

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of Lukhanji Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets, statement of comparison of budget and actual amounts 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 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, 2012 (Act No. 5 of 2012) (DoRA), 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 the 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

Revenue from non-exchange transactions

4. Revenue from non-exchange transactions of R240,8 million (2012: R220,5 million) is disclosed in notes 22, 23, and 25 to the financial statements. The underlying accounting records for property rates, government grants and subsidies as recorded in the accounting system could not be reconciled to the general ledger and financial statements and management could not provide audit evidence to substantiate these differences. The municipality also did not account for all its revenue and as a result revenue from non-exchange transactions and receivables are understated by R45,5 million. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments relating to revenue from non-exchange transactions in the financial statements were necessary.

Accumulated surplus

5. Accumulated surplus of R1 billion disclosed in the statement of net assets. Sufficient appropriate audit evidence was not obtained to confirm adjustments made to the opening balance in the statement of changes in net assets for all errors identified in revenue, expenditure, employee costs, assets and liabilities in the previous and other financial years. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the accumulated surplus in the financial statements were necessary.

Investment property

6. Investment property of R91,3 million (2012: R91,3 million) is disclosed in note 12 to the financial statements. The municipality did not assess the fair value of all its land and buildings at each reporting date in accordance with GRAP 16: *Investment Property*. I have not determined the correct fair value of these assets as it was impracticable to do so. Sufficient appropriate evidence was not available for the amounts disclosed as investment property. I was unable to confirm the investment property balance by alternative means. Consequently, I was unable to determine whether any further adjustments relating to investment property in the financial statements were necessary.

Property, plant and equipment

7. Property, plant and equipment of R751,5 million (2012: R724,3 million) is disclosed in note 11,1 to the financial statements. The municipality did not review the useful lives, residual values and deemed costs of property, plant and equipment in accordance with GRAP 17: *Property, plant and equipment and Directive 7: The application of deemed costs on the adoption of standards of GRAP*. In addition assets could not be located due to numerous limitations found within the municipality's asset register. I have not determined the correct net carrying amount of these assets as it was impracticable. Consequently, sufficient appropriate evidence was not available for the amounts disclosed as property, plant and equipment in note 11.1 and depreciation and amortisation as disclosed in note 33 to the financial statements. In addition buildings and accumulated surplus disclosed in note 11.1 is understated of R232 million. I was unable to confirm the assets and expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to property, plant and equipment in the financial statements were necessary.

Cash and cash equivalents

8. Cash and cash equivalents of R170,5 million (2012: R177,7 million) is disclosed in note 20 to the financial statements. Sufficient appropriate audit evidence was not available to clear reconciling items and errors found in the prior financial year. In addition not all bank accounts have been reconciled by the municipality. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents in the financial statements were necessary.

Revenue from exchange transactions

9. Revenue from exchange transactions of R270,9 million is disclosed in notes 24, 26, 27, 28 and 29 to the financial statements. The underlying accounting records

for revenue transactions as recorded in the accounting system could not be reconciled to the general ledger and financial statements and management could not provide audit evidence to substantiate these differences. The municipality also did not account for all its revenue and as a result revenue from exchange transactions and receivables is understated by R23,8 million. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments relating to revenue from exchange transactions in the financial statements were necessary.

Debt impairment

10. Debt impairment of R74,1 million is disclosed in note 32 to the financial statements. Sufficient appropriate audit evidence was not available for debt impairment as management processed system journals which could not be supported. In addition management could not provide a basis for the calculation of debt impairment journals. I was unable to confirm the debt impairment by alternative means. Consequently, I was unable to determine whether any adjustments relating to debt impairment in the financial statements were necessary.

Receivables from exchange transactions

11. Receivables from exchange transactions of R97,6 million (2012: R126,8 million) is disclosed in note 17 to the financial statements. The impairment allowance was not supported by adequate audit evidence. Management could also not provide evidence to substantiate the unbundling of the Chris Hani District Municipality receivable included in receivables from exchange transactions. In addition receivables from exchange transactions and revenue is understated by R7,2 million. I was thus unable to confirm the balance by other means. Consequently, I was unable to determine whether any further adjustments relating to receivables from exchange transactions in the financial statements were necessary.

Irregular expenditure

12. 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 47.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R77,4 million (2012: R15,9 million), while the opening balance for 2010/11 is understated by R22,6 million in this regard. 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 R40,6 million (2012: R 40,1 million). I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Unauthorised Expenditure

13. The municipality overspent on its budget by R60,2 million as disclosed in note 47.1. Sufficient appropriate audit evidence was not submitted to calculate the extent of unauthorised expenditure per vote as required by section 1 and 125(2)(d) of the MFMA. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further

adjustments were necessary to the unauthorised expenditure disclosed in note 47.1 to the financial statements.

General expenditure

14. General expenditure of R75,5 million is disclosed in note 40 to the financial statements. Sufficient appropriate audit evidence to support the disclosed amounts for general expenditure such as orders, requisitions, agreements and explanations could not be provided. In addition delegated management reflected as part of general expenditure in note 40 is overstated by R29,8 million and bulk services in the statement of financial performance is understated. I was unable to confirm this expenditure by an alternative means. Consequently, I was unable to determine whether any further adjustments to general expenditure were necessary.

Commitments

15. Commitments of R8 million (2012: R16 million) are disclosed in note 49. 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 all the municipality's commitments in the amounts in disclosure note 49 to the financial statements. In addition, sufficient appropriate audit evidence was not available for commitments disclosed and I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to commitments were necessary.

Value-added taxation (VAT)

16. VAT of R34,1 million is disclosed in note 10 to the financial statements. Sufficient appropriate evidence was not available to clear reconciling differences between South African Revenue Service (SARS) records and municipal records. In addition VAT and accumulated surplus is overstated by R7,2 million as the result of an incorrect payable that was recorded in the prior period. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to VAT in the financial statements were necessary.

Employee related costs

17. Employee related costs amounting to R104,9 million (2012: R99,3 million) disclosed in note 30 to the financial statements could not be supported with sufficient appropriate audit evidence due to the inadequacy of the municipality's employee record management system. I was unable to confirm employee related costs by alternative means. Consequently, I was unable to determine whether any further adjustments to employee related costs in the financial statements were necessary.

Unspent conditional grants and receipts

18. Unpaid conditional grants and receipts of R19,2 million (2012: R16,4 million) are disclosed in note 9 to the financial statements. Sufficient appropriate audit evidence was not available to clear reconciling items and errors found in the prior financial year. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to unspent conditional grants and receipts in the financial statements were

necessary.

Payables from exchange transactions

19. Payables from non-exchange transactions of R32,8 million (2012: R26,3 million) are disclosed in note 8 to the financial statements. The municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end, as well as leave records and did not include all outstanding amounts meeting the definition of a liability as per GRAP 1: *Presentation of Financial Statements*, in the financial statements, resulting in an overstatement of trade and other payables as disclosed in note 8 to the financial statements by at least R12,4 million (2012: R1,6 million), while receivables from exchange transactions was understated by R18,7 million and accumulated surplus understated by R6,3 million. In addition the municipality did not process a prior period adjustment for payables due to inadequate records. Due to the lack of systems in place, it was impracticable for me to determine the full extent of the understatement in payables from exchange transactions.

Cash flow statement

20. GRAP 2: *Cash flow statements*, requires the presentation of a cash flow statement summarising the entity's operating, investing and financing activities. The cash flow statement for the current and prior year could not be confirmed due to limitations imposed and due to a lack of sufficient appropriate audit evidence for receipts from government, payments to suppliers, loans repaid and new loans raised. I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the cash flow statement.

Receivables from non-exchange transactions

21. Receivables from non-exchange transactions of R26,7 million is disclosed in note 18 to the financial statements. The impairment allowance raised against receivables from non-exchange transactions was not supported by sufficient appropriate audit evidence as management could not provide a listing of impaired receivables. I was unable to confirm the balance by other means. In addition receivables from non-exchange transactions and revenue is understated by R46,6 million. Consequently, I was unable to determine whether any adjustments relating to receivables from non-exchange transactions in the financial statements were necessary.

Provisions

22. Provisions of R12,6 million is disclosed in notes 4 and 7 to the financial statements. The provision for landfill sites and expenditure is understated by R16 million (2012: R385 000) as a result of the municipality not accounting for a valuation that was performed at year end by a management expert.

Material losses

23. The municipality disclosed material losses in note 47.4 to the financial statements for water and electricity as required by section 125(2)(d)(i) of the MFMA. Material losses for the current and prior year could not be confirmed due to limitations imposed by the lack of sufficient appropriate audit evidence included in this report. I was unable to confirm this disclosure by alternative means.

Consequently, I was unable to determine whether any further adjustments relating to material losses in the financial statements were necessary.

Statement of comparison of budgets to actual amounts

24. GRAP 24: *Presentation of budget information in financial statements*, requires explanations of material variances as well as explanations of amendments made to the originally approved budget. Explanations for variances and amendments to the originally approved budget could not be obtained. I was unable to confirm the statement by alternative means. Consequently, I was unable to determine whether any adjustments to the statement of comparison of budgets to actual amounts were necessary.

Aggregation of immaterial uncorrected misstatements

25. 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 performance to the financial statements:
26. I was unable to obtain sufficient appropriate audit evidence and was therefore unable to confirm the following elements by alternative means:
- Repairs and maintenance of R12,8 million included in the disclosed amount of R14,1 million disclosed in note 35 to the financial statements.
 - Contracted services expenditure of R1,6 million included in the disclosed amount of R3,1 million disclosed in note 38 to the financial statements.
 - Bulk purchases of R10,6 million included in the disclosed amount of R145 million disclosed in note 37 to the financial statements.
- As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Aggregation of immaterial uncorrected misstatements in corresponding figures

27. 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 performance and position to the financial statements:
- Receivables from exchange transactions amounting to R126,8 million as disclosed in note 17 is understated by R16,9 million.
 - Provision for bad debts amounting to R424,7 million as disclosed in notes 17 and 18 is understated by R13 million.
28. In addition, I was unable to obtain sufficient appropriate audit evidence and was therefore unable to confirm the following elements by alternative means:
- Accumulated surplus of R10,8 million included in the statement of net assets in the amount of R989 million in the financial statements.
 - VAT of R7,2 million included in the disclosed amount of R4,8 million in note 10 to the financial statements.
 - Property, plant and equipment (moveable) of R6,3 million included in the disclosed amount of R724,3 million in note 11.1.
 - Revenue from exchange transactions of R11,2 million included in the disclosed amount of R270,9 million in notes 24, 26, 27, 28 and 29 to the financial statements.

- Operating grant expenditure of R7,3 million included in the disclosed amount of R6,3 million in note 39 to the financial statements.
- Other receivables from non-exchange transactions of R3,7 million included in the disclosed amount of R5,7 million in note 17 to the financial statements.

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Disclaimer of opinion

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 matter

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

Restatement of corresponding figures

30. As disclosed in note 41 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the financial statements at, and for the year ended, 30 June 2012.

Material impairments

31. As disclosed in notes 17 and 18 to the financial statements, an amount of R424,8 million (2012: R337,2 million) has been impaired as a result of a non-payment of consumer debtor accounts.

Additional matters

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

Unaudited supplementary schedules

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

34. 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

35. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of

the annual report.

36. 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 (FMPPi)*.
37. The reliability of the information in respect of the selected programme is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
38. The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance were not disclosed.

39. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved.
40. Measures to improve performance were not provided for 79% of indicators disclosed in the annual performance report. This was due to limitations placed on the scope of my work.
41. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to whether there are reliable measures taken to improve performance.

Measurability

Performance targets not specific

42. The FMPPi requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 33% of the targets relevant to all the key priorities of the municipality were not specific in clearly identifying the nature and the required level of performance. This was due to the lack of appropriate management supervision to ensure that the municipality complies with relevant laws and regulations around performance management, i.e. suitable monitoring, recording and reporting on predetermined objectives.

Performance targets not measurable

43. The FMPPi requires that performance targets be measurable. The required performance could not be measured for 100% of the targets. This was due to management not providing all information relating to the audit of performance information.

Performance targets not time bound

44. The FMPPI requires that the time period or deadline for delivery be specified. A total of 100% of the targets relevant to all the key priorities of the municipality were not time bound in specifying a time period or deadline for delivery. This was due to the lack of appropriate management supervision to ensure that the municipality complies with relevant laws and regulations around performance management, i.e. suitable monitoring, recording and reporting on predetermined objectives.

Performance indicators not well defined

45. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators relevant to all the objectives of the municipality 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 lack of appropriate management supervision to ensure that the municipality complies with relevant laws and regulations around performance management, i.e. suitable monitoring, recording and reporting on predetermined objectives.

Indicators not verifiable

46. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators relevant to all the key priorities of the municipality were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the absence of a performance management system and a lack of understanding of the requirements of the National Treasury FMPPI.

Relevance

47. The FMPPI requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. 100% of indicators did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the integrated development plan.

48. This was due to the lack of development and implementation of proper performance planning and management practices to provide for the development of performance indicators and targets included in the annual performance plan.

Reliability of selected objectives in the annual performance report

Objective 10: Economic Development

49. The *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.

50. 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 objective of Economic Development.

51. 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 presented with respect to the objective.

Objectives 14 and 15: To provide basic level of infrastructure through the Municipal Infrastructure Grant (MIG) funding

52. The FMPPPI 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.

53. 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 objective to provide basic level of infrastructure through the Municipal Infrastructure Grant (MIG) funding.

54. 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 presented with respect to the objective.

Compliance with laws and regulations

55. I performed procedures to obtain evidence that the entity 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:

56. The municipal council did not consult with the local community in the drafting and implementation of the municipality's integrated development plan (IDP), by means of a municipal wide structure for community participation/through a forum that enhances community participation, as required by section 28 of the MSA and section 15(1)(a)(i) of the Municipal Planning and Performance Management Regulation Published under *Government Notice R796 in Government Gazette 22605* dated 24 August 2001 (MPPMR).

57. The IDP adopted by the municipality does not reflect and identify a financial plan and the key performance indicators and targets, as required by sections 26 and 41 of the MSA. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by regulation 15(3) of the MPPMR.

58. The municipality did not conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and regulation 6 of the MPPMR.

59. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.

60. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 41(1)(a) of the MSA and regulation 1 and 9(1)(a) of the MPPMR.
61. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the MSA and regulation 12(1) and 12(2)(e) of the MPPMR.
62. The mayor of the municipality did not verify whether the municipality's approved budget is implemented in accordance with the service delivery and budget implementation plan, issue any appropriate instructions to the accounting officer to ensure that the budget is implemented in accordance with the service delivery and budget implementation plan and ensured that spending of funds and revenue collection proceed in accordance with the budget; identify any financial problems facing the municipality, including any emerging or impending financial problems as required by Section 54(1) of the MFMA.
63. 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 .
64. The annual performance report for the year under review does not include a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(a), (b) and (c) of the MSA.
65. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

Annual financial statements, performance and annual reports

66. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
67. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.
68. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

Budget

69. Quarterly reports were not submitted to the council on the implementation of the budget and/or 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.
70. The total unforeseen and unavoidable expenditure incurred exceeded 4% of own revenue and R15 million, in contravention of Municipal Budget and Reporting Regulation 72.

71. Sufficient appropriate audit evidence could not be obtained that monthly budget statements were submitted to the mayor or relevant provincial treasury or accounting officer, as required by section 71(1) of the MFMA.

Audit Committee

72. The audit committee did not advise the council or accounting officer on matters relating to internal financial control and internal audits, accounting policies, effective governance, performance management, performance evaluation as required by section 166(2)(a) of the MFMA.

73. The audit committee did not advise the council or accounting officer 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.

74. The audit committee did not advise the council or accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

75. 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 legislation, as required by section 166(2)(b) of the MFMA.

76. 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.

77. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

78. The audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by regulation 14(4)(a)(iii) of the MPPMR.

79. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by regulation 14(4)(a)(iii) of the MPPMR.

Internal Audit

80. Internal audit 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/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.

81. The internal audit unit did not advise the accounting officer and/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.

82. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and regulation 14(1)(a) of the MPPMR.
83. The internal audit unit did not assess the functionality of the performance management system, as required by regulation 14(1)(b)(i) of the MPPMR.
84. 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 regulation 14(1)(b)(ii) of the MPPMR.
85. The internal audit unit did not audit the performance measurements on a continuous basis and/or submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by regulation 14(1)(c) of the MPPMR.

Expenditure management

86. 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.
87. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
88. An effective system of expenditure control, including procedures for the approval, authorisation withdrawal, payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
89. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors, accounted for payments made, as required by section 65(2)(b) of the MFMA.
90. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

91. 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.
92. 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.

Liability management

93. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
94. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.
95. Long-term debt was incurred without a resolution of the municipal council approving the debt agreement, in contravention of section 46(2) of the MFMA.

Revenue management

96. An adequate management, accounting and information system which accounts for revenue, debtors, receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
97. An effective system of internal control for debtors, revenue was not in place, as required by section 64(2)(f) of the MFMA.
98. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
99. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2) of the MFMA.
100. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Procurement and contract management

101. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by regulation 17(a) and (c) of the Municipal SCM Regulations issued in Government Gazette 27636 of 30 May 2005 (SCM Regulation).
102. 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 regulations 16(b) and 17(b) of the SCM Regulation.
103. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by regulations 19(a) and 36(1) of the SCM Regulations.
104. 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 regulation 27(2)(a) of the SCM Regulation.
105. 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 regulation 27(3) of the SCM Regulation.
106. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by regulations 22(1) and 22(2) of the SCM Regulations.
107. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM

practitioner of the municipality as required by regulation 28(2) of the SCM Regulations.

108. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by Regulations 21(b) and 28(1)(a) of the SCM Regulation and Preferential Procurement Regulations.
109. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with regulation 29(2) of the SCM Regulation.
110. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by Regulation 29(5)(b) of the SCM Regulation.
111. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPF).
112. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
113. 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.
114. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act, 2000 (Act No. 38 of 2000) and CIDB Regulation 18.
115. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by regulation 13(c) of the SCM Regulation.
116. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000 as required by section 2(a) of the PPPF and regulation 28(1)(a) of the SCM regulation .
117. Construction contracts were awarded to contractors that were not registered with the CIDB and/or did not qualify for the contract, in accordance with section 18(1) of the CIDB Act and CIDB Regulations 17 and 25(7A).
118. Sufficient appropriate audit evidence could not S be obtained that contract and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service (SARS) to be in order as required by Regulation 43 of the SCM Regulation.
119. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify

for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of regulations 14(1)(a)(ii) and 14(2) of the SCM Regulations.

120. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as management did not provide the requested information.
121. The municipality did not implement an SCM policy as required by section 111 of the MFMA.

Human resource management and compensation

122. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
123. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of the MSA.
124. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels (MRMCL) published in *Government Gazette 29967* dated 15 June 2007 .
125. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by regulation 14(2)(a) of the MRMCL.
126. The 2011-12 annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by regulation 14(2)(b) of the MRMCL.
127. The head of supply chain management did not meet any of the prescribed competency areas as required by section 119 of the MFMA and regulation 10 and 11 of the MRMCL.
128. All senior managers did not meet any of the prescribed competency areas as required by regulation 6 and 7 of the MRMCL.
129. Finance officials at middle management did not meet any of the prescribed competency areas as required by regulation 8 and 9 of the MRMCL.
130. Sufficient appropriate audit evidence could not be obtained that the municipality developed and adopted appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff as required by section 67(d) of the MSA .
131. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

132. The municipal manager, all senior managers, head of supply chain management and a finance middle management official were appointed without having met the prescribed minimum competency levels as required by section 54A(2) and 56(1)(b) of the MSA.
133. Sufficient appropriate audit evidence could not be obtained that the senior managers dismissed for financial misconduct in a previous position were re-appointed before the expiry of 10 years in contravention of section 57A of the MFMA.
134. The accounting officer did not meet any of the prescribed competency areas as required by sec 83 of the Municipal Finance Management Act and Regulation 2 and 3 of the MRMCL.
135. The chief financial officer did not meet any of the prescribed competency areas as required by sec 83 of the Municipal Finance Management Act and Regulation 4 and 5 of the MRMCL.

Conditional grants

136. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
137. The municipality did not evaluate its performance in respect of programmes funded by the MSIG and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
138. The municipality did not submitted, within 10 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.35399.
139. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the DoRA Grant Framework, Gazette No.35399.

Consequence management

Sufficient, appropriate audit evidence could not be obtained to confirm the following:

140. Unauthorised 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.
141. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2) of the MFMA.
142. 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.

143. The condoning of irregular expenditure was not approved by the appropriate relevant authority, in accordance with the requirements of sections 1 and 170 of the MFMA.
144. Unauthorised, irregular, fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
145. Unauthorised, irregular, fruitless and wasteful expenditure was written-off as irrecoverable without being certified by council as irrecoverable, as required by section 32(2) of the MFMA.
146. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2) of the MFMA.
147. The accounting officer or the council did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by sections 32(6) and 32(7) of the MFMA.
148. Allegations of fraud, corruption, improper conduct and failure to comply with the supply chain management system laid against officials were not investigated by the accounting officer, as required by regulation 38(1)(b) of the SCM Regulation.
149. Appropriate action was not taken against officials in the supply chain management system where investigations proved failure to comply with the supply chain management system, as required by regulation 38(1)(b) of the SCM Regulation.
150. The accounting officer did not always report cases of irregular conduct that constituted a crime to the South African Police Service, as required by regulation 28(1)(b) of the SCM Regulation .
151. Allegations of financial misconduct against senior managers were not always tabled before council, as required by section 5(2) of the Local Government: Disciplinary Regulations for Senior Managers.
152. The council did not appoint an independent investigator to investigate all allegations where there were reasonable cause to believe an act of misconduct has been committed, as required by regulation 5(3)(a) of the Local Government: Disciplinary Regulation for Senior Managers 5(3)(a).
153. Disciplinary proceedings were not instituted by the council where the report of independent investigators confirmed the financial misconduct by a senior manager, as required by regulation 5(6) of the Local Government: Disciplinary Regulation for Senior Managers.
154. Cases of financial misconduct which constitute a crime committed by senior managers were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.
155. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA. Disciplinary proceedings were not instituted against officials of the municipality, when investigations warranted such a step, as required by section 171(4)(b) of the MFMA.

156. Cases of financial misconduct which constitute a crime were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.

Internal control

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

Leadership

157. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls and compliance with laws and regulations and did not insist on daily disciplines to ensure sound financial and performance management and compliance with laws and regulations. This resulted in inaccurate, incomplete and inadequate financial and performance reporting. In addition, leadership has not resolved most of the recurring audit findings that have been raised for the past four financial years.
158. The policies and procedures relating to human resource management, as well as an unsuitable organogram render HR management ineffective. Adequate and sufficiently skilled resources were not in place and the performance of municipal officials was not monitored by those charged with governance and leadership.
159. Leadership has not ensured that the revised action plan was approved by Council and ensured that it was overseen by governance structures such as MPAC, audit committee or the finance portfolio committee.
160. The established and communicated policies and procedures of the municipality were outdated and did not adequately support the municipality in complying with laws, regulations and reporting requirements of GRAP.
161. Although an IT governance framework is in place it has not been devolved to incorporate the unique circumstances and challenges of the municipality.

Financial and performance management

162. Inadequate record management practices, poor financial discipline and inadequate monitoring controls resulted in significant deficiencies in the general control environment. Where information was availed it was either often incomplete or did not support the underlying accounting records reported in the financial statements and the performance report. The municipality did not institute regular processes of collecting, collating and reporting on credible information which assisted with decision making and direction of the municipality's financial and performance objectives. As a result, sufficient appropriate audit evidence was not obtained for a number of significant components reported in the financial statements and performance report.
163. Appropriate daily and monthly processes, procedures and controls were not introduced to ensure that all transactions were accurately recorded, classified, reconciled, approved and reported on, in accordance with GRAP and the FMPP. Material misstatements across all cycles and components signified a lack of

review of transactions and balances at all managerial levels within the municipality, including the inadequacy of detection systems to alert management of control failures. Officials did not always fulfil their assigned duties and responsibilities and the performance of staff was further compromised by outdated policies and procedures, lack of training of newly appointed staff and not holding staff responsible and accountable for their actions.

164. The lack of financial discipline and monitoring throughout the financial year resulted in a large number of reconciliations, journals and corrections being performed after year-end, mainly by consultants. In addition a number of prior period corrections were made which in most instances could not be substantiated or supported by sufficient, appropriate audit evidence.
165. Leadership did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation such as the MFMA, DoRA and Systems and Structures Acts, as a result the majority of municipal laws and regulations were not complied with. In addition SCM compliance awareness amongst officials across all functional areas was not at the desired level, as evidenced by the abnormal amount of irregular expenditure identified during the audit.
166. The municipality did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information. This was further evidenced by the lack of reconciliations between IT system generated reports and amounts disclosed in the financial statements.

Governance

167. The municipality's risk management strategy remained in draft form and was not implemented nor monitored by management. Although a risk assessment was performed it was inadequate as no responsibilities or actions were assigned in terms of identified risks and as a result were not used as a mitigating tool by management.
168. Internal audit only tabled three audit reports to the audit committee. In addition the audit committee only met twice during the year. The lack of co-ordination in the district together with the capacity problems experienced by internal audit severely hampered any efforts by the committee to play a constructive oversight role. As a result the committee did not fulfil its assigned responsibilities in terms of the MFMA, specifically the review of financial and performance reporting and compliance with laws and regulations and as a result did not provide the municipality with the required assurance.

East London
30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA