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**AUDITOR - GENERAL
SOUTH AFRICA**

Lukhanji Municipality

Audit Report

For the year ended 30 June 2014

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 the Lukhanji Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison with budget for the year then ended, as well as 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), 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, 2013 (Act No. 2 of 2013) (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. 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

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment due to the following matters:
 - 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.*
 - Assets could not be physically located during the audit due to the lack of information in the municipality's asset register.
 - Details for land and buildings did not correspond to the register and I could not confirm that all municipal properties were included.
5. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments were required to property, plant and equipment of R682,5 million (2013: R639,7 million) as disclosed in the statement of financial position and note 11 or depreciation and amortisation disclosed in the statement of financial performance.
6. The entity did not account for its property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* in the following instances:
 - The value of land and buildings did not correspond to the valuation certificates.
 - Management did not record all assets in the register and financial statements.

- The municipality did not include a reconciliation for property, plant and equipment in the notes to the financial statements.
7. Consequently, property, plant and equipment as disclosed in the statement of financial position and note 11 is understated by R44,9 million (2013: R2,7 million), accumulated surplus as disclosed in the statement of financial position is understated by R17,1 million (2013: R2,7 million), expenditure as disclosed in the statement of financial performance is overstated by R33,4 million, depreciation and loss on disposal as disclosed in the statement of financial performance are understated by R1,7 million and R3,9 million respectively.

Investment property

8. I was unable to obtain sufficient appropriate audit evidence for investment property due to the following matters:
- Properties could not be physically located as the municipality did not prepare a register that was fully compliant with the requirements of GRAP 16: *Investment property*.
 - Ownership of properties included on the register could not be confirmed.
 - Details for properties did not correspond to the register and I could not confirm that all municipal properties were included.
9. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments were required to investment property of R153,5 million (2013: R125,1 million) as disclosed in the statement of financial position and note 12 to the financial statements.
10. The municipality did not adequately assess the fair value of all its land and buildings at each reporting date in accordance with GRAP 16: *Investment property* and differences were identified between the valuation certificates and the recorded values.
11. Consequently, investment property as disclosed in the statement of financial position and note 12, the fair value adjustment as disclosed in the statement of financial performance and accumulated surplus as disclosed in the statement of financial position are overstated by R38,4 million (2013: R9,4 million), R28,9 million (2013: R9,4 million) and R9,5 million respectively.

Value-added tax receivable

12. I was unable to obtain sufficient appropriate audit evidence for the value-added tax (VAT) receivable due to the following matters:
- Evidence was not available to clear reconciling differences between the South African Revenue Service (SARS) records and municipal records.
 - Evidence was not available for journal adjustments processed.
13. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to VAT of R27,1 million (2013: R14,2 million) as disclosed in note 10 to the financial statements were necessary.
14. The municipality did not adequately account for output VAT transactions. Consequently, the VAT receivable as disclosed in the statement of financial position and note 10 to the financial statements is understated and expenditure as disclosed in the statement of financial performance is overstated by R5,5 million.

Accumulated surplus

15. 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 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 of R908,9 million (2013: R864,2 million) as disclosed in the statement of changes in net assets and statement of financial position were necessary.

Prior period error note

16. Sufficient appropriate audit evidence was not submitted to support the correction of errors as disclosed in note 41 to the financial statements. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the correction of errors disclosure note.
17. The municipality did not disclose the nature of the correction of error for each correction in accordance with GRAP 3: *Accounting policies, changes in accounting estimates and errors* in note 41 to the financial statements. Consequently, the financial statements have not been prepared in accordance with all the requirements of the standard.

Debt impairment

18. I was unable to obtain sufficient appropriate audit evidence for the debt impairment due to the following matters:
 - Management processed system journals which could not be supported with a detailed listing of accounts impaired.
 - Management could not provide a detailed basis for the calculation of debt impairment journals.
19. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments relating to debt impairment of R77,4 million (2013: R74,1 million) as disclosed in the statement of financial performance and note 32 to the financial statements were necessary.
20. The municipality did not reconcile the listing of bad debts to the financial statements and, consequently, debt impairment as disclosed in the statement of financial performance and note 32 is overstated and receivables from exchange transactions as disclosed in the statement of financial position are understated by R5,6 million.

Unauthorised expenditure

21. I was unable to obtain sufficient appropriate audit evidence for the unauthorised expenditure as management does not have appropriate systems to identify this expenditure.
22. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to unauthorised expenditure of R2,9 million (2013: R60,2 million) as disclosed in note 46.1 to the financial statements were necessary.
23. Management does not have appropriate systems to identify this expenditure and, consequently, R27,1 million of unauthorised expenditure that was detected during the audit process was not disclosed in note 46.1.

Irregular expenditure

24. I was unable to obtain sufficient appropriate audit evidence for the irregular expenditure as management does not have appropriate systems to identify this expenditure.

25. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure of R41,5 million (2013: R40,6 million) as disclosed in note 46.3 were necessary.
26. 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). Consequently, the irregular expenditure disclosed in note 46.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R57 million.

Cash flow statement

27. I was unable to obtain sufficient appropriate audit evidence for the cash flow statement for the current and corresponding amounts due to a lack of sufficient appropriate audit evidence, including management workings for loans repaid, new loans raised and cash generated by operations as disclosed in the cash flow statement and note 42. GRAP 2: *Cash flow statements* requires the presentation of a cash flow statement summarising the entity's operating, investing and financing activities. I could not confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the cash flow statement.

Discontinued operations

28. I was unable to obtain sufficient appropriate audit evidence for the disclosure of discontinued operations. The municipality transferred its water operations to the Chris Hani District Municipality after the financial year-end. GRAP 100: *Non-current assets held for sale* requires that the information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposal of non-current assets (or disposal groups) should be presented and disclosed. No disclosure of this has been made in note 21 to the financial statements. Adequate records to substantiate the affected revenue, expenditure, assets and liabilities were not available to determine the amounts to be disclosed. I was unable to confirm the amounts to be disclosed by alternative means. Consequently, I was unable to determine the full extent of the understatement.

Material losses

29. I was unable to obtain sufficient appropriate audit evidence relating to material losses for the current and corresponding amounts due to the following matters:
 - Management did not have appropriate systems to collect the information required for the disclosure as required by section 125(2)(d)(i) of the MFMA.
 - Management did not prepare a reconciliation between the financial system and other data.
30. I was unable to confirm this disclosure by alternative means. Consequently, I was unable to determine whether any adjustments relating to material losses as disclosed in note 46.4 to the financial statements were necessary.

Receivables from exchange transactions

31. I was unable to obtain sufficient appropriate audit evidence relating to receivables from exchange transactions due to the following matters:
 - Information to support debtor balances was not available.
 - The impairment allowance was not supported by a detailed listing of impaired receivables.
32. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any further adjustments relating to receivables from exchange transactions of R20 million (2013: R15,2 million) as disclosed in the statement of financial position and note 17 to the financial statements were necessary.

33. System errors led to the misclassification between the receivables from exchange transactions and non-exchange transactions and consequently receivables from exchange transactions as disclosed in the statement of financial position and note 17 are overstated by R7,9 million (2013: R24,9 million understated), receivables from non-exchange transactions as disclosed in the statement of financial position and note 18 are understated by R7,6 million and accumulated surplus as disclosed in the statement of financial position is overstated by R301 132 (2013: R24,9 million understated).

Employee-related costs

34. I was unable to obtain sufficient appropriate audit evidence relating to employee costs due to the inadequacy of the municipality's employee record management system.
35. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to employee-related costs amounting to R139,2 million (2013: R104,9 million) disclosed in the statement of financial performance and note 30 to the financial statements were necessary.
36. The municipality made calculation errors on wages and consequently employee costs as disclosed in the statement of financial performance and note 30 is overstated and receivables from exchange transactions as disclosed in the statement of financial position are understated by R2,8 million.

Payables from exchange transactions

37. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions due to the following matters:
- The municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid for at year-end.
 - The municipality did not maintain adequate leave records.
38. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to payables from exchange transactions of R62,5 million (2013: R37,6 million) as disclosed in the statement of financial position and note 8 to the financial statements were necessary.
39. The municipality did not include all outstanding amounts meeting the definition of a liability as per GRAP 1: *Presentation of financial statements* in the financial statements. Consequently, trade payables from exchange transactions as disclosed in the statement of financial position and note 8 to the financial statements is understated by R15,9 million and expenditure as disclosed in the statement of financial performance is understated by the same amount. In addition, the municipality did not process all leave transactions during the year and consequently staff leave as disclosed in note 8 to the financial statements and employee costs as disclosed in the statement of financial performance is overstated by R11,1 million (2013: R8,8 million).

Receivables from non-exchange transactions

40. I was unable to obtain sufficient appropriate audit evidence for receivables from non-exchange transactions due to the following matters:
- Information to support debtor balances was not available.
 - The impairment allowance was not supported by a detailed listing of impaired receivables.
41. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables from non-exchange transactions of R54,1 million (2013: R26,7 million) as disclosed in the statement of financial position and note 18 to the financial statements were necessary.
42. The municipality did not account for all of its revenue and consequently the corresponding amounts for receivables from non-exchange transactions as disclosed in the statement of financial position, revenue from non-exchange transactions as

disclosed in the statement of financial performance and payables from exchange transactions as disclosed in the statement of financial position are understated by R46,5 million, R41,8 million and R4,7 million, respectively.

General expenditure

43. I was unable to obtain sufficient appropriate audit evidence for general expenditure such as orders, requisitions, agreements and explanations. I was unable to confirm this expenditure by an alternative means. Consequently, I was unable to determine whether any adjustments to general expenditure of R97,5 million (2013: R75,3 million) as disclosed in the statement of financial performance and note 40 to the financial statements were necessary.
44. The amount of R46,2 million (2013: R30 million) reflected for delegated management which is part of general expenditure in note 40 is overstated by R42,5 million (2013: R25,7 million), bulk purchases in the statement of financial performance are understated by R42,5 million (2013: R25,2 million) and revenue from exchange transactions corresponding amount as disclosed in the statement of financial performance is overstated by R558 065. Furthermore, general expenditure as disclosed in the statement of financial performance is overstated and receivables from exchange transactions as disclosed in the statement of financial position is understated by R3,3 million.

Statement of comparison of budgets to actual amounts

45. The municipality did not present the statement of comparison of budget and actual amounts in accordance with GRAP 24: *Presentation of budget information in financial statements*, as follows:
- The actual amounts per the statement of comparison of budget do not agree to the amounts in the statement of financial position, performance and cash flow statement, which in addition has resulted in inaccurate variances being reported.
 - The budget and adjusted budget amounts per the statement of comparison of budget to actual do not agree to the approved budget and adjusted budget.
 - The statement of comparison of budget and actual amounts does not include explanations for all variances or adjustments constituting more than material differences as stated in the accounting policy. Consequently, the financial statements have not been prepared in accordance with all the requirements of the standard.

Financial instruments

46. Financial instrument disclosure required by GRAP 104: *Financial instruments* have not been included in note 50 to the financial statements. Due to the lack of systems I was unable to confirm the disclosure by alternative means. It was not practical to determine the full extent of the understatement. Consequently, I was unable to determine whether any further adjustments were necessary to the financial instruments disclosure note.

Revenue from exchange transactions uncorrected corresponding figure

47. I was unable to obtain sufficient appropriate audit evidence for the corresponding amount for revenue from exchange transactions due to the following matters:
- The underlying accounting records for revenue transactions as recorded in the accounting system could not be reconciled to the general ledger and financial statements.
 - Management could not provide audit evidence to substantiate these differences.
48. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any further adjustments relating to the corresponding amount for revenue from exchange transactions of R270,9 million as disclosed in the

statement of financial performance and notes 25, 26, 27, 28 and 29 to the financial statements were necessary. My opinion has been modified because of the possible effects of the unresolved matter on the comparability of the current year's figures and the corresponding figures.

Revenue from non-exchange transactions uncorrected corresponding figure

49. I was unable to obtain sufficient appropriate audit evidence for the corresponding amount for revenue from exchange transactions due to the following matters:

- 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.
- Management could not provide audit evidence to substantiate these differences.

50. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any further adjustments relating to the corresponding amount for revenue from non-exchange transactions of R240,8 million as disclosed in the statement of financial performance and notes 22, 23, and 24 to the financial statements were necessary. My opinion has been modified because of the possible effects of the unresolved matter on the comparability of the current year's figures and the corresponding figures.

Cash and cash equivalents uncorrected corresponding figure

51. I was unable to obtain sufficient appropriate audit evidence for the corresponding amount for cash and cash equivalents due to the following matters:

- Evidence to clear reconciling items and errors found in the prior financial year was not available.
- Not all bank accounts were reconciled by the municipality.

52. I was unable to obtain the required evidence through alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents of R174,3 million for the corresponding figures as disclosed in note 20 to the financial statements were necessary. My opinion has been modified because of the possible effects of the unresolved matter on the comparability of the current year's figures and the corresponding figures.

Aggregation of immaterial uncorrected misstatements in corresponding figures

53. 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 corresponding amounts in the statement of financial performance and disclosure in the financial statements:

- Contingencies as disclosed in the corresponding amount in note 54 to the financial statements are understated by R4,9 million.

54. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to determine or confirm by alternative means whether adjustments were required:

- Repairs and maintenance disclosed in the corresponding amount in note 35 to the financial statements and the statement of financial performance.
- Contracted services expenditure disclosed in the corresponding amount in note 38 to the financial statements and the statement of financial performance.
- Bulk purchases disclosed in the corresponding amount in note 37 to the financial statements and the statement of financial performance.
- Commitments disclosed in the corresponding amount in note 48 to the financial statements.

55. My opinion has been modified because of the possible effects of the unresolved matters on the comparability of the current year's figures and the corresponding figures.

Disclaimer of opinion

56. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

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

Restatement of corresponding figures

58. As disclosed in the statement of changes in net assets, the corresponding figures for 30 June 2013 have been restated as a result of errors only corrected during the year ended 30 June 2014 that existed in the financial statements at, and for the year ended 30 June 2013.

Material impairments

59. Disclosed in note 32 to the financial statements is an amount R77,4 million (2013: R74,1 million) for debt that has been impaired as a result of non-payment of consumer debtor accounts.

Additional matters

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

Unaudited supplementary schedules

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

Unaudited disclosure notes

62. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Withdrawal from the audit engagement

63. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the ISAs.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

64. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

65. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Key performance area: Basic service and infrastructure development (on pages x to x)
 - Key performance area: Local economic development (on pages x to x).
66. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
67. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
68. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
69. The material findings in respect of the selected key performance areas are as follows:

Basic services and infrastructure development

Usefulness of reported performance information

70. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 57% of all planned objectives specified in the integrated development plan (IDP) for the year under review. This was due to a lack of information systems recording and documenting actual achievements against targets and a lack of review of the completeness of reporting documents by management and the internal audit unit.
71. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the development priorities, objectives, indicators and targets in the annual performance report without following the process as prescribed in section 28 of the MFMA and or without adoption by the municipal council. This was as a result of management not developing appropriate measures to monitor compliance with applicable law and regulations. Management has also not created and implemented action plans that address deficiencies identified by external auditors.
72. The FMPPI requires the following:
- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, and the period or deadline for delivery of targets must be specified.

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions and proper systems and processes and formal standard operating procedures or documented system descriptions.
73. The FMPPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. A total of 46% of the indicators did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the five-year IDP. This was because proper performance planning and management practices had not been implemented to provide for the development of performance indicators and targets included in the IDP.

Reliability of reported performance information

74. The FMPPPI requires auditees to 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. I was unable to obtain the information and explanations I considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

75. I draw attention to the following matters. My conclusion is not modified in respect of these matters:

Achievement of planned targets

76. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the disclaimer of conclusions expressed on usefulness and reliability of the reported performance information in paragraphs xx of this report.

Unaudited supplementary information

77. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not express a conclusion thereon.

Local economic development

Usefulness of reported performance information

78. Section 41(c) of the MSA requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 58% of all planned objectives, 100% of all planned indicators and 83% of all planned targets specified in the IDP for the year under review. This was due to a lack of information systems recording and documenting actual achievements against targets and a lack of review of the completeness of reporting documents by management and the internal audit unit.
79. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the development objectives, indicators and targets in the annual performance report without following the process as prescribed in section 28 of the MFMA and or without adoption

by the municipal council. This was as a result of management not developing appropriate measures to monitor compliance with applicable law and regulations. Management has also not created and implemented action plans that address deficiencies identified by external auditors.

80. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, and the period or deadline for delivery of targets must be specified.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions and proper systems and processes and formal standard operating procedures or documented system descriptions.

81. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The relevance of the indicators could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation for why the indicators were considered important and relevant to the realisation of strategic goals and objectives.

Reliability of reported performance information

82. The FMPPI requires auditees to 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

83. I draw attention to the following matters. My conclusion is not modified in respect of these matters:

Achievement of planned targets

84. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the disclaimer of conclusions expressed on usefulness and reliability of the reported performance information in paragraphs xx of this report.

Unaudited supplementary information

85. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not express a conclusion thereon.

Compliance with legislation

86. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic and performance management

87. Sufficient appropriate audit evidence could not be obtained that the local community was consulted by means of a municipal-wide structure for community participation or

through a forum that enhances community participation in drafting and implementing the IDP, as required by section 28 of the MSA and municipal planning and performance management regulation 15(1)(a)(i).

88. The adopted IDP did not reflect and identify a financial plan and the key performance indicators and targets, as required by sections 26 and 41 of the MSA, as well as municipal planning and performance management regulation 2(1)(c).
89. Sufficient appropriate audit evidence could not be obtained that the local community was afforded the opportunity to comment on the final draft of the IDP before adoption, as required by section 42 of the MSA and municipal planning and performance management regulations 9, 13(1), 13(4)(c) and 15(3).
90. The municipality did not give effect to its IDP and 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 municipal planning and performance management regulation 6.
91. The IDP was not annually reviewed based on the assessment of its performance measurements and changing circumstances, as required by section 34 of the MSA and municipal planning and performance management regulations 3 and 11.
92. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
93. The performance management system was not in line with the priorities, objectives, indicators and targets contained in the IDP and did not clarify the roles and responsibilities of each role player. Furthermore, it did not determine the frequency of reporting and the lines of accountability and relate to the employee's performance management processes. It also did not link to the integrated development planning processes, as required by section 38(a) of the MSA and municipal planning and performance management regulation 7(2)(c), (e), (f) and (g).
94. The performance management system did not provide for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the MSA. It also did not provide for steps of improvement where performance targets were not met, as required by section 41(1)(d) of the MSA.
95. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
96. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and municipal planning and performance management regulations 1 and 9(1)(a).
97. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e).
98. Sufficient appropriate audit evidence could not be obtained that revisions of the service delivery and budget implementation plan were approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
99. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

100. The annual performance report for the year under review did not include the performance of the municipality and 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.
101. Annual performance agreements for the municipal manager and all senior managers linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan were not signed as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
102. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Annual financial statements, performance and annual reports

103. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
104. Material misstatements of disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
105. An oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012-13 annual report was tabled, as required by section 129(1) of the MFMA.
106. The council's oversight report on the 2013-14 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

Budget

107. Expenditure was not incurred in accordance with the approved budget or was 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.

Audit committee

108. Sufficient appropriate audit evidence could not be obtained that the audit committee advised the council and accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management, performance evaluation, the adequacy, the reliability and accuracy of financial reporting and information and compliance with legislation as required by section 166(2)(a), (iv) and (vii) of the MFMA. Sufficient appropriate audit evidence could not be obtained that it responded 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.
109. Sufficient appropriate audit evidence could not be obtained that the audit committee reviewed the municipality's performance management system and made recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii). It also did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i). Furthermore, sufficient appropriate audit evidence could not be obtained that it submitted, 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). It was also not constituted in the manner required by section 166(4)(a) of the MFMA as the committee did not consist of at least three persons with appropriate experience. Sufficient appropriate audit evidence could not be obtained that it met at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

110. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review. It also did not report to the audit committee on the implementation of the internal audit plan. Furthermore, it did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
111. The internal audit unit did not advise the accounting officer and 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.

Expenditure management

112. 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.
113. 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.
114. An adequate management, accounting and information system which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made was not in place, as required by section 65(2)(b) of the MFMA.
115. 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.

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 (including an appropriate asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

118. 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.
119. 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.

Revenue management

120. 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 MFMA.
121. An adequate management, accounting and information system which accounts for debtors was not in place, as required by section 64(2)(e) of the MFMA.
122. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.

Procurement and contract management

123. 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).
124. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were not drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).

125. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
126. 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 SCM regulation 28(2).
127. 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*.
128. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
129. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
130. 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, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
131. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
132. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to and quotations were accepted from bidders who scored the highest points in the evaluation process, as required by section 2(1)(f) of the PPPFA.
133. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to and quotations were accepted from bidders who had submitted 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).
134. 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, 2000) (CIDB) and CIDB regulation 18.
135. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
136. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
137. Sufficient appropriate audit evidence could not be obtained that quotations were only accepted from providers whose tax matters had been declared by SARS to be in order, as required by SCM regulation 43.

Human resource management

138. An acting municipal manager and chief financial officer were appointed for a period of more than three months without the approval by the member of the executive council (MEC) for local government, in contravention of sections 54A(2A) and 56(1)(c) of the MSA.

139. The competencies of financial and supply chain management officials were not assessed in a timely manner to identify and address gaps in competency levels, as required by the regulation 13 of the *Municipal regulations on minimum competency levels*.
140. 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 regulation 14(2)(a) of the *Regulations on minimum competency levels*.
141. The accounting officer, chief financial officer, senior managers and finance officials at middle management did not meet any of the prescribed competency areas as required by section 83 of the MFMA and regulations 2 to 9 of the *Municipal regulations on minimum competency levels*.
142. 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.
143. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Conditional grants

144. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant (MIG), Municipal Systems Improvement Grant (MSIG) and Local Government Financial Management Grant (FMG) allocation, as required by section 12(5) of DoRA.
145. The MSIG allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of DoRA.

Consequence management

146. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
147. The accounting officer and council did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) of the MFMA.
148. Allegations of fraud, corruption, favouritism, unfair or irregular practice and failure to comply with the SCM system made against officials and role players were not investigated by the accounting officer, as required by municipal SCM regulation 38(1)(b).
149. Allegations of theft, fraud, extortion, forgery and uttering a forged document which exceeded R100 000 were not reported to the South African Police Service, as required by section 34(1) of the Prevention and Combating of Corrupt Activities Act, 2004 (Act No. 12 of 2004) (PCCAA).
150. The accounting officer did not always report cases of alleged criminal conduct to the South African Police Service, as required by municipal SCM regulation 28(1)(b).
151. Allegations of financial misconduct against senior managers were not always tabled before council, as required by regulation 5(2) of the *Disciplinary regulations for senior managers*.
152. Cases of financial misconduct by senior managers, which constituted a crime, were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.
153. Investigations were not conducted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

154. 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.
155. Cases of financial misconduct which constituted a crime were not always reported to the South African Police Service, as required by section 62(1)(e) of the MFMA.

Internal control

156. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion and the findings on the performance report and compliance with legislation included in this report.

Leadership

157. Leadership did not fulfil its oversight responsibilities with regard 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. No consequence management was applied for past transgressions and poor performance of employees.
158. Sufficient attention was not given to the revision of the organogram and filling of critical vacancies to ensure sufficient capacity to address the ongoing control deficiencies. This impacted negatively on the effectiveness of leadership and undermined accountability.
159. The revision of policies, including the IT governance framework, has not been prioritised, which has resulted in a lack of improvement in the overall control assessment.
160. Leadership did not implement the action plan in time to have a meaningful impact on the control environment. It was also not monitored by the oversight bodies to ensure that action was taken.
161. There has been a slow response to the messages of the auditor-general and as a result there are numerous repeat findings that were not effectively dealt with by management during the year.

Financial and performance management

162. The lack of record management and daily financial disciplines continues to have a negative effect on the financial administration of the municipality. The municipality did not have adequate skills and competencies and relied on consultants to prepare reconciliations and registers. A number of these were only prepared after the financial year-end which did not allow sufficient time for adequate reviews to take place.
163. 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.
164. 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.
165. Inadequate record management practices and inadequate monitoring controls resulted in significant deficiencies in the general control environment. Information submitted for audit did not support the underlying records reported in the performance report. The municipality did not institute regular processes of collecting, collating and reporting on credible information which assisted with decision-making and the direction of the municipality's 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.

Governance

166. Risk management activities were not sufficient as evidenced by the large number of repeat findings. The municipality also lacked effective risk monitoring processes to ensure that risks identified are appropriately managed.
167. The internal audit function lacked sufficient capacity to function effectively and produce reports during the financial year. This hampered the ability of the audit committee to fulfil their oversight function and other compliance responsibilities in terms of the MFMA.

Auditor-General

East London

28 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence