

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL OF INXUBA YETHEMBA MUNICIPALITY**

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated and separate financial statements of the Inxuba Yethemba Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statement of financial performance, statement of changes in net assets and statement of 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 consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the consolidated and separate financial statements based on conducting the 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. 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

Trade and other receivables from exchange transactions

4. The municipality failed to recognise items that are classified as Trade and other receivables from exchange items as per the requirements of GRAP 1 – *Presentation of financial statements* resulting in Trade and other receivables from exchange transactions being understated by R1.7 million, Trade and other payables understated by R691 151 and Interest on Trade and other receivables per note 31 to the financial statements R974 388 as a result of:
 - misclassification of trade debtors with negative balances
 - incorrect calculation of interest charged on outstanding debtors

5. Sufficient appropriate audit evidence was not available to support a material unexplained difference between the general ledger and the trade and other receivables from exchange transactions disclosed on the statement of financial position and in note 5 to the financial statements and journals that were processed on the system. I was unable to confirm the trade and other receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other receivables from exchange transactions of R13,8 million (2011/12: R30.3 million) as disclosed on the statement of financial position and in note 5 to the financial statements.

Other receivables from non exchange transactions

6. The municipality failed to recognise items that are classified as other receivables from non exchange items as per requirements of GRAP 1 – *Presentation of financial statements* resulting in Other receivables from non-exchange transactions being understated by R9.6 million, Interest on Trade and other receivables understated by R335 073 and employee costs overstated by R9.3 million as a result of:
 - Incorrect calculation of interest charged on outstanding debtors
 - use of incorrect hours worked and applicable wage rates in wage pay calculations
7. Sufficient appropriate audit evidence was not available to support journals that were processed on the system and there were material unexplained difference between the general ledger and other receivables from non-exchange transactions disclosed on the statement of financial position and in note 6 to the financial statements as well as the difference between the disclosed provision for the impairment and its analysis in the same note. In addition, there was an unexplained difference between the comparative figure as per note 6 and the amount disclosed on the statement of financial position. I was unable to confirm other receivables from non exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to other receivables from non exchange transactions of R4.2 million (2011/12: R-7.2 million)) as disclosed on the statement of financial position and in note 6 to the financial statements.

Cash and cash equivalents

8. Sufficient appropriate audit evidence was not available to support material differences between the bank reconciliations, cash book balances and the cash and bank balances as disclosed on the statement of financial position as well as in note 7 to the financial statements. In addition, supporting documentation was not available for transfers made during the year between bank accounts. I was unable to confirm the cash and bank balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to cash and cash equivalents of R14.3 million (2011/12: R11.2 million and Bank overdraft of R15.9 million) as disclosed on the statement of financial position and in note 7 to the financial statements.

Investment property

9. The municipality failed to recognise investment properties as required by GRAP 16 – *Investment properties*. This resulted in investment properties and accumulated surplus being understated by R10.3 million due to inadequate controls over the recording and reconciling of investment properties. Furthermore, the municipality failed to account for land and buildings separately in note 10 to the financial statements and to disclose that no revaluations were performed in the current year as required by GRAP 16 – *Investment properties*.

10. In addition, sufficient appropriate audit evidence was not available to support a material unexplained difference between the general ledger and the investment property register. Supporting documentation in support of investment property as being controlled by the municipality was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the investment property balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to investment property of R40.1 million (2011/12: R40.2 million) as disclosed on the Statement of Financial Position and in note 10 to the financial statements.

Property, plant and equipment

11. The municipality did not have adequate systems in place to ensure that all its assets are recorded and disclosed in the financial statements as required by GRAP 17 – Property, plant and equipment. The property, plant and equipment disclosed on the statement of financial position and in note 8 to the financial statements is understated in respect of assets that could not be traced to the fixed asset register. Due to the lack of an adequate fixed asset register and reconciliations between the fixed asset register and the general ledger, it was impracticable to determine the full extent of the understatement of property, plant and equipment and the impact on accumulated surplus.
12. Further, the municipality did not correctly calculate the depreciation of property, plant and equipment in terms of the requirements of GRAP 17 – Property, plant and equipment, thus resulting in depreciation and amortisation disclosed on the statement of financial performance and accumulated depreciation disclosed in note 8 to the financial statements being overstated by R19.9 million.
13. Sufficient appropriate audit evidence was not available to support a material unexplained difference between the general ledger and fixed asset register, between the annual financial statements and the general ledger and between the annual financial statements and the fixed asset register. Furthermore, I was unable to obtain sufficient appropriate audit evidence on the impairment of property, plant and equipment and the review of residual values and remaining useful lives. Supporting documentation in support of the property, plant and equipment opening balance, additions and accumulated depreciation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the property, plant and equipment balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment of R654,3 million (2011/12: R611,8 million) as disclosed on the statement of financial position and in note 8 to the financial statements.

Trade and other payables

14. The municipality did not correctly account for all payables as required per GRAP 1 – *Presentation of financial statements*. As a result, trade and other payables is understated by R3.2 million and provisions overstated by R2.5 million and trade and other receivables from exchange transactions understated by R691 151 due to:
 - misclassification of employee related accrual to provision
 - misclassification of receivables with credit balances to trade and other receivables from exchange transactions
15. In addition the municipality did not correctly account for leave accruals as required per GRAP 25 – *Employee benefits*. As a result, accrued leave pay was not disclosed separately as current employee benefits but was included in trade and other payables. This resulted in trade and other payables being overstated by R6.7 million and current employee benefits being understated by the same amount.

16. In addition, sufficient appropriate audit evidence was not available to support journals that were processed on the system and there were material differences between the general ledger and the balance disclosed on the statement of financial position and in note 14 to the financial statements, as well as between the supplier reconciliations and the relevant creditors' ledger accounts. Furthermore, supporting documentation in support of trade and other payables was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the trade and other payables balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade and other payables of R29.8 million (2011/12: R31.9 million) as disclosed on the statement of financial position and in note 14 to the financial statements

VAT payable

17. Sufficient appropriate audit evidence was not available to support journals that were processed on the system and material difference between the general ledger and the balance disclosed on the statement of financial position and in note 16 to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the VAT payable balance of R19.4 million (2011/12: R11.9 million) as disclosed on the statement of financial position and in note 16 to the financial statements.

Unspent conditional grants

18. GRAP 23 – *Revenue from Non-Exchange Transactions* requires that revenue is recognised as the goods and services are provided. The municipality did not recognise and disclose all the Government grants and subsidies received to the value of R5.1 million resulting in Government grants and subsidies revenue as disclosed on the statement of financial performance being understated and the Unspent conditional grant payable as disclosed on the statement of financial position and in note 18 to the financial statements being overstated by the same amount.
19. In addition, sufficient appropriate audit evidence was not available to support a material difference between the conditional grant register and the balance disclosed on the statement of financial position and in note 18 to the financial statements. Sufficient documentation in support of the unspent conditional grant was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the unspent conditional grants by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to Unspent conditional grants of R4.7 million (2011/12: R-259 434) as disclosed on the statement of financial position and in note 18 to the financial statements

Provisions

20. The municipality failed to correctly classify and disclose employee-related accruals as required by GRAP 25 – *Employee benefits* resulting in provision being overstated by R2.5 million and Current employee benefits being understated by the same amount.
21. In addition, sufficient appropriate audit evidence was not available to support a material difference between the general ledger and the balance disclosed on the statement of financial position and in note 20 the financial statements. Sufficient documentation in support of the provisions was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the provisions balance by alternative means. Consequently, I was unable to determine whether any further adjustments were

necessary to the current and non-current provisions balances of R2.5 million (2011/12: NIL) and R25.9 million (2011/12: R296 114) respectively as disclosed on the statement of financial position and in note 20 to the financial statements

Accumulated surplus

22. Sufficient appropriate audit evidence was not available to support the opening accumulated surplus balance as at 1 July 2011 as well as changes made due to prior year restatements as disclosed in the statement of changes in net assets. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the movements to accumulated surplus as well as the closing balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to accumulated surplus of R601.5 million (2011/12: R589.6 million) as disclosed on the statement of financial position and in the statement of changes in net assets.

Property rates

23. Sufficient appropriate audit evidence was not available to support the journals that were processed in the system and income forgone disclosed in note 24 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the income forgone by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Property rates of R22.6 million (2011/12: R17.6 million) as disclosed in note 24 to the financial statements.

Service charges

24. Sufficient appropriate audit evidence was not available to support journals that were processed on the system and material unexplained difference between the general ledger and the service charges disclosed in note 25 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to service charges of R88.1 million (2011/12: R96.6 million) as disclosed in note 25 to the financial statements.

Government grants and subsidies

25. Supporting documentation for journals that were processed in the system and expenditure incurred against conditional grants and the related revenue recognised was not provided for audit purposes. In addition there were unexplained differences between the amounts disclosed in note 26 and the detailed spending per grant also disclosed in note 26 as well as differences between the general ledger and the financial statements. I was unable to confirm the government grants and subsidies amount by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to Government grants and subsidies of R58.7 million (2011/12: R56.1 million) as disclosed in note 26 to the financial statements.

Interest received - investment

26. The municipality did not correctly account for Interest received as required per GRAP 1 – *Presentation of financial statements* as interest charged on trade and other receivables was included as part of interest from investments. As a result, interest received from investments, as disclosed on the statement of financial performance and in note 31 to the financial statements, is overstated by R5.9 million and interest on trade and other receivables is understated by the same amount.

Employee related costs

27. Sufficient appropriate audit evidence was not available to support journals processed in the system and allowances paid to employees. In addition there was a material unexplained difference between the employee related costs per the general ledger and the amount disclosed in the financial statements. I was unable to confirm the employee related costs by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to employee related costs of R59.4 million (2011/12: R57.7 million) as disclosed on the statement of financial performance and in note 29 to the financial statements.

Depreciation and amortisation

28. The municipality did not calculate the depreciation of property, plant and equipment in terms of GRAP 17 – *Property, plant and equipment* resulting in both current year depreciation and accumulated depreciation as disclosed in note 8 to the financial statements being understated by R19.9 million respectively.
29. In addition, sufficient appropriate audit evidence was not available to support a material difference between the depreciation disclosed on the statement of financial position and the depreciation per note 8 to the financial statements as well as unexplained differences between the fixed asset register, general ledger and financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the depreciation expense by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to depreciation and amortisation expense as disclosed on the statement of financial performance of R-29.6 million (2011/12: R77 million) and depreciation in note 8 to the financial statements of R15.1 million (2011/12: R32.9 million) respectively.

Debt impairment

30. The provision for debt impairment of R178.3 million as disclosed in note 5 and R35.7 million as disclosed in note 6 of the financial statements has been provided on the full balance of debtors outstanding for longer than 90 days without classifying the debtors in separate risk categories as required by GRAP 104 – *Financial instruments*. I have not determined the correct amounts for the debt impairments as it was impracticable to do so.
31. In addition, sufficient appropriate audit evidence was not available to support a material difference between the general ledger and the amount disclosed in the financial statements, as well as differences between the amount disclosed on the statement of financial performance and the movement in the debt impairment in notes 5 and 6 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the provision for debt impairment by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the debt impairment expense of R32.3 million (2011/12: R50.1 million) as disclosed on the statement of financial

performance and the allowance for debt impairment of R178.3 million (2011/12: R137.2 million) and R23.4 million (2011/12: R35.6 million) as disclosed in notes 5 and 6 respectively to the financial statements.

Repairs and maintenance

32. Sufficient appropriate audit evidence was not available to support the repairs and maintenance expense as disclosed on the statement of financial performance, as well as a material unexplained difference between the general ledger and the amount disclosed on the statement of financial performance. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the repairs and maintenance expense by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the repairs and maintenance expense of R6.6 million (2011/12: R3.6 million) as disclosed on the statement of financial performance.

Contracted services

33. Sufficient appropriate audit evidence was not available to support a material unexplained difference between the general ledger and the amount disclosed on the statement of financial performance and in note 35 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the expenditure on contracted services by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the contracted services expense of R1.9 million (2011/12: R364 013) as disclosed on the statement of financial performance and in note 35 to the financial statements.

Grants and subsidies paid

34. Sufficient appropriate audit evidence was not available to support the grants and subsidies paid as disclosed on the statement of financial performance. Further, the municipality is not required to pay grants or subsidies to any third parties or municipal entities. Due to the lack of adequate systems and financial records at the municipality, I was unable to confirm the correct allocation of this amount. In addition, an unexplained difference was identified between the general ledger and the amount disclosed in the financial statements relating to grants and subsidies paid. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the grants and subsidies paid by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the grants and subsidies paid of R6.5 million (2011/12: R5.1 million) as disclosed on the statement of financial performance and in note 36 to the financial statements.

General expenses

35. Sufficient appropriate audit evidence was not available to support journals that were processed on the system and general expenses disclosed on the statement of financial performance and in note 28 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. In addition, sufficient appropriate audit evidence was not available to support a material unexplained difference between the general ledger and the amount disclosed in the financial statements. I was unable to confirm general expenses by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to general expenses of R23.8million (2011/12: R20.8 million) as disclosed on the statement of financial performance and in note 28 to the financial statements.

Cash flow statement

36. Sufficient appropriate audit evidence was not available to support the cash generated from operations as disclosed in the cash flow statement and note 38 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. Consequently, I was unable to determine whether any adjustments were necessary to cash generated from operations of R34.7million (2011/12: R45.5 million) as disclosed on the cash flow statement and in note 38 to the financial statements.

Additional disclosures in terms of Municipal Finance Management Act

37. The municipality did not have adequate systems in place to identify and disclose complete and accurate additional disclosures as required by section 125(1)(b), (c) and (e) of the MFMA. Consequently, additional disclosures disclosed in note 47 to the financial statements relating to pension and medical aid deductions is understated by R4.1 million.

Commitments

38. The municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments and did not include commitments of at least R10.2 million in the amounts disclosed in note 49 to the financial statements. Due to the lack of adequate systems in place, it was impracticable to determine the full extent of the understatement.
39. In addition, sufficient appropriate audit evidence was not available for commitments as disclosed in note 49 to the financial statements and documentation in support of commitments was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the commitments disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the commitments balance of R8.3 million (2011/12: R3.7million) as disclosed in note 49 to the financial statements.

Unauthorised expenditure

40. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The municipality has disclosed a nil value in note 50 to the financial statements whereas there were votes which exceeded their budgeted expenditure in the current year to the value of R3.4 million. Therefore unauthorised expenditure as disclosed in note 50 to the financial statements was understated by R3.4 million.

Irregular expenditure

41. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 52 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R4 million. Due to the lack of systems, and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R15.8 million (2011/12: R10.5 million). Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Related parties

42. The municipality failed to comply with all the provisions of GRAP 20 – *Related parties* as note 40 to the financial statements omitted disclosure of remuneration paid to management and councillors. Due to the limitations experienced in auditing employee costs, I have not determined the correct disclosure amounts for related parties as it was impracticable to do so.

Budget and actual performance

43. The municipality did not present their original and adjusted budgets against actual outcomes in the financial statements as required by GRAP 24 – *Presentation of Budget Information in Financial Statements*. I have not determined the actual variances between actual performance and budgeted performance of the municipality as it was impracticable to do so.

Restatement of corresponding figures

44. As described in note 41 and 42 to the financial statements, restatements to prior year amounts were made in order to rectify prior year misstatements. These misstatements were however not appropriately presented as required in terms of GRAP 3 – *Accounting policies, changes in accounting estimates and errors*.
45. The restatements were made in order to rectify prior year misstatements; however, supporting documentation was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the restatements by alternative means. Consequently I was unable to determine whether any adjustments to restatements of corresponding figures as disclosed in note 41 and 42 to the financial statements were necessary.

Material losses

46. The municipality did not disclose material losses for water and electricity in the financial statements as required by section 125(2)(d)(i) of the MFMA. Due to the lack of adequate systems in place, I have not determined the relevant disclosure amounts for material losses for water and electricity as it was impracticable to do so.

Financial instruments

47. The municipality failed to comply with all the provisions of GRAP 104 – *Financial Instruments* relating to the disclosure, recognition and measurement of financial instruments. The disclosure note for Financial instruments omitted the following disclosure requirements:
- The carrying amounts of each of the categories of financial instruments
 - The municipality's exposure to credit and liquidity risk was not sufficient as it did not include the nature and extent of risks arising from financial instruments to which the municipality is exposed during the period and at the end of the reporting period, and how the municipality manages those risks
48. It was not possible to assess the impact of such non-disclosure on the financial statements.

Aggregation of immaterial uncorrected misstatements

49. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements together with limitations reflected below for the following elements making up the statement of financial position and the statement of financial performance:
- Interest charged on trade and other receivables is understated by R1.3 million.
50. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm the following elements by alternative means:
- Other financial liabilities as disclosed in note 13,
 - Property rates-penalties imposed and collection charges as disclosed in note 24,
 - Fees earned as disclosed in note 27,
 - Remuneration of councillors as disclosed in note 30, and
 - Finance lease obligation as disclosed in note 48.
51. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Opinion

52. 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 these financial statements.

Emphasis of matters

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

Material under spending of the budget

54. The municipality has materially under spent the budget to the amount of R15.9 million. As a consequence, the municipality has not achieved its planned objectives.

Additional matters

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

Unaudited supplementary information

56. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. We have not audited these schedules and, accordingly, we do not express an opinion thereon.

Withdrawal from the audit engagement

57. Due to the numerous limitations imposed on the audit by management, we have disclaimed our opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, we would have withdrawn from the engagement in terms of the ISAs.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

58. 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

59. 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.

60. 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 *Framework for managing programme performance information*.

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

61. The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

62. Section 46 of the Municipal Systems Act (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for 100% of the planned targets not achieved were not reflected in the annual performance report. This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

Reported objectives not consistent with planned objectives

63. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 40% of the reported objectives, 36% of the reported indicators and 37% of the reported targets are not consistent with the objectives, indicators and targets as per the approved integrated development plan. This is due to lack of oversight by those charged with governance when preparing the integrated development plan and the service delivery budget plan, as well as a lack of review by those tasked with providing assurance responsibilities to the municipality. In addition, the Integrated Development Plan Manager post is vacant therefore there is a lack of isolation of responsibilities to skilled personnel who must manage and administer the Integrated Development Plan process to ensure that the principles of the FMPPI are implemented by the municipality.

Changes to objectives, indicators and targets not approved

64. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in terms of section 34 and remains in force until an integrated development plan is adopted by the next elected council. Therefore, if the integrated development plan is changed in-year this process has to take place in accordance with the process as prescribed per section 34 of the MSA.
65. A total of 100% of development objectives, indicators and targets reported in the annual performance report were changed in-year without following the process as prescribed in section 34 of the MSA. This is due to the lack of oversight by those charged with governance when preparing the integrated development plan and the service delivery budget plan, as well as a lack of review on a continuous basis by those tasked with providing assurance responsibilities to the municipality.

Measurability

Performance targets not specific

66. The National Treasury FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 75% 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 aware of the requirements of the FMPPI but chose not to apply the principles contained therein. In addition, the Integrated Development Plan Manager post is vacant therefore there is a lack of isolation of responsibilities to skilled personnel who must manage and administer the Integrated Development Plan process to ensure that the principles of the FMPPI are implemented by the municipality.

Performance targets not measurable

67. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 75% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to apply the principles contained therein. In addition, the Integrated Development Plan Manager post is vacant therefore there is a lack of isolation of responsibilities to skilled personnel who must manage and administer the Integrated Development Plan process to ensure that the principles of the FMPPI are implemented by the municipality.

Performance targets not time bound

68. The National Treasury FMPPI requires that the time period or deadline for delivery be specified. A total of 57% of the targets of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to apply the principles contained therein. In addition, the Integrated Development Plan Manager post is vacant therefore there is a lack of isolation of responsibilities to skilled personnel who must manage and administer the Integrated Development Plan process to ensure that the principles of the FMPPI are implemented by the municipality.

Performance indicators not well defined

69. The National Treasury FMPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 67% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance indicators not verifiable

70. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 67% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the fact management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Reliability of information

Reliability of Technical Services, Community Services and Local Economic Development Departments in the annual performance report

Reported performance not reliable

71. The National Treasury FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
72. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the selected programmes as follows:
- Technical Services Department selected for audit purposes
 - Local Economic Development Department selected for audit purposes
 - Community Services Department selected for audit purposes
73. This was due to limitations placed on the scope of my work due to the fact that the institution could not provide sufficient appropriate evidence in support of the information reported for the selected programmes, and also due to the lack of oversight by management to ensure that reported achievements are reviewed against source documentation. In addition, the municipality has not implemented an appropriate system to collect, collate and verify achieved performance and the record keeping measures are not adequate.

Compliance with laws and regulations

74. 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:

Strategic planning and performance management

75. The municipality, in terms of its PMS and in accordance with any regulations and guidelines that may be prescribed, did not set measurable performance targets with regard to each of the development priorities and objectives and KPIs for the financial year.

76. 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, as required by section 72(1)(a)(ii) of the MFMA. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls over predetermined objective reporting as required by section 62(1)(c)(i) of the MFMA.

Budget

77. Expenditure was incurred not in terms of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual report

78. 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, which resulted in the financial statements receiving a disclaimer of opinion.

Audit committees

79. The audit committee did not advise the council on matters relating to internal control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
80. The audit committee did not advise the council 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.
81. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
82. 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 14(4)(a)(ii).
83. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).

Internal audit

84. 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 and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, loss control.
85. The internal audit unit did not advise the accounting officer or report to the audit committee on matters relating to compliance with the MFMA, the DORA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

86. The internal audit unit did not assess 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 Municipal planning and performance management regulation 14(1)(b)(iii).
87. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the audit committee, as required by Municipal planning and performance management regulation 14(1)(c).

Human resource management

88. Bonuses were awarded to the municipal manager and or senior managers directly accountable to the municipal manager before the annual report for the financial year under review was tabled and adopted by council and approval of such evaluation by the municipal council in contravention of section 57(2)(a) of the MSA.

Expenditure management

89. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
90. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
91. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
92. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds was not in place, as required by section 65(2)(a) of the MFMA.

Asset and liability management

93. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
94. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

95. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by Supply Chain Management (SCM) regulation 17(a) and (c).
96. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
97. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).

98. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
99. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
100. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
101. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
102. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
103. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
104. Construction contracts were awarded to contractors that did not qualify for the contract, in accordance with section 18(1) of the Construction Industry Development Board Act (CIDB Act) and CIDB regulations 17.
105. Awards were made to providers who are in the service of other state institutions or whose directors are in the service of other state institutions, in contravention of MFMA 112(j) and 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).

Consequence management

106. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
107. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Internal control

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

Leadership

109. Although there was no change in leadership, the municipality has not improved from the prior year. Notwithstanding the consistency in leadership, there was a lack of oversight and accountability, together with management's failure to respond to prior year internal and external audit findings adequately, which has resulted in a number of repeat audit findings.
110. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatements in the annual financial statements that were submitted for audit, non compliance with applicable laws and regulations as well as information presented in the report on predetermined objectives not being valid, accurate and complete.

Financial and performance management

111. The municipality remains reliant on the use of consultants to perform financial administration and reporting functions that should be performed by the staff employed by the municipality. A poor control environment over financial reporting exists as extensive manual reconciliation of accounting records and supporting schedules was required at year end as these controls were not performed on a regular ongoing basis during the year. As a result, material misstatements were identified through the audit process that could not be substantially corrected by management at that stage. Further, there was a lack of segregation of duties as reliance is placed on a few key personnel to perform crucial functions. This has the impact of limiting supervision and monitoring. Should adequate monitoring, supervision and controls be implemented, these misstatements should be able to be identified and corrected by management on a timeous basis.
112. Information requested for audit purposes was not obtained without delays and supporting documents were not obtained for a number of account balances and classes of transactions. This was due to weaknesses identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation, or the supporting documentation is not readily available for audit purposes.
113. The financial statements submitted for audit purposes contained numerous misstatements, which was as a result of a lack of adequate review of the financial statements and supporting documentation prior to submission of the annual financial statements for audit purposes.
114. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality has no formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

Governance

115. Insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed. Management failed to implement the recommendations of the internal audit unit which resulted in external audit findings within the current year. This has contributed to repeat audit findings in a number of areas.

116. The municipality has an audit committee and internal audit unit in place, and the audit committee held regular meetings as required by the MFMA. However, the audit committees' ability to provide assurance was limited due to the inadequacy of the financial reports provided for their review.

Auditor - General.

East London

6 December 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence