated by R35 million (2011: R36 million).

### **Investment property**

7. The municipality did not have adequate systems in place to ensure correct measurement of investment properties, which resulted in non-compliance with the measurement criteria of GRAP 16: *Investment property*. Investment properties were recognised at incorrect values in the records of the municipality and as a result, investment property disclosed in note 11 to the financial statements and accumulated surplus in the statement of changes in net assets are both understated by R50 million (2011: R50 million). In addition, the municipality did not have an adequate system in place for the identification and recognition of investment properties and did not include all the investment properties of the municipality in the amount disclosed in note 11 to the financial statements. Due to the lack of systems in place, it was impracticable to determine the full extent of the understatement. I was unable to determine this amount by alternative means. Consequently, I was unable to determine whether any further adjustments to the investment property note were necessary.

### **Cash and cash equivalents**

8. The municipality did not have adequate systems to ensure that only valid reconciling items were included as a component of cash and cash equivalents. Current liabilities: Cash and cash equivalents as disclosed in note 19 to the financial statements are therefore overstated by R13,1 million, due to invalid outstanding bank reconciling items included in this balance. Consequently, payables from exchange transactions disclosed in note 7 are also understated by R13,1 million.

### **Payables from exchange transactions**

9. Payables from exchange transactions as disclosed in note 7 to the financial statements are understated by a further R1,6 million. This is due to payables being recognised at incorrect values, the misallocation of debtor refund amounts, and the incomplete identification and recognition of all amounts owed by the municipality at year-end. Consequently, receivables from non-exchange transactions as disclosed in note 17 are understated by R667 192, other operating grant expenditure as disclosed in the statement of financial performance are understated by R245 579, employee related costs in note 27 are understated by R317 964, and general expenses in note 35 to the financial statements are understated by R377 802.
10. In addition, included in payables from exchange transactions as disclosed in note 7 to the financial statements are suspense accounts to the value of R258 443, for which sufficient appropriate audit evidence was not available to ensure that the amounts relate to financial liabilities as defined in GRAP 104: *Financial instruments*. I was unable to confirm this amount by alternative means. Consequently, it was not possible to determine whether any adjustments to payables from exchange transactions were necessary.

### **Irregular expenditure**

11. The municipality did not have adequate systems to identify and disclose all irregular expenditure incurred during the year, as required by section 125(2)(d) of the MFMA. The irregular expenditure disclosed in note 44.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R2,8 million.

### **Disclosure - Supply chain management deviations**

12. The municipality did not have adequate systems to identify and disclose all supply chain management (SCM) deviations, as required by SCM Regulation 36(2). SCM deviations of R2 million were not disclosed as a note to the financial statements.

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### **Disclosure - Inventory**

13. The municipality did not disclose the amount of inventory recognised as expenditure during the year in note 15 to the financial statements, as required by GRAP 12: *Inventory*. Due to the inadequate systems and incomplete accounting records over inventory issued, it was impracticable to confirm the value of the inventory expensed during the year. I was unable to confirm this amount by alternative means. Consequently, I was unable to determine whether any adjustments to inventory disclosure were necessary.

### **Aggregation of immaterial uncorrected misstatements**

14. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position:
- Biological assets reflected as R2,1 million in note 14 to the financial statements are overstated by R71 437.
  - Receivables from exchange transactions reflected as R14,4 in note 16 to the financial statements are overstated by R95 478.
  - Receivables from non-exchange transactions reflected as R925 082 in note 19 to the financial statements are understated by R109 806.
  - Accumulated surplus reflected as R240,4 million in the statement of changes in net assets is understated by R90 658.
  - Non-current provisions reflected as R3,1 million in note 3 to the financial statements are understated by R90 341.
15. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm or verify the following elements by alternative means.
- Inventory reflected as R464 599 in note 15 to the financial statements.
  - Receivables from exchange transactions reflected as R14,4 million in note 16 to the financial statements.
16. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

### **Qualified opinion**

17. In my opinion, except for the 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 the Maletswai Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

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

### **Restatement of corresponding figures**

19. As disclosed in notes 36 and 37 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during the year ended 30 June 2012.

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## **Financial sustainability**

20. Note 54 to the financial statements indicates that the municipality incurred material losses relating to electricity amounting to R3,5 million and water amounting to R452 890 during the year ended 30 June 2012 and, as of that date, the municipality's current liabilities exceeded its total assets. These conditions, along with other matters as set forth in note 54, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue to deliver services to its citizens in the foreseeable future.

## **Unauthorised expenditure**

21. As disclosed in note 44.1 to the financial statements the municipality incurred unauthorised expenditure amounting to R21 million due to overspending on the votes and a further R6,8 million as a result of unspent grant funding used to fund operational expenditure.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

22. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

23. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
24. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI). The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
25. The material findings are as follows:

### **Usefulness of information**

#### **Presentation**

#### **Measures taken to improve performance not disclosed**

26. Improvement measures in the annual performance report were not disclosed for a total of 28% of the planned targets not achieved, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information. Management failed to identify that the variances between the targeted and actual achievements required explanatory paragraphs.

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**Measures taken to improve performance not supported by sufficient appropriate evidence**

27. Section 46 of the MSA requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for any (100%) of the measures taken to improve performance as disclosed in the annual performance report. The municipality's 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 validity, accuracy and completeness of the measures taken to improve performance.

**Consistency**

**Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

28. Section 41(c) of the MSA requires that the integrated development plan (IDP) and the associated service delivery budget implementation plan (SDBIP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. The reported objectives, indicators and targets were not consistent with the planned objectives, indicators and targets as per the approved SDBIP. This is due to the municipality not implementing proper review processes and the municipality's internal audit unit not reviewing these processes.

**Additional matter**

29. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

**Achievement of planned targets**

30. Of the total number of planned targets, only 265 were achieved during the year under review. This represents 37% of the total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets that were set out in the SDBIP were not carried through to and reported on in the annual performance report.

**Compliance with laws and regulations**

31. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

**Budgets**

32. Not all quarterly reports were submitted to the council on the implementation of the budget and 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.
33. Not all monthly budget statements were submitted to the mayor, as required by section 71(1) of the MFMA.

**Financial statements, performance report and annual report**

34. 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 non-current assets, non-current liabilities, current liabilities, current assets, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were subsequently provided, but the

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uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

35. The accounting officer did not make public the council's oversight report on the 2010-11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
36. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.

#### **Audit committee**

37. The audit committee did not advise the accounting officer and management staff on matters relating to accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
38. The audit committee did not advise the accounting officer and the management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
39. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(b) of the MFMA.
40. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal Planning and Performance Management Regulation (MPPMR) 14(4)(a)(ii).
41. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by MPPMR 14(4)(a)(i).
42. The audit committee did not submit an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).

#### **Internal audit**

43. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not advise the accounting officer and report to the audit committee on matters relating to internal audit and loss control.
44. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and MPPMR 14(1)(a).
45. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA or the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by MPPMR 14(1)(b)(i), (ii) and (iii).
46. The internal audit unit did not audit the performance measurements on a continuous basis or submit quarterly reports on its audits to the municipal manager and the performance audit committee, as required by MPPMR 14(1)(c).

#### **Conditional grants expenditure**

47. The municipality did not submit quarterly performance reports to the transferring national officer, the Eastern Cape Provincial Treasury and the National Treasury within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
48. The municipality did not evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA.

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49. The municipality did not timeously submit project registration forms for projects it intended to implement in the financial year under review to the Department of Local Government, as required by the Division of Revenue Grant Framework issued in Gazette No. 34280 (DoRGF).
  50. The municipality did not submit project implementation plans to the national Department of Cooperative Governance and Traditional Affairs (CoGTA), as required by the DoRGF.
  51. The municipality did not submit its monthly expenditure reports to CoGTA within 20 days after the end of each month, as required by the DoRGF.

#### **Asset management**

52. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
53. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

#### **Expenditure management**

54. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
55. The accounting officer did not take effective steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

#### **Human resource management**

56. Sufficient appropriate audit evidence could not be obtained that the competencies of financial and SCM officials had been promptly assessed in order to identify and address gaps in competency levels, as required by Municipal Regulation on Minimum Competency Levels (MRMCL) 13.
57. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and the Eastern Cape Provincial Treasury, as required by MRMCL 14(2)(a).
58. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by MRMCL 14(2)(b).
59. Sufficient appropriate audit evidence could not be obtained to confirm minimum competencies and therefore whether the performance agreements of the municipal manager and chief financial officer should have included the attainment of minimum competencies as a performance target, as required by MRMCL 16(2).
60. Sufficient appropriate audit evidence could not be obtained to confirm minimum competencies and therefore whether the performance agreements of the financial and SCM officials should have included the attainment of minimum competencies as a performance target, as required by MRMCL 16(1).

#### **Procurement and contract management**

61. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, as required by SCM Regulation 17(a) and (c).
62. Bids were not always evaluated by bid evaluation committees composed of at least one SCM practitioner of the municipality, as required by SCM Regulation 28(2).
63. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations, 2001.

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64. Contracts and quotations were awarded to bidders based on preference points that were not allocated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.
  65. Quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM Regulation 43.
  66. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).
  67. Goods and services were procured through contracts and services secured by other organs of state, without evidence that the other organ of state had applied a competitive bidding process and that the municipality had reason to believe that the contract was valid and that there were demonstrable discounts or benefits for the municipality, as required by SCM Regulation 32(a), (b) and (c).

#### **Internal control**

68. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

69. Processes and procedures have not yet been developed and implemented to ensure that management can discharge its responsibility over the review of financial and performance reporting and compliance with laws and regulations. There is a shortage of skills and competencies within the municipality, where necessary changes to reports and records cannot be made without incurring additional costs on consultants. This has resulted in numerous findings regarding non-compliance, performance information reporting as well as uncorrected material misstatements.
70. Turnaround plans to address weaknesses in internal controls were ineffective during the year, due to a lack of emphasis on the importance of review and proper oversight over key accounting and performance areas. Furthermore, policies and procedures were not clearly communicated throughout the municipality and were not drafted with sufficient emphasis on the roles of monitoring and the isolation of responsibilities. The internal audit unit did not report with sufficient regularity to management and the audit committee to enable them to monitor turnaround plans, which resulted in material misstatements in the financial statements, performance information not being useful, and non-compliance with laws and regulations.

#### **Financial and performance management**

71. The municipality did not always maintain its records in a manner conducive for the purposes of the audit, which resulted in investment property and property, plant and equipment not being complete or correctly valued. Internal control processes ensuring the completeness of payables and the correct accounting treatment of the components of the statement of financial position were not effectively monitored. Furthermore, bank reconciliations were not effectively reviewed and systems over the usage of inventory were not adequate to ensure that expensed inventory items were accounted for. This resulted in the reported material misstatements not being detected or corrected.
72. No monitoring systems or processes of review over the municipality's compliance with laws and regulations have been instituted. The information technology system did not have the necessary controls to ensure that the data integrity of the municipality's electronic information was maintained. This was mainly due to resources not being available to institute systems and



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processes, which resulted in numerous non-compliance matters and Irregular expenditure not being detected or corrected by management.

### **Governance**

73. The management of risk by those charged with governance remains a problem area. Although both the internal audit unit and the audit committee functioned throughout the year, there was insufficient focus on, and pre-emptive measures taken to address, the emerging risks relating to the change in accounting policies required under full SA Standards of GRAP reporting. Processes and procedures were therefore not aligned to the more onerous reporting requirements and the majority of the accounting staff remained unaware of the requirements of the standards. The internal audit unit also did not prepare reports with sufficient regularity for presentation to the audit committee. No reports were presented on performance information and as such neither the audit committee nor the internal audit unit discharged their duties in terms of this review. This resulted in misstatements in the usefulness of performance information, misstatements in financial information and non-compliance with laws and regulations not being detected or corrected timeously.

*Auditor-General*

East London

30 November 2012



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*