



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Audit Report

Chris Hani District Municipality

For the Year ended 30-June 2012

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of Chris Hani District Municipality set out on pages ... to ..., which comprise statement of financial position as at 30 June 2012, the statement of financial performance, changes in net assets and cash flows 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), as well as 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 adverse audit opinion.

Basis for adverse opinion

Trade and other payables

6. Trade creditors and expenditure were understated by R161,7 million (2011: R33,6 million) as the municipality did not account for expenditure and accruals at year-end.

Irregular expenditure

7. The municipality did not implement and maintain an appropriate procurement and

provisioning system as required by the MFMA. The municipality made payments in contravention of the supply chain management requirements which were not disclosed as irregular expenditure, resulting in irregular expenditure being understated by R199, 5 million.

Value-added tax receivable

8. The municipality did not have adequate systems in place, to record input value-added tax (VAT) on purchases of property, plant and equipment. The value of the assets is recorded inclusive of the VAT portion in the fixed asset register and the general ledger, instead of the VAT portion being allocated to the VAT input account and this resulted in infrastructure assets being overstated by R27, 5 million, while the VAT receivable is understated by the same amount.

Property, plant and equipment

9. The municipality incorrectly accounted for land and buildings for which they do not have the title deeds. This land was transferred to the municipality by the provincial government; however, the title deeds for the land were not transferred. The land does not meet the definition of an asset as it is not probable that economic benefits or service potential will flow to the municipality. This resulted in an overstatement to land and buildings and accumulated surplus amounting to R19,7 million.

Accumulated surplus

10. The municipality incorrectly restated prior year balances to reflect revenue that was charged at the incorrect tariff rates or not charged at all to consumers in the prior year. The municipality incorrectly debited the accumulated surplus balance with R12,9 million. The adjustment represents the value of revenue that should have been billed but was not billed in the prior year. As a result accumulated surplus is understated and the corresponding figure for revenue from services is also understated by R12,9 million.

Corresponding figures

11. During the 2010-11 year, I was unable to obtain sufficient appropriate audit evidence for the for the following elements:
 - Receivables from exchange transactions – R100,2 million
 - Trade and other payables – R118 million
 - Other Debtors – R24,5 million
 - Inventory – R4,2 million
 - Employee costs – R3,2 million
 - Property, plant and equipment – R3,4 million
12. I was unable to obtain sufficient appropriate audit evidence for the above by alternative means. Consequently, I was unable to determine whether any adjustments to these amounts and accumulated surplus were necessary. My audit opinion on the financial statements for the period ended 2010-11 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Receivables from exchange transactions

13. The prior year comparative figure is understated by R34, 4 million as the municipality impaired the full amount for consumer debtors and did not calculate the impairment for consumer debtors in accordance with the requirements of IAS 39. My opinion on the

current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Revenue

14. Prior year revenue is understated by R5,6 million as no adequate system of internal control over revenue for water was not in place, as consumers were billed at incorrect tariffs or were not billed at all. As a result, the corresponding figure for revenue and receivables from non-exchange transactions is understated by R5,6 million. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Expenditure

15. The prior year comparative expenditure amount is overstated by R5,2 million as expenditure was recognised inclusive of VAT when the VAT portion should have been allocated to the VAT input account, or not recognised at all as some suppliers were not registered for VAT. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Accumulation of immaterial uncorrected misstatements

16. 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 and the statement of financial performance:

Statement of financial position

- Trade receivables from non-exchange transactions reflected as R105,6 million in the statement of financial position and note 5 is overstated by R2,6 million
- VAT receivable balance reflected as R16,4 million in the statement of financial position and note 6 is overstated by R237 120

Statement of financial performance

- Impairment losses reflected as R9 million in the statement of financial performance and note 30 is understated by R2,8 million
- General expenditure reflected as R28,3 million in the statement of financial performance and note 35 is understated by R470 700

17. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm or verify the following elements:

Statement of financial position

- Adjustments of R2, 2 million to accumulated surplus reflected as R3, 001 million in the statement of financial position and note 20
- Creditors of R55 592 reflected as R29,6 million in the statement of financial position and note 14

Statement of financial performance

- Government grants and subsidies received of R1,7 million included in the disclosed amount of R799,5 million in the statement of financial performance and note 21
- General expenditure of R412 908 included the disclosed amount of R28,3million in the statement of financial performance and note 35
- Other income of R84 776 included the disclosed amount of R55,5million in the statement of financial performance and note 26

18. As a result, we were unable to determine whether any adjustments to these elements were necessary.

Adverse opinion

19. 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 financial position of Chris Hani District Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Significant uncertainties

21. With reference to note 50 of the annual financial statements the municipality is a defendant in lawsuits. The outcome of these lawsuits cannot be determined at present and no provision has been made for any liability that may result.

Restatement of corresponding figures

22. As disclosed in note 38 to the financial statements, the corresponding figures for the prior year balance sheet date have been restated as a result of an error discovered during the current year. These corrections were made in the financial statements of the Chris Hani District Municipality at 30 June 2012.

Material impairments

23. As disclosed in note 30 to the financial statements, material losses to the amount of R9 million were incurred as a result of receivables from non-exchange transactions.

Unauthorised expenditure

24. As disclosed in note 44.1 to the financial statements, the municipality incurred unauthorised expenditure of R56,4 million as a result of exceeding the total budgeted amount of expenditure.

Additional matters

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

Unaudited supplementary schedules

26. The supplementary annexures 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 this schedule and, accordingly, I do not express an opinion thereon.

Achievement of planned targets

27. Of the total number of 146 targets planned for the year, 51 were not achieved during the year under review. This represents 35% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

28. 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

29. 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.
30. 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 development priorities. The usefulness of information further relates to whether indicators and targets are measurable, i.e. well defined, verifiable, specific and measurable and time bound and relevant as required by the National Treasury Framework for managing programme performance information.
31. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
32. The material findings are as follows:

Usefulness of information

Presentation

33. Improvement measures in the annual performance report for all of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act, 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.

Consistency

34. A total of 22% of the reported targets are not consistent with the targets as per the approved IDP. This is due to the lack of adhering to applicable laws and regulations.

Measurability

Performance targets not specific

35. The National Treasury *Framework for managing programme performance information* (FMPPi) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 69% of the targets were not specific in clearly

identifying the nature and the required level of performance. This was due to the fact that management was not aware of the requirements of the FMPPI.

Reliability of information

Reported performance not valid

36. The FMPPI requires that processes and systems which produce the indicator should be verifiable. A total of 20% of the actual reported performance relevant to basic service delivery and infrastructure investment objectives and strategies was not valid when compared to the source information and/or evidence provided. This was due to a lack of standard operating procedures for the recording of actual achievements by senior management.

Reported performance not accurate

37. The FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 31% of the actual reported performance relevant to basic service delivery and infrastructure investment objectives and strategies were not accurate when compared to source information.

Compliance with laws and regulations

38. 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 follow:

Per compliance focus area

Budgets

39. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
40. Quarterly reports were not submitted to the council on 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.

Strategic planning and performance management

41. The municipality did not take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.

Annual financial statements, performance and annual report

42. 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 in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving an adverse audit opinion.
43. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.

Human resource management

44. The municipality did not submit quarterly reports on the status of disciplinary cases to the

MEC responsible for local government in the province as required by Disciplinary Regulations for Senior Managers regulation 19(3)(1) and (3).

45. No evidence was provided indicating that the municipality performed background checks on the senior managers that were appointed during the year to ensure that they were not dismissed in the past 10 years for financial misconduct in local government, corruption or fraud as required by MSA section 57A(1) to 57A(5).

Procurement and contract management

46. Goods and services with a transaction value below 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) & (c).
47. 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 and SCM regulation 28(1)(a). Two transactions advertised did not state the preference point system to be used.
48. Awards were made to providers who are persons in service of other state institutions and whose directors are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1). Twenty-seven companies did not declare their interest or connection to persons in the service of the state and were awarded contracts. Similarly, three companies owned by people who are in the service of the state and declared their interest were awarded contracts as well.
49. Appropriate action was not taken against officials and role players in the SCM system where investigations did not comply with the SCM system, as required by SCM regulation 38(1)(b).
50. The municipality did not implement an SCM policy as required by section 111 of the MFMA. The 2011-12 draft SCM policy review was not approved during the period under review.

Expenditure management

51. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 65(2)(b) of the MFMA.
52. The accounting officer did not promptly inform the mayor in writing, of unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality, as required by section 32(4)(a) of the MFMA.

Conditional grants

53. The municipality did not evaluate its performance in respect of programmes funded by the allocation within two months after the end of the financial year, as required by section 12(6) of DoRA.
54. Unspent conditional grant funds not approved by the National Treasury for retention were not surrendered to National Revenue Fund, as required by section 20(1) of the DoRA.

55. The municipality did not submit, within 20 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 34280.
56. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 34280.

Asset management

57. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2) (a) and (b) of the MFMA.

Internal control

58. I considered internal controls relevant to my audit of the financial statements, 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 disclaimer of opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

59. Oversight responsibilities regarding the monitoring of internal controls over financial reporting, compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatement in the annual financial statements that were submitted for audit purposes, non-compliance with applicable laws and regulations and also resulted in the information presented in the report on predetermined objectives not being valid, accurate and complete.
60. Leadership failed to implement adequate controls to prevent or detect (and subsequently report) on irregular expenditure and unauthorised expenditure incurred.

Financial and performance management

61. The municipality did not prepare reliable and accurate monthly and quarterly financial statements. This is due to not understanding the requirements of the applicable reporting framework and the instability that existed in key positions in the finance department.
62. The municipality did not have updated policies and procedures to support the compliance with the GRAP reporting framework and accounting for transactions in accordance with the reporting framework.
63. The municipality has not implemented controls to ensure that the information supporting the report on predetermined objectives is credible, accurate and complete. As misstatements were identified on the accuracy, validity and of reported performance.
64. The municipality does not perform daily and monthly processing and reconciling of transactions throughout the financial year, as a result material misstatements are identified during the audit and cannot be substantially corrected by management, thereby having a negative impact on the audit outcome.
65. The municipality has not implemented adequate review mechanisms to ensure the report on predetermined objectives and the annual financial statements are reviewed for accuracy

and completeness prior to submission for audit purposes.

Governance

66. The municipality has an audit committee and internal audit unit in place. The recommendations of the audit committee and internal audit unit are not adequately addressed by management and will therefore have a negative impact in addressing control deficiencies that exist in the municipality's control environment.

OTHER REPORTS

Investigations

67. An investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on the allegation of possible authorisation of financial transactions and/ or payments made on the municipal banking system contrary to the profile of the municipality. The profile provides that two of the four municipal signatories must authorise and release payments. The municipal banking profile was changed by the systems administrator during year ultimately resulting in payments being released and authorised by one signatory. The investigation was still ongoing at the reporting date.
68. An investigation was conducted by the internal audit unit on request of the municipal council on the appointment of service providers without following proper supply main chain process for cleaning and refurbishment of the Cradock Garden of Remembrance and the close relation of a key official within the municipality to the appointed service providers. The investigation was still ongoing at the reporting date.

Auditor-General

East London

30 November 2012



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