



The accounting officer
Intsika Yethu Municipality
Private Bag X1251
Cofimvaba
5380

30 November 2013

Reference: 21306REG12/13

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Intsika Yethu Local Municipality for the year ended 30 June 2013

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and in terms of section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature Auditor-General in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in

the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely



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

Introduction

1. I have audited the financial statements of the Intsika Yethu Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

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

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for adverse audit opinion

Unauthorised expenditure

6. Due to the numerous findings on expenditure, the amounts disclosed in the statement of financial performance do not fairly present the actual expenditure of the municipality for the current and prior period. Consequently, I was unable to determine whether any further adjustments were necessary to the unauthorised expenditure disclosed in note 32 to the financial statements at an amount of R34.5 million (2011-12: R117,2 million).

Irregular expenditure

7. 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 34 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R7,7 million (2011-12: R32,4 million).
8. Due to the inadequate systems and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable for me to determine the full extent of the understatement of irregular expenditure disclosed at R4,4 million (2011-12: R4,4 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.
9. The comparative amount for irregular expenditure was restated from R31,7 million as disclosed in the prior year financial statements to R4,4 million as disclosed in note 34 to the financial statements. Sufficient appropriate audit evidence was not available for this adjustment as documentation was not submitted for audit purposes. I was unable to confirm the comparative amount disclosed as irregular expenditure. Consequently, I was unable to determine whether any further adjustments were necessary to the comparative figure of R4,4 million as disclosed in note 34 to the financial statements.

Property, plant and equipment

10. The municipality did not have adequate systems in place to ensure that items of property, plant and equipment existed and were correctly valued, classified and disclosed in the financial statements. Property, plant and equipment is overstated by R10 million (2011-12: R5,2 million), accumulated surplus overstated by R1,6 million (2011-12: R5,1 million), expenditure understated by R8,9 million (2011-12: R81 248) and depreciation and amortisation overstated by R497 797 (2011-12: R48 190 understated) as a result of the following:
 - assets which could not be physically verified
 - assets which had been donated still appearing on the fixed asset register
 - depreciation being incorrectly calculated
 - assets less than R5 000 being incorrectly recorded in the fixed asset register, which is not in accordance with the policy
11. Furthermore, not all assets were recorded in the fixed asset register during the current and prior year. I have not determined the correct value for these assets as it was impracticable to do so.
12. Completed projects of R13,1 million (2011-12: R3 million) were incorrectly included as work-in-progress, resulting in community assets and road transport assets being understated by R10 million (2011-12: R2,7 million) and R3,1 million (2011-12: R401 087) respectively. As disclosed in note 24 to the financial statements, rental income of R885 378 (2011-12: R757 618) was received during the year, however, the properties on which these rentals were earned were not classified as investment property, as required by GRAP 16: Investment property.
13. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years as documentation in support of property, plant and equipment was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the amounts disclosed as property, plant and equipment by alternative means. Consequently, I was unable to determine whether any further

adjustments were necessary to property, plant and equipment of R544,3 million (2011-12: R528,7 million) as disclosed in note 3 to the financial statements.

14. Furthermore, it was not possible to determine the impact of these findings on depreciation and amortisation of R34 million (2011-12: R32,8 million) as disclosed in note 22 to the financial statements.
15. The prior year depreciation of R91,6 million as disclosed in note 3 to the financial statements does not reconcile with the comparative amount for depreciation and amortisation of R32,8 million as disclosed in note 22 to the financial statements. No explanation for this difference was provided. Furthermore, as disclosed in note 31 to the financial statements, the comparative amounts were restated to correct errors identified during the current year. Sufficient appropriate audit evidence was not available for the adjustments made to comparative amounts and it was not possible to confirm whether any further adjustments were required.

Non-distributable reserves

16. The municipality has disclosed a non-distributable reserve in the statement of changes in net assets. In terms of the GRAP reporting framework, the only reserves that are allowed to be disclosed in the statement of changes in net assets are those that are allowed in terms of the various GRAP standards. The GRAP standards do not make provision for a non-distributable reserve. In terms of the National Treasury guidance that has been issued in this regard, internal funds and reserves should form part of the accumulated surplus and should not be disclosed on the face of the statement of changes in net assets.
17. Furthermore, sufficient appropriate audit evidence was not available during the prior year to support the balance of R450,5 million relating to non-distributable reserves. Sufficient appropriate audit evidence was not provided during the current year for the prior year adjustment of R112 million (2011-12: R1,8 million) and the correction of error of R31,4 million 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 balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to non-distributable reserves of R407,2 million (2011-12: R487,8 million) as disclosed in the financial statements.

Accumulated surplus

18. Sufficient appropriate audit evidence was not available in the prior year for the opening balance of the accumulated surplus of R85,1 million, as disclosed in the statement of changes in net assets. Furthermore, sufficient appropriate audit evidence was not provided during the current year for prior year adjustments of R74,9 million (2011-12: R19,8 million) and these amounts did not reconcile with the prior period error of R27 million as disclosed in note 31 to the financial statements. I was unable to confirm the adjustments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the accumulated surplus of R97,1 million (2011-12: R14,4 million) as disclosed in the financial statements.

Prior period errors

19. As disclosed in note 31 to the financial statements, prior period errors were identified during the current year and the financial statements were restated accordingly. These prior period errors were not appropriately presented as required in terms of GRAP 3: *Accounting policies, changes in accounting estimates and errors*, in that the nature of the error was not disclosed and not all line items affected were disclosed. Furthermore, the corrections made to the non-distributable reserve are incorrectly reflected as revaluation reserve.

20. In addition, sufficient appropriate audit evidence was not available for the adjustments as the documentation was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the adjustments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the comparative amounts as disclosed in the financial statements.

Revenue from exchange and non-exchange transactions

21. The municipality did not have adequate controls in place to ensure that all revenue owed to the municipality was billed and that revenue was calculated correctly. Revenue from exchange transactions is understated by R25,8 million, revenue from non-exchange transactions is understated by R23,4 million, other income is overstated by R700 000, receivables from exchange transactions is understated by R25,8 million, receivables from non-exchange transactions is understated by R23,4 million, unspent conditional grants is understated by R700 000 and VAT receivable understated by R44 366 as a result of:

- inter-departmental charges which were incorrectly duplicated
- revenue from property rates being incorrectly calculated
- rates not charged on properties on the valuation roll
- service charges billed on properties that are not on the valuation roll
- water and refuse charges which were incorrectly calculated
- output VAT incorrectly deducted from revenue

22. In addition, sufficient appropriate audit evidence was not available for either the current or the comparative years and the documentation in support of sanitation charges and the sale of water was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to sewerage and sanitation charges of R2 million (2011-12: R1,8 million) and the sale of water of R1,8 million as disclosed in note 16 to the financial statements.

23. During the prior year, property rates were charged on properties which do not appear on the valuation roll, VAT refunds and personnel expenditure were incorrectly allocated to revenue and rental income was charged on expired leases. As a result, the comparative amount for revenue is overstated by R3,5 million, personnel expenditure understated by R676 049, receivables from non-exchange transactions overstated by R729 197, VAT receivable overstated by R3,1 million and receivables from exchange transactions overstated by R312 711. Furthermore, sufficient appropriate audit evidence was not provided during the prior year for other income of R4,8 million. I was unable to confirm the revenue by alternative means. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Expenditure

24. The municipality did not have adequate controls over the processing of transactions in the general ledger. Expenditure is overstated by R10,9 million (2011-12: R177 593), personnel costs understated by R4 million, trade payables overstated by R148 919 (2011-12: R1,1 million understated), accumulated surplus overstated by R3,6 million (2011-12: R1.9 million), unspent conditional grants understated by R187 378, VAT receivable overstated by R94 677 (2011-12: R620 660 overstated), councillor's remuneration overstated by R386 743 and property, plant and equipment understated by R3,7 million as a result of:

- grant income and councillor's remuneration being incorrectly classified as expenditure
- expenditure being recognised in the incorrect year
- VAT being incorrectly processed on the system
- journals being incorrectly processed on the system
- assets and employee costs being incorrectly classified as expenditure being incorrectly allocated between different categories of expenditure
- differences identified between the amounts recorded in the accounting system and the supporting documentation

25. The above matters has also resulted in audit fees of R6 million as disclosed in notes 19 and 35 to the financial statements being overstated by R2,8 million.

26. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and documentation in support of expenditure was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to repairs and maintenance of R4,5 million (2011-12: R3,4 million) and general expenses of R47,8 million (2011-12: R79,5 million) as disclosed in the statement of financial performance and note 19 to the financial statements.

Personnel expenditure

27. The municipality did not have adequate controls over the capturing of salaries and wages during the current and prior year and reconciliations between the accounting records and the payroll system were not performed on a monthly basis. Personnel expenditure is overstated by R20,4 million (2011-12: R467 347), expenditure understated by R12 million, councillors remuneration is understated by R2,7 million and other receivables understated by R5,7 million (2011-12: R467 367) as a result of:

- subsistence and travelling expenditure being incorrectly calculated and incorrectly allocated to personnel costs
- subsistence and travelling expenditure paid to councillors being incorrectly classified as personnel costs
- employees not physically verified during the year
- salaries paid in excess of contract amounts
- overtime being incorrectly calculated
- differences identified between the net pay on the payroll and the amount paid per the bank statement

28. In addition, sufficient appropriate audit evidence was not available for either the current or the comparative years as documentation in support of personnel expenditure was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to personnel expenditure of R76 million (2011-12: R63,9 million) as disclosed in note 20 to the financial statements.

Commitments

29. Commitments of R17,7 million (2011-12: R10,4 million) as disclosed in note 28 to the financial statements are understated by R8,2 million (2011-12: R419 771) as a result of commitments being incorrectly calculated and the amounts not agreeing to the underlying accounting records.

30. The comparative amount for commitments is further understated by R7,3 million as not all commitments were included in the prior year. In addition, sufficient appropriate audit

evidence was not available in the prior year as documentation in support of commitments was either not submitted or that which was submitted was incomplete. Consequently, I was unable to determine whether any further adjustments were necessary to the comparative amount of R10,4 million as disclosed in note 28 to the financial statements.

Payables from exchange transactions

31. Included in other creditors of R19,5 million as disclosed in note 14 to the financial statements is the leave pay accrual and thirteenth cheque accrual. This amount is overstated by R3,1 million and personnel expenditure overstated by the same amount as a result of the following:

- thirteenth cheque accrual being incorrectly calculated and not recorded in payables
- difference between the leave pay schedule and the amount disclosed in the financial statements
- employees not included on the schedule for the provision for leave pay
- leave pay incorrectly calculated

32. The municipality did not have adequate systems in place for the raising and recording of trade payables of R4,9 million as disclosed in note 14 to the financial statements. Differences were identified between the age analysis and the amount disclosed in the financial statements, payments were allocated against creditors accounts instead of expenditure and trade payables were recorded at the incorrect values, which resulted in trade payables being understated by R1,7 million and expenditure being understated by R1,7 million.

33. In addition, sufficient appropriate audit evidence was not available for either the current or the comparative years and documentation in support of payables from exchange transactions was either not submitted for audit purposes or that which was submitted was incomplete. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to payables from exchange transactions of R24,4 million (2011-12: R29,9 million) as disclosed in note 14 to the financial statements.

Receivables from exchange and non-exchange transactions

34. GRAP 1: *Presentation of financial statements* requires an entity to disclose in the notes to the financial statements, further sub-classifications on the line items presented, classified in a manner appropriate to the entity's operations. The ageing per major category of receivables and the category of consumer, specifically identifying those amounts owed by other spheres of government, has not been disclosed in notes 7 and 9 to the financial statements. Furthermore, the receivables age analysis did not distinguish between receivables from exchange and non-exchange transactions, therefore it was not possible to determine whether the amounts in the financial statements were correctly classified.

35. Receivables with credit balances of R1,3 million (2011-12: R921 748) were included in receivables, resulting in receivables from exchange and non-exchange transactions being understated by R1,3 million (2011-12: R921 748) and trade payables being understated by the same amount.

36. The municipality did not disclose an allowance for impairment of receivables from non-exchange transactions of R7,4 million (2011-12: R2,2 million) as disclosed in note 7 to the financial statements, despite the majority of this debt being outstanding for more than 180 days. I have not determined the correct disclosure amounts for the allowance for impairment of receivables from non-exchange transactions and bad debts as it was impracticable to do so.

37. Sufficient appropriate audit evidence in support of the allowance for impairment of receivables was not available for both the current and the prior year and documentation and calculations in support of allowance was not submitted for audit purposes. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the allowance for impairment relating to receivables from exchange transactions of R2,4 million (2011-12: R5 million) and bad debts of R4,1 million (2011-12: R3,9 million) as disclosed in notes 9 and 19 to the financial statements.
38. During the 2011-12 year, sufficient appropriate audit evidence was not available to support receivables from exchange and non-exchange transactions as documentation in support of the amounts was either not submitted for audit purposes or that which was submitted was not adequate. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the comparative amounts for receivables from non-exchange transactions of R2,2 million and receivables from exchange transactions of R5,9 million, as disclosed in notes 7 and 9 to the financial statements. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Value-added tax receivable

39. The VAT receivable of R722 959 as disclosed in note 8 to the financial statements agreed to the refund received from the South African Revenue Service (SARS) subsequent to year-end. However, the municipality has not accounted for VAT on the accrued revenue and accrued expenditure as disclosed in the financial statements. Due to the findings reported on revenue from exchange transactions and trade and other payables, it was impracticable to determine the correct disclosure amounts for the outstanding VAT at year-end.
40. Furthermore, during the 2011-12 financial year, VAT refunds from SARS amounting to R2,8 million were incorrectly allocated against revenue and output VAT of R726 540 was not reversed on the allowance for debt impairment, resulting in the VAT receivable being overstated by R2,1 million, revenue being overstated by R2,8 million and the allowance for impairment of receivables being overstated by R726 540. Sufficient appropriate evidence was not available in support of the VAT receivable balance as documentation was either not submitted for audit purposes or that which was submitted was not adequate. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the comparative amount for VAT receivable were necessary. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Cash flow statement

41. GRAP 2: *Cash flow statements* requires the presentation of a cash flow statement, summarising the entity's operating, investing and financing activities. The municipality was not able to provide adequate supporting documentation and calculations for the current and comparative amounts disclosed in the cash flow statement. Furthermore, due to the numerous findings on account balances and classes of transactions, the amounts disclosed in the cash flow statement do not fairly present the cash inflows and outflows of the municipality for the current and prior period.

Statement of comparative and actual information

42. GRAP 24: *Presentation of budget information in financial statements* requires that a full set of financial statements should include a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements. The municipality included limited budget versus actual disclosure in note 36 to the financial statements, however, the capital budget and expenditure was not included and no explanations for the material variances were disclosed. Consequently, the disclosure of the budget versus actual comparison is not appropriate or complete in terms of the requirements.

Financial instruments

43. The municipality has not disclosed information that enables users of the financial statements to evaluate the nature and extent of risks arising from financial instruments to which it is exposed at the end of the reporting period, as required by GRAP 104: *Financial instruments*. It was not possible to assess the impact of such non-disclosure on the financial statements.

Disclosure requirements

44. The following disclosures, as required by section 124(1) of the MFMA have not been included in note 21 to the financial statements:

- a statement by the accounting officer whether or not salaries, allowances and benefits of political office-bearers are within the upper limits of the framework envisaged in section 219 of the Constitution
- any arrears owed by individual councillors to the municipality

Unspent conditional grants

45. The comparative amounts for unspent conditional grants are understated by R2,7 million, revenue is overstated by R7 million, expenditure is overstated by R285 032, receivables from exchange transactions are understated by R138 080, accumulated surplus is understated by R3 million and trade payables are understated by R1,1 million as a result of the following findings during the 2011-12 financial year:

- other deposits being incorrectly allocated to grant revenue
- unspent portion of the MIG grant being incorrectly recognised as revenue
- expenditure recognised in the incorrect period
- expenditure duplicated in the accounting records

46. Furthermore, sufficient appropriate evidence was not available for grant expenditure incurred during the prior year. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the comparative amounts for unspent conditional grants, revenue from non-exchange transactions and expenditure were necessary. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the opening balance and the comparability of the current period's figures.

Cash and cash equivalents

47. During 2011-12, sufficient appropriate evidence was not available in support of cash and cash equivalents. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the comparative amount of R6,9 million as disclosed in note 10 to the financial statements were necessary. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Adverse opinion

48. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Intsika Yethu Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

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

Material losses

50. As disclosed in note 19 to the financial statements, material losses to the amount of R4,1 million (2011-12: R3,9 million) were incurred as a result of bad debts being written off during the year.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

51. 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

52. 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.

53. 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).

54. 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). The material findings are as follows:

Usefulness of information

Presentation

55. 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. Adequate and reliable corroborating evidence could not be provided for all measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures.

56. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

Consistency

57. Section 41(1)(c) of the MSA requires that the service delivery budget and implementation plan (SDBIP) should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. All of the reported objectives and indicators and all of the reported targets are not consistent with the objectives, indicators and targets as per the approved SDBIP. This is due to the lack of sufficient monitoring controls to ensure the proper implementation of the overall performance process of planning, implementation and reporting.
58. 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.
59. All of the development objectives, indicators and targets reported in the annual performance report which were changed in-year, were changed without following the process as prescribed in section 34 of the MSA and without adoption by the council of the municipality. This was due to controls not being implemented to ensure compliance with all laws and regulations.

Measurability

60. The FMPPi requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 73% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the lack of standard operating procedures for development of targets.
61. The FMPPi requires that performance targets be measurable. The required performance could not be measured for a total of 82% of the targets. This was due to the lack of standard operating procedures for development of targets.
62. The FMPPi requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use and it must be possible to validate the processes and systems that produce the indicator. All of the indicators were not well defined and verifiable in that clear, unambiguous data definitions were not available to allow for data to be collected consistently and valid processes and systems that produce the information on actual performance did not exist. This was due to a lack of proper review when indicators and targets were decided on and formulated for inclusion in the integrated development plan and SDBIP.

Reliability of information

Project management, roads and storm water

63. 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.
64. 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 project management, roads and storm water development priority.
65. This was due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the project management, roads and storm water development priority.

Water and sanitation

66. The FMPP1 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.
67. 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 water and sanitation development priority.
68. This was due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the water and sanitation development priority.

Compliance with laws and regulations

69. 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

70. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and the municipal planning and performance management regulation 6.
71. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
72. 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 the municipal planning and performance management regulation 1 and 9(1)(a).
73. 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 the municipal planning and performance management regulation 12(1) and 12(2)(e).
74. 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.
75. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by the municipal planning and performance management regulation 14(4)(a)(ii).
76. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by the municipal planning and performance management regulation 14(4)(a)(i).
77. 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 Municipal planning and performance management regulation 14(4)(a)(iii).

78. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal planning and performance management regulation 14(1)(a).
79. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1)(b)(i).
80. 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).
81. The internal audit unit did not audit the performance measurements on a continuous basis and submit 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).
82. The annual performance report for the previous financial year was not included in the annual report, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
83. The annual performance report for the year under review does not include the performance of each external service provider as required by section 46(1)(a) of the MSA.
84. The annual performance report for the year under review does not include a comparison with the previous financial year as required by section 46(1)(b) of the MSA.
85. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.
86. 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.

Budgets

87. The 2012-13 annual budget was not approved by the council before the start of the financial year, as required by section 16(1) of the MFMA.
88. Quarterly reports were not submitted to the council within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
89. Expenditure was incurred not in terms of the approved budget and in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual report

90. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
91. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving an adverse audit opinion.

92. The annual report for the year under review does not include an assessment by the accounting officer of any arrears on municipal taxes and service charges, as required by section 121(3)(e) of the MFMA.
93. The annual report for the year under review does not include the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote, as required by section 121(3)(f) of the MFMA.
94. The annual report for the year under review does not include particulars of any corrective action taken or to be taken in response to issues raised in the audit report, as required by section 121(3)(g) of the MFMA.
95. The annual report for the year under review does not include the report of the audit committee, as required by section 121(3)(j) of the MFMA.

Procurement and contract management

96. Bids were not always evaluated by bid evaluation committees which composed of at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
97. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
98. The preference point system was not applied in all procurement for goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
99. Contracts were awarded to bidders based on preference points that were not allocated and awarded in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
100. 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 of connected to any person employed by the state, as required by SCM regulation 13(c).

Consequences management

101. Unauthorised and irregular expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
102. 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.

Expenditure management

103. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality had always been paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
104. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
105. 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.

106. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.
107. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

108. A credit control and debt collection policy was not adopted, maintained and implemented, as required section 62(1)(f)(iii) of MFMA.
109. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, accounted for debtors or accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
110. Interest was not charged on all accounts in arrears as, required by section 64(2)(g) of the MFMA.
111. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Conditional grants

112. Quarterly reports were not submitted to the transferring national officer and the National Treasury on municipal performance for the quarter against the targets stipulated in the infrastructure performance framework, within 30 days after the end of each quarter, as required by section 11(2)(c)(ii) of the DoRA.
113. 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.
114. The municipality did not evaluate its performance in respect of programmes funded by the Integrated National Electrification Grant, Municipal Systems Improvement Grant and the Municipal Infrastructure Grant and did not 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.
115. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 35399.

Asset management

116. 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.
117. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

118. 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.

Human resource management

119. 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 the Municipal Regulations on Minimum Competency Levels regulation 13.

120. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by the Regulations on Minimum Competency Levels regulation 14(2)(a).
121. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the Regulations on Minimum Competency Levels regulation 14(2)(b).
122. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.
123. Bonuses were awarded to the municipal manager and senior managers directly accountable to the municipal manager before the annual report for the financial year under review was tabled and adopted by council, in contravention of section 57(4)(b) MSA.

Internal audit

124. The internal audit unit did not prepare a risk-based audit plan and an internal audit programme for the financial year under review, as required by section 165(2)(a) of the MFMA.
125. The internal audit unit did not report to the audit committee on the implementation of the internal audit plan, as required by section 165(2)(b) of the MFMA.
126. The internal audit plan did not advise the accounting officer to report to the audit committee on matters relating to loss control, as required by section 165(2)(b)(iv) of the MFMA.
127. The internal audit unit did not advise the accounting officer to report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Internal control

128. 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 the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

129. Although there was no change in leadership, the municipality made minimal improvement from the prior year to the current 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 in the current year.
130. 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 purposes, non-compliance with applicable laws and regulations as well as information presented in the report on predetermined objectives not being valid, accurate and complete.

131. Furthermore, the leadership failed to take disciplinary action against officials who caused or allowed unauthorised, irregular and fruitless and wasteful expenditure to be incurred by the municipality, as well as against officials who failed to comply with the policies, processes and procedures of the municipality.
132. Based on the disclosures in the related party note in the financial statements, relatives of councillors and senior managers have been appointed at the municipality. Based on an analysis of employees and councillors with the same surnames, this disclosure does not appear to be complete.

Financial and performance management

133. 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 is required at year-end as these controls are not performed on a regular ongoing basis during the year. Should adequate monitoring, supervision and controls be implemented, these misstatements should be able to be identified and corrected by management on a timely basis.
134. Adequate supporting documents were not obtained for a number of account balances and classes of transactions. This is due to weaknesses identified in the record keeping of the municipality resulting in recorded transactions not always having adequate supporting documentation. The municipality was unable to provide the relevant supporting documentation for transactions within assets, receivables, payables, compensation of employees, revenue, expenditure and reserves, as well as portfolios of evidence to support the audit of predetermined objectives.
135. The municipality did not prepare reliable and accurate monthly and quarterly financial statements. This is due to the municipality's policies and procedures that are not updated to support compliance with the GRAP reporting framework, the officials not understanding the requirements of the applicable reporting framework. Furthermore, there was a lack of segregation of duties as reliance is placed on a few key personnel to perform crucial functions. This had the impact of limiting supervision and monitoring.
136. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality does not comply with the reporting requirements as prescribed by the National Treasury.
137. The municipality has not implemented adequate review mechanisms to ensure that the report on predetermined objectives and the annual financial statements are reviewed for accuracy and completeness prior to submission for audit.

Governance

138. The municipality has an audit committee and internal audit unit in place. However, 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, compliance and performance objectives were addressed.
139. Management failed to implement the recommendations made by the audit committee, internal audit and external audit which resulted in a number of repeat audit findings in the current year.

140. The internal audit unit did not have an annual plan in place for the year under review. This contributed to the internal audit unit not performing adequate reviews of the internal control systems and providing the required level of assurance. This also impacted on the effectiveness of the audit committee.

141. Although the audit committee reviewed the adequacy, reliability and accuracy of the financial statements prior to submission for external audit purposes, there were still a significant number of material misstatements identified through the audit process.

OTHER REPORTS

Investigations

142. An investigation into the misappropriation of assets by an official was conducted during the year. The investigation resulted in the official being dismissed.

Auditor-General

East London

30 November 2013



**AUDITOR-GENERAL
SOUTH AFRICA**

Auditing to build public confidence