

DRAFT REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON KING SABATA DALINDYEBO MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the King Sabata Dalindyebo municipality, which comprise, the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, and the accounting officers' report, as set out on pages XX... to XX....

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 applicable financial reporting framework and the requirements of the Municipal Finance Management Act (MFMA), and for such internal control as management determines 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. As required by section 188 of the Constitution of South Africa and section 4 of the Public Audit Act of South Africa, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. 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

I draw attention in respect of these matters.

Corresponding figures

5. The audit report on the financial statements for the year ended 30 June 2010 was modified. Adjustments have been effected to the financial statements to correct the matters raised in the prior year audit report. Misstatements were identified in the adjustments that were made to the opening balances. As a result, the effect of the prior year uncertainties has an effect on the accumulated surplus and balance sheet items. The municipality has not addressed the issues raised in the previous audit report and as required by section 131 (1) of the MFMA.

Property, Plant and Equipment

4. Land and Buildings is disclosed in note 7 to the financial statements of R327.1 million (2010:R327 million). Properties registered in the name of the municipality with the deeds office were not recorded in the asset register. In addition, Properties amounting to R57.7 million could not be traced to the asset register. Alternative procedures could not be performed to verify the completeness of land and building. The full extent of the error is not known. (Ex.208, 286,304).

5. The municipality has adopted the revaluation method as the subsequent measurement basis for its land and buildings. Developers have built on some of the municipal land. This land has been valued based on amounts as reflected on the valuation roll. The value per valuation roll represents ratable valuation that includes the value of land and buildings. Alternative audit procedures could not be performed to verify the valuation of this land separately and consequently I could not obtain sufficient and appropriate audit evidence regarding valuation of land as disclosed in note 7 to the financial statements of R327.1 million. (EX.307)
6. GRAP 17 requires revaluations to be carried out with sufficient regularity to make sure that the carrying amount does not differ materially from that which would be determined using fair value at reporting date. This review was not carried out by the municipality. Alternative procedures could not be performed to verify the valuation of land and buildings and consequently I could not obtain sufficient and appropriate audit evidence regarding the valuation of land as disclosed in note 7 to the financial statements of R327.1 million. (ex,231)
7. Infrastructure assets is disclosed in note 7 to the financial statements of R328.1 million (R266.7 million). Included in this amount is Roads Infrastructure that was physically verified but could not be traced to the asset register. Alternative procedures could not be performed to verify the completeness of the infrastructure assets. The full extent of this error is not known. (Ex.208,286,304)
8. The municipality engaged experts to assist with identification and valuation of all roads. The reports from the experts indicate that 8 roads were not included as part of the valuation exercise. Under these circumstance, no alternative procedures could be performed and consequently I could not obtain sufficient appropriate audit evidence regarding completeness, existence and valuation of roads infrastructure amounting to R328.1 million (2010:R266.7 million) as disclosed in note 7 to the financial statements. (Ex. 300)
9. The municipality did not provide sufficient appropriate audit evidence to verify that it had assessed the residual values, revised useful lives and performed impairment testing to Property, Plant and Equipment. No alternative audit procedures could be performed to verify the valuation of assets as disclosed in note 7 to the financial statements of R882.5 million (2010: R827.3 million). I am thus unable to satisfy myself regarding the valuation of the carrying amounts of the assets, the related depreciation charges and its impact on accumulated depreciation and any impairment charges relating to Property, Plant and Equipment. (Ex 70, 65).
10. GRAP 17 *Property, plant and equipment* requires that each part of an item of property, plant and equipment with a cost that is significant in relation to the cost of the item be depreciated separately. The asset register does not separately disclose significant components for Roads and Electricity Infrastructure assets and no separate depreciation was calculated for these significant components as required by GRAP 17. No alternative audit procedures could be performed to verify the valuation of the carrying amounts of the assets, the related depreciation charges and its impact on accumulated depreciation relating to Property, Plant and Equipment of these assets amounting to as disclosed in note 7 to the financial statements of R328.1 million (2010:R266.7 million) and consequently, I could not satisfy myself regarding valuation of Roads and Electricity Infrastructure. (EX 73).

11. Infrastructure assets is disclosed in note 7 to the financial statements of R328.1 million. The Municipality used the depreciated replacement cost for the valuation of Infrastructure Electricity assets. On recalculation of the replacement cost for these assets a difference of R84 million was noted between my calculation and the municipality's calculation. As a result, Infrastructure Electricity assets are overstated by R84 million, depreciation and accumulated depreciation are overstated by R2.8million and accumulated surplus is understated by R86.8 million. (Ex.302)
12. Furthermore, I was not presented with sufficient appropriate audit evidence to support the replacement costs for Roads Infrastructure assets that was used in the valuation of these assets. No alternative audit procedures could be performed to verify the valuation of these assets amounting to R327.1 million (2010: 327 million) as disclosed in note 7 to the financial statements and consequently, I was unable to satisfy myself regarding valuation of Roads and Electricity assets.(Ex 302 and 303)
13. The municipality holds several properties that are being occupied by municipal staff. I was not able to obtain sufficient appropriate audit evidence to determine if these properties are correctly classified. The amount may represent property held for sale or imply that a fringe benefit exists for these employees. Should these properties be held for sale, the monthly rentals will be deemed to be loans to employees renting municipal houses. No alternative audit procedures could be performed to verify the rights and obligation of these properties (Ex.144)

Investment Property

14. Investment Property is disclosed in 9 to the financial statements of R41.9 million (2010:R58.7 million). The fair-values for investment properties were determined incorrectly in the prior year. This has an effect on the movement in fair value of R16.9 million as disclosed on the face of the statement of financial performance and in note 34 to the financial statements. . No alternative audit procedures could be performed to verify the valuation and accuracy of these properties. Consequently, I could not obtain sufficient appropriate evidence to satisfy myself on the valuation and accuracy of the decrease in fair-value adjustment of R16.9 million as disclosed in note 34 of financial statements.
15. Investment property R41.8 million (2010: R58.7 million) is included in the statement of financial position and note 9 to the financial statements. The ERF number of investment properties amounting to R5.7 million could not be traced to the deeds office records. The ERF numbers were invalid. Even after performing alternative audit procedures, sufficient appropriate audit evidence could not be obtained to verify the rights and obligation of these properties. Consequently, I could not obtain sufficient appropriate evidence to satisfy myself on the rights and obligation of these properties (EX.281).

Trade and other payables from exchange transactions

16. The leave balance of employees could not be verified as the leave records of the municipality have not been adequately maintained. No alternative audit procedures could be performed to verify the completeness and accuracy of the accrual. As a result I am unable to conclude if the accrual of R17 million (2010:R15.2 million) as disclosed in the statement of financial position and note 11 is complete and accurate.(EX.124)
17. Sufficient appropriate audit evidence could not be provided to confirm the balance of R3.47 million owed to the Department of Water Affairs (DWAF) included in accruals of R18.6 million in note 11 to the financial statements. Even after performing alternative audit procedures, sufficient appropriate audit evidence was not obtained to verify that the DWAF

account was properly recorded. I was unable to satisfy myself as to the valuation and rights and obligation of this accrual in the financial statements.(EX.125)

18. **Included in Trade and other payables** of R99 million (2010: 54.5 million) as disclosed in the statement of financial position and note 11 **are suspense accounts for uncleared deposits to the value of R2.4 million (2010:R81 890)**. Sufficient appropriate audit evidence **could not be provided to confirm the balance of these accounts. The municipality's records did not permit the application of alternative audit procedures** and consequently I was not able to **satisfy myself as to the existence, rights and obligations, completeness and valuation of the accounts payable clearing accounts**. The impact on other balances or classes of transactions cannot be determined.
19. The municipality's credit control and debt collection by-law requires that a consumer deposit as prescribed by council be paid once a rate payer applies for the provision of municipal service. This deposit must be reviewed annually and may be increased or decreased on written notice to consumers. Sufficient appropriate audit evidence could not be provided to verify the accuracy and completeness of the amount recorded in the municipal records. I was unable to perform alternative procedures to determine the accuracy and completeness of consumer deposits of R1.3 million (2010: R0.9 million) as disclosed in the statement of financial position and note 12 to the financial statements.
20. **Value Added Tax**
Value Added Tax (VAT) receivable R42.3 million (2010: R37.7 million) is disclosed in the statement of financial position and in note 13 of the financial statements. Amounts reflected on the VAT returns for the year under review did not agree to the amounts reflected in the general ledger. I was unable to obtain sufficient appropriate audit evidence to reconcile an amount of R3 million between the two records, **even after performing alternative audit procedures, sufficient audit evidence could not be obtained regarding the completeness, valuation and existence of the VAT receivable**. The full extent of this error is not known. .
21. The municipality has not programmed its accounting system properly to account for VAT on transactions. Instances were noted where vatable transactions were recorded inclusive of VAT and where VAT was charged on non vatable transactions. This has lead to an overstatement of expenditure and understatement of VAT receivable by R3.6 million.

Unspent conditional grants and receipts

22. In terms of section 28(2)(e) of the MFMA and circular 51 and 55 to the MFMA, the municipality had to apply for rollover of funds for 2009/10 and 2010/11 financial years ended. Unspent conditional grants and receipts is disclosed in the statement of financial position and note 14 to the financial statements of R68.7 million (2010:R93.7 million). The municipality did not obtain permission to rollover unspent conditional grants of R66.7 million from National Treasury, as required.

Provisions

23. A provision should be made for the municipality's present obligation incurred as a consequence of its past use of the landfill sites in accordance with the Standard of Generally Recognised Accounting Practice GRAP 19, Provisions, contingent liabilities and contingent assets. GRAP 19 requires that a discount rate that is, a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability is used. The municipality has used a discount rate of 7%, instead 11.5% which is the standard

interest rate on debt owing to the state. The provision of R21.8 million (2010:R23.3 million) as disclosed in the statement of financial position and in note 17 to the financial statements is overstated by R3.6 million (2010: R4.2 million) and Property, Plant and Equipment are understated by the same amount. Consequently, depreciation and accumulated depreciation is understated by R0.36 million (2010: R0.42 million). (Ex.226)

Trade and other receivables from exchange transactions

24. In terms of the International Accounting Standards 39 and International Financial Reporting Standards 7, Receivables should be stated at their present value in the financial statements as at year end, with the difference between the nominal amount and the present value recognized as interest income over the financing period. Receivables were not present valued at year end and this has resulted in an understatement of interest income of R0.1 million (2010:R0.87 million), overstatement of accounts receivables of R1 823 391 and an overstatement of revenue of R2.1 million (2010:R2 .7 million) and not properly disclosed as a class of financial assets.
25. Debtors adjustment is disclosed in the statement of financial performance at R1.2million (2010: R8.9 million). I was not presented with sufficient appropriate audit evidence regarding the debtors adjustment. I was unable to perform alternative procedures to determine the accuracy of the adjustment and consequently I could not satisfy myself regarding the accuracy of the bad debts.

Revenue from Non-exchange and exchange transactions

26. Service charges revenue of R202.9 million is disclosed in the statement of financial performance and in note 19 to the financial statements. Included in this amount are services charges of R2.9 million that have been charged to the different departments within the municipality. These charges do not represent revenue earned by the municipality and should not be included in the service charges revenue. This has resulted in overstatement of service charges revenue and trade and other receivables by 2.9 million. (Ex.61)
27. Reconciliations to ensure that rates charged per the revenue accounting system agreed to rates charged per valuation roll were not performed by the municipality. There were some properties that were charged rates based on the old valuations and not on the current supplementary valuations. Furthermore, I identified 120 properties that had zero values on the valuation roll. I could not perform alternative audit procedures to confirm that rates had been charged correctly on all rateable properties and consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of property rates revenue of R122.6 million (2010: R117.2 million) as disclosed in the statement of financial performance and in note 18 to the financial statements. (EX.230,236.292)
28. There was no adequate system of internal control over licence fees and permits. No alternative procedures could be performed to verify the completeness of licence fees and permits. Furthermore, there were no approved tariffs for business licenses and permits. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of revenue from licenses and permits amounting to R10.1 million (2010: R11 3 million) as disclosed in the statement of financial performance. (Ex.54, 55)
29. Interest earned - outstanding receivable of R22 million is disclosed in the statement of financial performance and note 22 to the financial statements. The interest charged by the

system on outstanding accounts receivables balances is incorrect. The full extent of the error cannot be determined taking into account paragraphs 23 to 26 above.(Ex.224)

30. Revenue from fines has been recorded on a cash basis contrary to GRAP 23, *Revenue from Non-exchange Transactions*, which requires that assets arising from fines are measured at the best estimate of the inflow of resources to the entity. There was no adequate internal controls and systems in place to ensure that all issued and paid fines are recorded, hence, I could not perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding outstanding fines to satisfy myself on the completeness of revenue from fines of R1.9 million (2010: R1.8 million) as disclosed in the statement of financial performance. (Ex,222)
31. **Rentals of facilities and equipment R12.3 million (2010: 10.9 million) is disclosed in the statement of financial performance and in note 20 to the financial statements. Included in this is rental for office space and land. Rent was charged against vacated office space. In some cases lease rental agreements were only signed after the commencement date of the leases. In other instances, the rentals were not escalated as stipulated in the lease agreements. I was unable to perform alternative audit procedures to determine the completeness and accuracy of rental income and consequently I could not obtain sufficient appropriate audit evidence to satisfy myself on the completeness and accuracy of rental income of R2 8 million (2010: R2.7 million) as disclosed in note 20 to the financial statements.(Ex.82,182,180)**

Commitments

32. The municipality does not have an adequate contract management system in place for the identification, recognition and filing of contracts. Sufficient supporting documents could not be provided to verify that electrical project commitments amounting to R23 million was accurate and complete. There were no alternative audit procedures that I could perform to satisfy myself that all commitments were complete and accurate of R194 million (2010: R210 million) as disclosed in note 38.1 to the financial statements.. (Ex 298)
33. In addition, differences were identified between the commitment schedule and supporting documentation for the Municipal Infrastructure Grant (MIG) projects. This has lead to an overstatement of commitments by R1.3million. (EX 297)

Expenditure

Remuneration of Councillors

34. Remuneration for Councillors of R18.7 million is disclosed in the statement of financial performance and in note 26 to the statement of financial statements. Included in this amount is an amount of R2.1 million, which was paid in excess of the upper limits allowed in terms of Section 7(1), 8(5)(a) of the Remuneration of Public Bearers Act No. 20 of 1998. Government Gazette, 10 December 2010. This amount has been disclosed as irregular expenditure in note 36.3 to the annual financial statements. An amount of R1.6 million was still outstanding at year end. A debtor has not been raised for this amount and interest has not been charged on the outstanding amount. Remuneration for Councillors has been overstated by R2.1million, and other receivables from non exchange transactions have been understated by R1.6 million.

Repairs and Maintenance

35. Repairs and Maintenance of R8.6 million is disclosed in the statement of financial performance and in note 28 to the financial statements. Included in the repairs and maintenance expenditure is an amount of R8.02 million which has been incorrectly classified, R3.45 million of this relates to other general expenses and R4.57 million relates to Property, Plant and Equipment. Therefore repairs and maintenance has been overstated by R8.02 million, general expenses and Property, Plant and Equipment has been understated by R 3.45 and R 4.57 million respectively. (EX.90)

Grants and subsidies paid

36. Included in the statement of financial performance and in note 31 of the financial statements is grants and subsidies expenditure of R21.3 million (2010: R18.8 million). Sufficient appropriate audit evidence for expenditure to the value of R9.6 million was not provided for audit purposes. I was not able to perform alternative audit procedures to obtain reasonable assurance that grants and subsidies expenditure was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to accuracy, occurrence and classification of grants and subsidies expenditure in the financial statements.(EX.291)

Government grants and subsidies

37. Include in the statement of financial performance and note 23 to the financial statement is Government grants and subsidies-Operating and Government grants and subsidies - Capital of 147.9 million and 62.6 million respectively. R6.7million relating to the National Municipal Infrastructure Grant (capital) has been incorrectly classified as a National Energy Regulator grant (operating). This has lead to an understatement of the capital grant and overstatement of the operating grant by R6.7million.

Cash flow statement

38. The cash flow statement has not been correctly prepared. The prior year figure for the purchase of Property, Plant and Equipment reflects a receipt of R17 million. I could not verify where this amount comes from.
39. The cash paid to suppliers and employees was recalculated as R440.3 million as opposed to the R423.4 million disclosed in the cash flow. This resulted in a difference of R16.9 million. This relates to fair value adjustment on investment property and it should not be included in the cash paid to suppliers and employees.

Reserves

40. Included in the Statement of changes in Net Assets is a revaluation reserve of R147.5 million (2010: R147.5 million). The accounting policy for revaluation reserve states that the surplus arising from the revaluation of land and buildings will be credited to a non-distributable reserve. The revaluation surplus is realised as re-valued buildings are depreciated, through a transfer from the revaluation reserve to the accumulated surplus/(deficit). No amounts has been released to the Accumulated Surplus/(Deficit) during the year. There was no alternative audit procedure that I could perform to obtain reasonable assurance of the amount that should have been transferred to Accumulated Surplus/(Deficit). Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to accuracy and completeness of the revaluation reserve and the accumulated surplus/ (deficit). (Ex.309 not communicated)

Unauthorised expenditure

41. As disclosed in note 36 to the financial statements is unauthorised expenditure of R1.48 million and fruitless and wasteful expenditure of R1.23 million. An expenditure amounting to R3.2 million was identified during my audit which was not authorised as it exceeded the budget. This relates to remuneration of councillors and this amount is not included in unauthorised expenditure as disclosed in note 36.1 to the financial statements. (EX.128)

Irregular expenditure

42. **Section 62 of the Municipal Finance Management Act, (Act no. 56 of 2003) requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective. Expenditure amounting to R72.6 million was made in contravention of the supply chain management requirements. This amount identified by myself was not included in irregular expenditure as disclosed in note 36.3 to the financial statements.**

Disclaimer Opinion

43. 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

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

Significant uncertainties

45. As disclosed in note 40 to the financial statements, the municipality is a defendant in various lawsuits relating to land, employee related and resident claims. The municipality is opposing the claims. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

46. As disclosed in note 45 to the financial statements, material adjustments were made to the corresponding figures as at 30 June 2010. The account balances and classes of transactions have been restated due to errors identified in the prior year audit and this is included in the corresponding figures.

Material losses/ Impairments

47. As disclosed in the statement of financial performance, is a material impairment amounting to R51 million. This is the movement in the provision of doubtful debts. The recoverability of these debtors is not certain.
48. Electricity distribution losses of 6.5% are disclosed in note 37.5 to the annual financial statements. This represents R9 million in loss.

Unaudited supplementary schedules

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

Additional matters

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REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

50. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages XX...to XX... and material non-compliance with laws and regulations applicable to the municipality..

Predetermined objectives

Presentation of information

51. **The following criteria are relevant to the findings below:**

Performance against predetermined objectives is reported using the National Treasury guidelines

- Measures taken to improve performance were not indicated in the annual performance report

52. No explanations were provided for major variances between the planned and the actual reported targets for the following programmes: Infrastructure, Urban renewal and public safety, as required in terms of the relevant reporting guidance. In total 100% of the reported targets with major variances were not explained. (leadership) [Insert detailed information]

Usefulness of information

53. **The following criteria are relevant to the findings below:**

- Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets
- Measurability: Indicators are well-defined and/or verifiable, and targets are specific, and/or measurable and/or time-bound.

54. **Audit findings: The following criteria are relevant to the findings below:**

Relevance: A clear and logical link does not exist between the objectives, indicators and performance targets.

There was no clear and logical link between the objectives, indicators and performance targets for 80% of the selected objectives (leadership).

55. **Measurability: Planned and reported targets are not specific/measurable/time bound.**

For the selected programmes, 100% of the planned and reported targets were not:

- specific in clearly identifying the nature and the required level of performance;
- measurable in identifying the required performance;
- time-bound in specifying the time period or deadline for delivery (leadership).

56. **Planned and reported indicators are not well defined**

For the selected programmes, 100% of the planned and reported indicators were not clear enough to allow data to be collected consistently (leadership).

Planned and reported indicators are not verifiable

For the selected programmes valid performance management processes and systems that produce actual performance against the planned indicators do not exist for 87% of the indicators (leadership).

Reliability of information

57. The following criteria are relevant to the findings below:

- Validity: Actual reported performance has occurred and pertains to the entity
- Accuracy: Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately
- Completeness: All actual results and events that should have been recorded have been included in the annual performance report

For the selected programmes the validity, accuracy and completeness of 100% of the reported indicators could not be established as sufficient appropriate audit evidence and or relevant source documentation could not be provided (financial and performance management).

Compliance with laws and regulations

Per compliance focus area

Strategic planning and performance management

58. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by sections 38, 39, 40 and 41 of the Municipal Systems Act and Municipal Planning and Performance Management Regulations 7 and 8. (Leadership).

Budgets

59. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the Municipal Finance Management Act. Remuneration of councillors was overspent by R3.2 million (20%) and contracted services (consultants) by R 2.4 million (74%) (Financial and performance management).

60. The mayor did not submit all quarterly reports to council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the Municipal Finance Management Act (leadership).

Annual financial statements, performance and annual report

61. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements were identified during the audit, certain of these were corrected

by management and those that were not are included in the basis for XXXXXX opinion paragraphs. (financial and performance management).

Audit committees

62. The audit committee did not function as required by section 166 of the Municipal Finance Management Act, in that:

- The audit committee did not advise the council, the accounting officer and the management staff of the municipality on matters relating to internal financial control and internal audits, risk management, accounting policies, performance management, effective governance, compliance with applicable legislation and performance evaluation;
- The audit committee did not review the annual financial statements;
- The audit committee did not respond to the council on any issues raised by the Auditor-General in the audit report; and
- The audit committee did not meet at least four times a year (governance).

63. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information as required by section 166(2)(a)(iv) of the Municipal Finance Management Act (governance).

64. The audit committee did not advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation as required by section 166(2)(a) of the Municipal Finance Management Act (governance).

65. The members of the audit committee were not appointed by the council of the municipality as required by section 166(5) of the Municipal Finance Management Act (governance).

66. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee as required by Municipal Planning and Performance Management Regulation 14. Consequently, the following activities were not done in line with the regulation (governance):

- meet at least twice during the financial year;
- review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality;
- review the municipality's performance management system and make recommendations in this regard to the council of the municipality; and
- submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

Internal Audit

67. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act. Internal audit was in existence for only 6 months of the financial year, in the absence of a functioning audit committee (governance).

- Internal audit did not report to the audit committee on the implementation of the internal audit plan;

- Internal audit did not report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices and risk and risk management.

Procurement and contract management

68. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of Supply Chain Management (SCM) regulation 17(a) & (c). Goods and services amounting to R1.13 million were procured in non compliance with this requirement (leadership).
69. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b) (leadership).
70. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1) Such awards amounted to R 4.8 million (leadership).
71. Sufficient appropriate audit evidence could not be obtained to verify if 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 the requirements of SCM regulation 27(2)(a) as some of the bid specification documents were not received for audit purposes (financial and performance management).
72. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on criteria that were similar to those stipulated in the original bid documents as per the requirements of SCM regulation 21(b) as information was not submitted for audit purposes(financial and performance management).
73. Invitations for competitive bidding were not always advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) & 22(2) (leadership).
74. As a result of the municipality not having a bid specifications committee in place, bids were not drafted by such committee which should be composed of one or more officials of the municipality as required by SCM regulation 27(3) (leadership).
75. 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 per the requirements of SCM regulation 28(2) (financial and performance management).
76. Final awards and recommendation of awards to the accounting officer were not always made by an adjudication committee which was constituted of at least four senior managers as per the requirements SCM regulation 29(2) (leadership).
77. Awards were made to providers whose tax matters had not been declared by the South African Revenue Services to be in order as required by SCM regulation 43.(leadership)
78. Awards were made to suppliers who did not submit a declaration of their employment by the state or their relationship to a person employed by the state as per the requirements of Municipal SCM regulation 13(c) (leadership).
79. 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 and SCM regulation 28(1)(a) (financial and performance management).

80. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations (financial and performance management).
81. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA (leadership).
82. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2) (leadership).
83. Sufficient appropriate audit evidence could not be obtained that contracts and quotations to the value of R1.1 million was procured in accordance with legislative requirements and the SCM policy (financial and performance management).
84. The municipality, as a result of the above matters, failed to adequately implement their SCM policy as required by section 111 of the MFMA (leadership).

Human resource management and compensation

85. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the Municipal Systems Act (leadership).

Expenditure management

86. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the Municipal Finance Management Act (financial and performance management).
87. The accounting officer did not take reasonable steps to prevent unauthorised expenditure/ irregular expenditure and/or fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act (leadership).
88. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the Municipal Finance Management Act (leadership).

Transfer of funds and/ or conditional grants

89. No instances of material non-compliance were identified during the audit.

Revenue management

90. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the Municipal Finance Management Act.
91. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised

revenue when it is earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the Municipal Finance Management Act.

Asset management

92. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the Municipal Finance Management Act (financial and performance management)..
93. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the Municipal Finance Management Act (financial and performance management).

Financial misconduct

94. No material issues were identified relating to non-compliance to laws and regulations as a result of financial misconduct.

Value Added Tax Act No. 89 of 1991

95. The Municipality has not adequately applied the requirements of sections 20 and 28 of the Value Added Tax (VAT) Act. (financial and performance management).

INTERNAL CONTROL

96. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

97. There was no adequate performance management system in place. Annual performance contracts were not signed by the section 57 employees for the year under review as a result, there were no consequences for poor performance and disciplinary action was not taken.
98. The municipality does not exercise oversight responsibility over reporting, compliance with laws and regulations and internal control. As a result, personnel were not aware of the allocation of duties, responsibilities and lines of reporting for the performance management system.
99. Actions are not taken to address the risks relating to the achievement of complete and accurate financial and performance reporting. Control weaknesses are not analysed and appropriate follow-up actions are not taken that address the root causes. Furthermore, the external audit findings were not adequately addressed. The other departments believe that the audit process is the responsibility of the finance department. This was also evident based on the attendance in the audit steering committee meetings.
100. There are inadequate monitoring processes in place to ensure compliance with policies and procedures, and, when monitoring does take place, the results are not routinely communicated to all managers and staff. There is also a culture of non-adherence to policies and procedures within the municipality and management does not take adequate disciplinary action against officials who fail to comply. Furthermore, the accounting officer does not evaluate whether management has implemented effective internal controls and senior management has not fulfilled their duties and responsibilities.

Financial and performance management

101. The municipality does not have proper record keeping and record management. In the supply chain management unit, most of the documents relating to the supply chain management process are kept by the user department. The documents are not properly filed and easily retrievable. There were numerous delays in providing the requested information for audit purposes. Information that was submitted for audit purposes on the tendering process was not always complete which resulted in a scope limitation being placed on the audit.
102. The municipality relies on manual systems for the preparation of the asset register, commitments, and certain other disclosures that are required for the financial statements. The manual systems are not adequate to support the nature and size of the municipality as

well as the preparation of the financial statements and performance reports, resulting in material misstatements in those balances.

103. The municipality does not have processes in place to ensure compliance with laws and regulations and the municipality has therefore failed to comply with all requirements of the Municipal Finance Management Act (MFMA) and National Treasury Regulations (NTRs).
104. The financial statements and other information to be included in the annual report were not reviewed for completeness and accuracy prior to submission for audit purposes. This resulted in material misstatements in the financial statements and performance information.

Governance

105. The municipality did not have an internal audit unit for a significant portion of the year under review.
106. The audit committee has not been functional for the year under review and as a result the internal audit unit reported directly to the accounting officer which impairs the independence of the unit as they should be functionally reporting to the audit committee.
107. No risk assessment was conducted for the year under review resulting in the municipality not having a risk based internal audit plan in the year under review. The fraud prevention plan has not yet been approved.

OTHER REPORTS

Investigations

108. An independent service provider has been appointed to investigate irregularities relating to the receipting of cash and revenue.
109. There were also on- going internal investigations relating to tender irregularities and theft of cash and inventory items from stores.
110. The investigation of meter readers who were suspected of receiving money for unauthorised reconnection of disconnected consumers was finalised during the year.

East London

30 November 2011



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

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