

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON OR TAMBO DISTRICT MUNICIPALITY

## REPORT ON THE CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the consolidated and separate financial statements of the OR Tambo District Municipality and its subsidiaries set out on pages ... to ..., which comprise the appropriation statement, the consolidated and separate statement of financial position as at 30 June 2014, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information 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 consolidated and separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards for GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on the consolidated and separate financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the General Notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Disclaimer of opinion

### Consolidation of material subsidiary

4. The requirements of GRAP 6 – *Consolidated and separate financial statements*, have not been considered and applied by the entity for Kei Fresh Produce Market and due to inadequate information the impact upon the consolidated financial statements and respective notes to the consolidated financial statements, for this subsidiary could not be determined for both the current and prior year. Although adjustments to the financial statements were necessary, I was unable to determine what these adjustments should be as sufficient appropriate audit evidence was not provided.

### Property, plant and equipment

5. Sufficient appropriate audit evidence was not available in support of Property, plant and equipment and journals processed to adjust comparative figures due to inadequate reconciliation processes in place. I was unable to confirm Property, plant and equipment by alternative means due to the lack of document management and controls over assets. Consequently, I was unable to determine whether any adjustments were necessary to Property, plant and equipment of R3.6 billion (2013: R3.2 billion) as disclosed in note 8

and depreciation and amortisation of R217.6 million (2013: R137.3 million) as disclosed in note 32 to the financial statements.

6. During 2012-13, the municipality incorrectly recognised costs on assets and depreciation on land, buildings, heritage, finance lease and other assets which were not in line with the requirements of GRAP 17 – *Property, plant and equipment*. This resulted in understatement of depreciation amounting to R137 606 and a resultant cumulative understatement of accumulated depreciation amounting to R1.4 million and overstatement within accumulated surplus due to inadequate controls over the recording and reconciling of movable assets. The municipality incorrectly recognised costs on assets and depreciation on infrastructure assets which were not in line with the requirements of GRAP 17 – *Property, plant and equipment*. This resulted in an understatement of prior year depreciation amounting to R155.0 million and a resultant cumulative understatement of prior year accumulated depreciation amounting to R1.4 billion and overstatement within accumulated surplus for 2012 of R407.8 million due to inadequate controls over the recording cost information and depreciation not according to approved accounting policy as it relates to additions of infrastructure assets. My audit opinion on the financial statements for the period ended 30 June 2013 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.

#### **Government grants and subsidies**

7. Sufficient appropriate audit evidence was not available for in support conditional grant expenditure and journals processed to adjust comparative figures. I was unable to confirm the grant expenditure and related grant revenue by alternative means due to inadequate reconciliation processes in place. Consequently, I was unable to determine whether any adjustments were necessary to conditional grants and subsidies revenue of R 866.7 million (2013: R932.8 million) included in note 25, Expenditure incurred from grants of R480.9 million (2013: R258.9 million) included in note 39 and Unspent conditional grants of R32.6 million (2013: R208.1 million) as disclosed in note 18 to the financial statements. Further, I was not able to confirm that Expenditure incurred from grants of R480.9 million included in note 39 was spent in accordance with the terms and conditions of the grant.
8. During 2012-13, the municipality incorrectly recognised transactions within general expenses which met the definition of assets as per GRAP 17 – *Property, plant and equipment* in the prior year. Grant expenditure was overstated by R4.2 million with a resultant understatement of government grants and subsidies revenue amounting to R975 687, overstatement of VAT Receivable of R669 189, understatement of Infrastructure, Property, plant and equipment of R 1.2 million and overstatement of Trade and other payables of R3.2 million due to inadequate systems over differentiation of recording expenditure and assets transactions within the general ledger. In addition, conditional grants and subsidies as included within note 25 was overstated by R170.9 million with a resultant understatement within Unspent government grants of R170.9 million due to early recognition of revenue where conditions on grant expenditure were yet to be met. My audit opinion on the financial statements for the period ended 30 June 2013 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.

#### **Employee related costs**

9. The municipality does not have adequate systems in place to reconcile the municipal payroll. As a result, sufficient appropriate audit evidence was not available in support of Employee related costs, Councillors remuneration and journals processed to adjust

comparative figures. Due to the inadequate reconciliation processes, I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Employee related costs of R302.9 million (2013: R249.4 million) as disclosed in note 30 and Councillors remuneration of R11.8 million as disclosed in note 31 to the financial statements.

10. During 2012-13, employee related costs were overstated by R1.8 million with a resultant understatement of trade and other payables of R304 697, understatement of other receivables from exchange transaction of R3.1 million and understatement of general expenses of R 908 844 as a result of inadequate systems in place to maintain personnel records to support basic salary, allowances and deductions. My audit opinion on the financial statements for the period ended 30 June 2013 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.

#### **Payables from non-exchange transactions**

11. The municipality does not have adequate systems in place to reconcile municipal monies owing to creditors. As a result sufficient appropriate audit evidence was not available in support of Payables from non-exchange transactions and journals processed to adjust comparative figures. Due to the inadequate reconciliation processes, I was unable to confirm these payables by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Payables from non-exchange transactions of R198 million (2013: R56.1 million) as disclosed in note 17 to the financial statements.

#### **Payables from exchange transactions**

12. The municipality does not have adequate systems in place to reconcile municipal monies owing to creditors. As a result sufficient appropriate audit evidence was not available in support of Trade Creditors and other payables and journals processed to adjust comparative figures. Due to the inadequate reconciliation processes, I was unable to confirm these payables by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Trade creditors and other payables of R153.0 million (2013: R181.9 million) as disclosed in note 16 to the financial statements.
13. During 2012-13, the municipality did not recognise transactions that met the definition of trade and other payables as per GRAP 104 – *Financial Instruments*, as required by the standard in the prior year. Trade and other payables was understated by R51.6 million with a resultant understatement within general expenses of R49.7 million and overstatement within Other Receivables of R1.9 million as a result of an inadequate system for the identification and recognition of accruals. The municipality did not have adequate systems in place to capture and account for leave taken and as a result accrual for leave has been understated by R12.9 million with a related understatement within employee related costs of R12.9 million. My audit opinion on the financial statements for the period ended 30 June 2013 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.

#### **Service charges**

14. Sufficient appropriate audit evidence was not available in support Service charges and material losses, including journals to correct prior year material losses. The municipality does not have adequate systems in place to reconcile municipal billing or water losses. As a result sufficient appropriate audit evidence was not available in support of Service charges and I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Service charges of R150.1 million (2013: R127.9 million) as disclosed in note 26 and Material losses of R 29.5 million (2013: R23.9 million) as disclosed in note 39.2 to the financial statements.

15. During 2012-13, the municipality did not recognise items that met the definition of revenue as per GRAP 9 – *Revenue from exchange transactions*, as required by the standard in the prior year. Service charges revenue as disclosed in note 26 was understated by R4.6 million with a resultant understatement within trade receivables of R1.9 million as a result of differences on the recalculation of meter readings and estimates and overstatement within trade and other payables of R 2.7 million due to prescription of long outstanding debts owed by the municipality. My audit opinion on the financial statements for the period ended 30 June 2013 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.

#### **Receivables from exchange transactions**

16. The municipality does not have adequate systems in place to reconcile municipal monies owing by debtors. As a result sufficient appropriate audit evidence was not available in support of Receivables from exchange transactions and journals processed to corresponding figures. Due to the inadequate reconciliation processes, I was unable to confirm these receivables by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Receivables from exchange transactions of R61.5 million (2013: R45.2 million) as disclosed in note 4, Impairment losses of R35.6 million (2013: R80.7 million) as disclosed in note 33 and Interest earned – outstanding debtors of R28 million (2013: R24.5 million) as disclosed in note 28 to the financial statements.

#### **Receivables from non-exchange transactions**

17. The municipality does not have adequate systems in place to reconcile municipal monies owing by debtors. As a result sufficient appropriate audit evidence was not available in support of Receivables from non-exchange transactions. Due to the inadequate reconciliation processes, I was unable to confirm these receivables by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Receivables from non-exchange transactions of R59.4 million (2013: R177.7 million) as disclosed in note 5 to the financial statements.

#### **VAT receivable**

18. Sufficient appropriate audit evidence was not available to support VAT receivables disclosed in note 6 to the financial statements and journals processed to corresponding figures. I was therefore unable to confirm the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to VAT receivable of R53.6 million (2013: R74.8 million) as disclosed in note 6 and VAT refund of R90.5 million (2013: R89.8 million) as disclosed in note 29 to the financial statements.

#### **Inventory**

19. Sufficient appropriate audit evidence was not available for both the current and the comparative years in support inventory. I was unable to confirm the inventory by alternative means due to the inconsistency between inventory listings provided for audit. Consequently, I was unable to determine whether any further adjustments were necessary to inventories of R38.1 million (2013: R19.7 million) as disclosed in note 2 to the financial statements.

### **Grants and subsidies paid**

20. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figures for Grants and subsidies paid. As described in note 42 to the financial statements, the restatement was made to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the Grants and subsidies paid corresponding figure of R61.2 million as disclosed in note 38 to the financial statements was necessary.

### **Commitments**

21. The municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments. As a result, sufficient appropriate audit evidence was not available in support of commitments and journals processed to corresponding figures. Consequently, I was unable to determine whether any further adjustments were necessary to commitments of R1.9 billion (2013: R968.6 million) as disclosed in note 49 to the financial statements.
22. During 2012-13, the municipality did not have an adequate and complete contract management system in place for the identification and recognition of contracted commitments and did not include all commitments of the municipality in the amounts disclosed to the financial statements, which resulted in an understatement of R375.1 million. My audit opinion on the financial statements for the period ended 30 June 2013 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.

### **Unauthorised expenditure**

23. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year as required by section 125(2)(d) of the MFMA. In addition, sufficient appropriate audit evidence was not available in support of unauthorised expenditure and journals processed to comparative figures. Consequently, I was unable to determine whether any adjustments were necessary to unauthorised expenditure of R1.5 billion as disclosed in note 47.1 to the financial statements.
24. During 2012-13, the municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year as required by section 125(2)(d) of the MFMA. The unauthorised expenditure disclosed in the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R229.1 million with a resultant misstatement at year-end amounting to R1.6 billion. My audit opinion on the financial statements for the period ended 30 June 2013 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.

### **Irregular expenditure**

25. 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) of the MFMA. The irregular expenditure disclosed in note 47.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process. Due to the lack of systems and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed as R277.2 million (2013: R274.2 million).

### **Related parties**

26. The municipality did not have an adequate system in place for the identification and recognition of related parties and related party transactions. Consequently, I was unable to determine whether any adjustments were necessary to related parties as disclosed in note 52 to the financial statements.

### **Budget vs actual**

27. GRAP 1 - *Presentation of financial statements* requires that a full set of financial statements includes a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements, when the entity makes its approved budget publicly available. Both the current and prior year budget statements contained material omissions. The municipality did not provide reasons for material budget variances within the statement of budget comparison as required in terms of GRAP 24 – *Presentation of budget information* in the financial statements.

### **Contingent liabilities**

28. Sufficient appropriate audit evidence was not available for contingent liabilities as disclosed in note 53 to the financial statements. Sufficient appropriate audit evidence was not available for the current year and documentation in support of contingent liabilities was either not submitted or that which was submitted, was insufficient. Therefore, I was unable to confirm contingent liabilities by alternate means. Consequently I was unable to determine whether adjustments to the contingent liabilities amounting to R34.5 million (2013: R34.5 million) within the disclosure note were necessary.

### **General expenses, bulk purchases and contracted services**

29. During 2012-13, the municipality incorrectly recognised items within general expenses and contracted services which met the definition of assets as per GRAP 17 – Property, plant and equipment. General expenses are overstated by R25.5 million with a resultant understatement within Infrastructure, Property, plant and equipment of R23.0 million, overstatement of trade and other payables of R3.5 million, understatement of VAT Receivable of R1.1 million due to inadequate systems in place for the identification and recognition of assets and recognition of expenditure based on the nature of the expenditure.
30. In addition, sufficient appropriate audit evidence was not available in support general expenses, bulk purchases, contracted services and journals processed to comparative figures was either not submitted for audit purposes or that which was submitted, was insufficient. General expenses contained journals amounting to at least R2.1 million to which the supporting information did not agree to the journal voucher or no sufficient appropriate audit evidence could be provided to verify the journal entries processed. I was unable to confirm the general expenses, bulk purchases and contracted services by alternative means due to the inadequate document management system. Consequently, I was unable to determine whether any further adjustments were necessary to general expenses, bulk purchases and contracted service of R577.6 million as disclosed in note 39, 36 and 37 to the financial statements.
31. My audit opinion on the financial statements for the period ended 30 June 2013 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.

### **Cash and cash equivalents**

32. During 2012-13, sufficient appropriate audit evidence was not available to support cash and cash equivalents disclosed in note 7 to the financial statements. The validity of reconciling items identified could not be adequately supported. I was unable to confirm the cash and cash equivalents by alternative means due to inadequate support to verify authorisation of payments and resultant other components impacted. Consequently, I was unable to determine whether any adjustments were necessary to cash and cash equivalents of R227.6 million as disclosed in note 7 to the financial statements.
33. My audit opinion on the financial statements for the period ended 30 June 2013 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.

### **Emphasis of matters**

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

### **Corresponding figures**

35. As disclosed in note 42 to the financial statements, the corresponding figures for 2012/13 have been restated as a result of errors discovered during the 2013/14 financial year in the financial statements of the municipality at, and for the year ended, 30 June 2013.

### **Material losses**

36. As disclosed in note 37.2 to the financial statements, material losses to the amount of R29.5 million were incurred as a result of water distribution losses.

### **Additional matters**

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

### **Unaudited supplementary schedules**

38. The supplementary information set out on pages XX to XX 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.

### **Unaudited disclosure notes**

39. 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 engagement**

40. Due to the numerous limitation and disagreement misstatements identified in the financial statements, I am unable to rule out the possibility of fraud which calls into question the reliability of evidence obtained and the authenticity of the accounting records and documentation. But for the legislated requirement to perform the audit of municipality, I would have withdrawn from the engagement in terms of the ISAs

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

41. 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 objectives presented in the annual performance report, non-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**

42. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Basic service delivery and infrastructure development on pages x to x
- Local economic development on pages x to x

43. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

44. 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 objectives. 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).

45. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

46. The material findings in respect of the selected objectives are as follows:

### **Basic service delivery and infrastructure development**

#### **Usefulness of reported performance information**

47. Significantly important targets in relation to delivery of basic services delivery and infrastructure development with regards to water and sanitation and road infrastructure were not specific (14), not measurable (8) and not time bound (8).

48. A total of 39% of the targets which are significantly important targets in relation to delivery of basic services were not well defined.

49. A total of 36% of the targets which are significantly important targets in relation to delivery of basic services were not verifiable.

#### **Reliability of reported performance information**

50. 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 we considered necessary to satisfy myself as to the reliability of the reported performance information.



51. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

#### **Local economic development**

##### **Usefulness of reported performance information**

52. A total of 21% of the targets which are not timebound. A total of 24% of the indicators not well defined. A total of 41% of the indicators not verifiable.

##### **Reliability of reported performance information**

53. 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 we considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

#### **Additional matters**

54. I draw attention to the following matters:

##### **Achievement of planned targets**

55. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected objectives reported in paragraphs x to xx of this report.

##### **Unaudited supplementary schedules**

56. The supplementary information set out on pages XX to XX 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 report thereon.

##### **Compliance with legislation**

57. 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 non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

##### **Strategic management**

58. Measurable performance targets for the financial year with regard to each of the objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and the Municipal planning and performance management regulations, 2001 (Government Gazette 22605 of 2001) (MPPMR) 12(1) and 12(2)(e).
59. Annual performance objectives and indicators were not established by agreement with Ntinga OR Tambo Development Agency and included in the municipal entity's multi-year business plan, as required by section 93B(a) of the MSA.

60. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance (planning, monitoring, measurement, review, reporting and improvement) and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the MPPMR.

#### **Expenditure management**

61. An effective system of expenditure control, including procedures for the payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
62. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.
63. 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.

#### **Annual financial statements**

64. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
65. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
66. The consolidated annual financial statements did not incorporate the annual financial statements of Kei Fresh Produce Market, as required by section 122(2) of the MFMA.

#### **Liability management**

67. 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.
68. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

#### **Asset management**

69. 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.
70. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

#### **Consequence management**

71. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
72. Disciplinary proceedings were not instituted by the council where the report of independent investigators confirmed the financial misconduct by a senior manager, as required by Disciplinary regulations for senior managers 5(6).
73. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.
74. 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.

### **Revenue management**

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

### **Internal audit**

77. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
  - it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
  - it did not advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
78. The internal audit unit did not advise the accounting officer on matters relating to compliance with the MFMA, the Division of Revenue Act and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

### **Audit committee**

79. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
80. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
81. 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).

### **Procurement and contract management**

82. 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).
83. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
84. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
85. 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).
86. 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 22(2).

87. 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).
88. 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).
89. Sufficient appropriate audit evidence could not be obtained that when awards were made to bidders other than those recommended by the bid evaluation committee, ratification by the accounting officer was obtained, as required by SCM regulation 29(5)(b).
90. The preference point system was not applied in all procurement of 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).
91. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
92. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of Preferential Procurement Policy Framework Act.
93. 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).
94. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) in accordance with section 18(1) of the CIDB Act.
95. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act and CIDB regulation 18.
96. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5
97. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
98. The municipality did not implement an SCM policy as required by section 111 of the MFMA.

#### **Internal control**

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

## **Leadership**

100. Officials continued to flout laws and regulations governing procurement and supply chain management. There is no evidence that leadership has followed up or investigated these supply chain transgressions by officials. The lack of appropriate action against officials has a material impact on the effectiveness, stability of the control environment and further undermines accountability. Leadership's inability to address and prioritise this critical area has a direct bearing on the number of compliance findings reported.
101. The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting within the annual financial statements and annual performance report as well as over compliance with laws and regulations. There is also inadequate oversight by senior officials to ensure that policies, procedures and controls are implemented correctly. Leadership's inability to fill vacancies before the financial year end undermines accountability as it has resulted in a significant breakdown in internal control thus producing financial statements and a performance report that are not credible.
102. Council has failed to adopt an updated organogram for the municipality by 30 June 2014. This has been a repeat audit finding since 2010/11. As a result, management has been unable to appoint officials to vacant posts (moratorium was placed on appointments until a new structure is approved). These vacancies have directly contributed to the stagnation in audit outcomes.

## **Financial and performance management**

103. Weekly and monthly reconciliations were not prepared for financial items during the year which resulted in the municipality placing extensive reliance on consultants at and after year end in order to prepare financial statements. Internal controls are not in place as a limited number of key officials within the finance unit are responsible for performing multiple incompatible functions. This is due to vacancies within the Budget and Treasury Office.
104. There were a number of basic errors as a result of the inadequate quality and review processes performed by the municipality. The working paper file submitted for audit purposes did not in all instances support amounts and disclosures in the financial statements. On receipt of the annual financial statements, standard audit tests were performed to ensure that the schedules presented agreed to the underlying financial records. In a number of instances, errors were found that should have been addressed by management, had appropriate monitoring controls been in place.
105. Reviews by the accounting officer and audit committee were not performed on the draft annual financial statements and annual performance report due to timing constraints.

## **Governance**

106. Although a risk assessment framework is in place, management does not adequately monitor and report on progress of controls implemented, or respond to new risks that may arise. Therefore the risk management process of the municipality is not considered to be adequate or effective.
107. The internal audit unit did not function within an approved internal audit plan for the majority of the 2013/14 financial year. Leadership does not act on a timely basis on internal audit's recommendations or reports thereby negatively impacting their effectiveness as an assurance provider to the leadership of the municipality.

108. The audit committees' ability to provide assurance was limited due to the inadequacy of the financial reports provided for their review. The audit committee also highlighted that the poor reporting culture within the municipality needs urgent management attention.

## OTHER REPORTS

### Investigations

109. Three investigations by The Hawks (the Directorate for Priority Crime Investigation (DPCI)) are in progress. These relate to fraudulent payments made by an employee, state funeral procurement as well as casual wages fraud.

Auditor-General

East London

12 December 2014



AUDITOR-GENERAL  
SOUTH AFRICA

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