

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

**Introduction**

1. I have audited the financial statements of the Sakhisizwe Local Municipality set out on pages 3 to 69, 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor-general's responsibility**

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

**Basis for qualified opinion**

**Irregular expenditure**

6. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose material irregular expenditure that occurred during the financial year. Audited payments amounting to R 7.4 million (2012: R 16 million) were irregular, as they were made in contravention of the supply chain management (SCM) requirements. These amounts were not included in the irregular expenditure disclosed in note 38.3 to the financial statements. Consequently, the irregular expenditure disclosed is understated by at least this amount. However, it was impracticable to determine the full extent of the understatement, as there was no system of control operating throughout the financial year to identify the completeness

thereof.

### **Water losses**

7. The municipality is required by section 125(2)d of the MFMA to disclose in the financial statements the amount of material water losses for the year. The municipality did not have a system for the identification and quantification of water losses and consequently did not disclose any water losses. I was unable to confirm or verify by alternative means the water losses for the year, and, as a result I was unable to determine the water losses to be disclosed in the financial statements.

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

8. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, performance and the notes to the financial statements:
  - Property, plant and equipment reflected as R100 million is overstated by R1,7 million.
  - Total receivables reflected as R11,7 million is understated by R1 million.
  - Grant expenditure reflected as R2,9 million is overstated by R1 million.

### **Qualified opinion**

9. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Sakhisizwe 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 matters**

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

### **Restatement of corresponding figures**

11. As disclosed in note 31 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of an error discovered during the current financial year in the financial statements of the municipality at, and for the year ended, 30 June 2013.

### **Unauthorised expenditure**

12. As disclosed in note 38.1 of the financial statements, the municipality incurred unauthorised expenditure of R24 million (2012: R10,4 million) as a result of expenditure incurred which exceeded the total approved budget.

### **Material impairments**

13. Debt impairments of R6,8 million (2012: R 5,7 million) as disclosed in note 24 to the financial statements were made against trade debts. These debts are long outstanding and are considered to be irrecoverable.

### **Additional matter**

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

### **Unaudited supplementary schedules**

15. The supplementary information set out on pages 70 to 72 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

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

16. 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**

17. The annual performance report was not presented for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.

18. The information was assessed to determine whether performance 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).

19. The material findings are as follows:

#### **Usefulness of information**

##### **Measurability**

20. The National Treasury Framework for managing programme performance information (FMPPI) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management does not fully understand the requirements of the FMPPI.

21. The FMPPI requires that performance targets be measurable. The required performance could not be measured for 100% of the targets. This was due to the fact that management does not fully understand the requirements of the FMPPI.

22. The FMPPI requires that the time period or deadline for delivery be specified. A total of 100% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management does not fully understand the requirements of the FMPPI.

23. The FMPP requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management does not fully understand the requirements of the FMPPI.

24. 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 were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This

was due to the fact that management does not fully understand the requirements of the FMPPI.

### **Relevance**

25. 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. A total of 48% 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 five-year integrated development plan.
26. 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 integrated development plan.

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### **Compliance with laws and regulations**

27. 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:

#### **Asset management**

28. The right to use a capital asset was granted without the approval of the municipal council, in contravention of the Municipal Asset Transfer Regulation 34(1)(b).

#### **Revenue management**

29. 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.

#### **Conditional grants received**

30. The municipality did not submit quarterly performance reports to the transferring national office and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
31. The municipality did not submit the evaluation of programmes funded by the municipal infrastructure grant to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of DoRA.
32. The municipality did not timeously submit project registration forms, for projects it intends implementing in the 2013-14 financial year, to the department of local government, as required by the DoRA Framework, Gazette No.35399.
33. The municipality did not submit project implementation plans to the national department (Department of Cooperative Governance and Traditional Affairs [CoGTA]), as required by the DoRA Framework, Gazette No.35399.
34. The municipality did not submit MFMA implementation plans to National Treasury to address weaknesses in financial management, as required by the DoRA Framework, Gazette No.35399.
35. The municipality did not submit, within 10 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the DoRA Framework, Gazette No.35399.
36. Unspent conditional grant funds not committed to identifiable projects were not surrendered to the National Revenue Fund, as required by section 21(1) of DoRA.

## **Expenditure management**

37. 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.
38. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Procurement**

39. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c). 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 SCM regulation 17(a) and (c).
40. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
41. 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 or that deviations approved by the accounting officer were only made if it was impractical to invite competitive bids, as required by SCM regulations 19(a) and 36(1).
42. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which comprised one or more officials of the municipality as required by SCM regulation 27(3).
43. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and (2). 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 SCM regulation 22(1) and (2).
44. 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 SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
45. Sufficient appropriate audit evidence could not be obtained that the councillors of the municipality participated in committees evaluating or approving tenders and quotations or attended meetings of committees evaluating or approving tenders and quotations, in contravention of section 117 of the MFMA.
46. 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 Preferential Procurement Policy Framework Act (PPPF) and SCM regulation 28(1)(a).
47. Sufficient appropriate audit evidence could not be obtained that quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPF and its regulations.
48. Contracts were awarded to bidders who did not score the highest points in the evaluation process, as required by section 2(1)(f) of the PPPF.
49. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the Construction Industry Development Board Act (CIDB) and CIDB regulation 18.

50. Quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
51. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
52. 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 the municipality was unable to present the necessary information for audit.

### **Consequence management**

53. 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.
54. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
55. 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.

### **Annual financial statements, performance and annual reports**

56. The municipality did not give effect to its integrated development plan and/or conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the Municipal Systems Act No 32 of 2000, section 21(2)(a) of the MFMA and Municipal Planning and Performance Management Regulation 6.
57. The municipality did not establish a performance management system, as required by sections 38(a), 40 and 41 of the MSA.
58. 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 .
59. The annual performance report for the financial year under review was not prepared and was not included in the annual report, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
60. The annual performance report that was required to be submitted for the year under review should have included the performance of the municipality and a comparison of the performance with set targets, a comparison with the previous financial year, measures taken to improve performance, as required by section 46 (1)(a), (b) and (c) of the MSA, as it was not compiled or submitted by the municipality.
61. 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.
62. The council's oversight report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

### **Audit committee**

63. The audit committee did not adequately advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA, as evidenced by the material adjustments made to the annual financial statements.
64. The audit committee did not adequately 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.
65. The audit committee did not adequately advise the council and accounting officer on matters relating to performance management and performance evaluation, as required by section 166(2)(a) of the MFMA, as no performance information was prepared and no annual performance report was submitted by the accounting officer.

### **Internal audit unit**

66. The internal audit unit did not adequately advise the accounting officer and 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, as no performance information was prepared and no annual performance report was submitted by the accounting officer.

### **Human resource management**

67. The competencies of financial and SCM 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.

### **Internal control**

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

### **Leadership**

69. There was a lack of oversight and accountability by senior management as sufficient monitoring controls were not in place to ensure the proper implementation of internal policies at an operational level. As a result the municipality did not prevent and detect irregular expenditure incurred through non-adherence to SCM prescripts.
70. The municipality did not develop documented and approved internal policies and procedures to address the collection, recording, processing, monitoring of, and reporting on predetermined objectives. Consequently, no annual performance report was prepared.

### **Financial and performance management**

71. The municipality did not have a proper system of record management that provides for the maintenance of information that supports the information that could be in the annual performance report. This includes information which relates to the collection, collation,

verification, storing of, and reporting on, actual performance information. As a result of these deficiencies, no annual performance report was prepared by management.

72. The municipality did not have adequate systems for the complete and accurate financial reporting of irregular expenditure, commitments and depreciation. This is as a result of inadequate in-year monitoring of expense transactions to ensure that SCM requirements were fully adhered to. Whilst for commitments and depreciation, the commitments register and fixed asset register were not maintained throughout the year and asset useful lives incorrectly assessed.
73. The municipality did not adequately assign responsibility and implement processes to monitor compliance with the approved budget and ensure compliance with all applicable laws and regulations. The municipality thus incurred unauthorised, irregular as well as fruitless and wasteful expenditure and did not fully comply with all the requirements of the MFMA, MSA, MPPM and SCM regulations.

### **Governance**

74. The municipality did not conduct a risk assessment as required by the MFMA. Consequently, there was a failure to monitor compliance with the MFMA, MSA, MPPM and SCM regulations, as well as the GRAP reporting framework requirements.
75. The performance audit committee and the internal audit function did not have the chance to review, or report on, the performance management system or performance reports during the year under review as none were prepared. The municipality thus lost the benefit that may have been obtained had these reports been completed.

East London

29 November 2013



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*