

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE 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, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, changes in net assets and cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No.6 of 2011 as amended) (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 the 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.

Basis for disclaimer of opinion

Property, plant and equipment

4. The municipality did not review the useful lives and residual values of property, plant and equipment at each reporting date in accordance with *GRAP 17: Property, Plant and Equipment*. I have not determined the correct net carrying amount of these assets as it was impracticable to do so. In addition, sufficient appropriate evidence was not available for the amounts disclosed as property, plant and equipment amounting to R726,3 million (2011: R710,7 million) as disclosed in note 6 and depreciation and amortisation of R15,8 million (2011: R15,3 million) as disclosed in note 25 to the financial statements. The municipality's asset register for both movable and immovable assets was incomplete as assets belonging to the municipality were not recorded. Conversely, assets per the asset register could not be located. I was unable to confirm the assets and expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to property, plant and equipment in the financial statements were necessary.
5. Asset disposals as disclosed in note 6 to the financial statements of R95 711 (2011: nil) do not correlate to the gain on disposal of assets of R1,7 million (2011: R9,4 million) as disclosed in note 31 to the financial statements. This gain related to assets sold in previous financial years and therefore the gain on disposal was incorrectly applied to the current financial year. Due to the lack of sufficient appropriate audit evidence and controls

regarding the municipality's asset register, I have not determined the correct gain on disposal of assets as it was impracticable to do so. I was unable to confirm this income by alternative means. Consequently, I was unable to determine whether any further adjustments to the gain on disposal of assets were necessary.

Investment property

6. The municipality did not assess the fair value of all its land and buildings at each reporting date in accordance with GRAP 16: *Investment Property*. I have not determined the correct fair value of these assets as it was impracticable to do so. In addition, land and buildings have been inappropriately classified as property, plant and equipment in note 6 to the financial statements. The asset register of the municipality was incomplete as not all land and buildings that belong to the municipality had been recorded in the asset register. Sufficient appropriate evidence was not available for the amounts disclosed as investment property amounting to R91,3 million (2011: R91,3 million) as disclosed in note 8 to the financial statements. I was unable to confirm the investment property balance by alternative means. Consequently, I was unable to determine whether any adjustments relating to investment property in the financial statements were necessary.

Inventory

7. The municipality did not reclassify land used for the erection of reconstruction and development (RDP) houses as inventory at each reporting date in accordance with GRAP 12: *Inventory*. The municipality's valuation roll did not detail the land parcels on which the RDP houses had been constructed, and the value of these land parcels could therefore not be determined in the current and previous financial year. I was unable to confirm the inventory amount by alternative means. Consequently, I was unable to determine the amount required to be disclosed as inventory in the financial statements.

Accumulated surplus

8. An adjustment to the prior period surplus of R5,3 million, relating to current and prior period errors, has not been correctly allocated to the corresponding items in the financial statements and cash flow from operating activities in the cash flow statement. The surplus for the prior financial year has been incorrectly carried to the statement of net assets by the same amount. Sufficient appropriate audit evidence was not obtained to confirm the accumulated surplus balance of R1 billion (2011: R926,1 million) in the statement of changes in net assets. Furthermore, the municipality has not made adjustments to the opening balance in the statement of changes in net assets for all errors found in revenue, expenditure, employee costs, assets and liabilities in the previous financial year. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to the accumulated surplus in the financial statements were necessary.

Other receivables from exchange transactions

9. The municipality disclosed water and sanitation related transactions and account balances as an agency agreement, in terms of GRAP 9: *Revenue from Exchange Transactions*. This has been included in other receivables from exchange transactions disclosed in note 3 to the financial statements at an amount of R114 million. In terms of the service level agreement signed with the district municipality, a principal type arrangement has been agreed, which requires the municipality to separately disclose water and sanitation revenue and expenditure, water and sanitation receivables, payables, inventory and water

distribution losses in the financial statements. Due to the lack of sufficient appropriate audit evidence, I have not determined the correct amounts of these required disclosures as it was impracticable to do so. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine the amounts to be adjusted to other receivables from exchange transactions and the related revenue, expenditure, trade receivables from exchange transactions, trade payables, inventory and water distribution losses in the financial statements.

10. The municipality did not recognise the fair value of the opening balance relating to the Chris Hani Agency account in accordance with GRAP 106: *Transfer of Function*. Furthermore, the Chris Hani Agency account, as reported in the previous financial year, with an amount of R106,3 million disclosed in note 3 to the financial statements, was not supported by sufficient appropriate audit evidence. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine the amounts to be adjusted to the opening balances in other receivables from exchange transactions and the related revenue, expenditure, trade receivables from exchange transactions, trade payables and inventory in the financial statements.

Administrative costs

11. The municipality processed journal entries to account for water and sanitation expenditure in the agency account of the municipality. The amount passed created an income in the financial statements of R12,9 million (2011: R8,6 million) and a corresponding receivable in other receivables from exchange transactions of the same amount. Due to a lack of sufficient appropriate audit evidence and a lack of reconciliations performed between the district and the local municipality, the recoverability of this amount could not be determined. I was unable to confirm the amounts by alternative means. Consequently I was unable to determine whether any adjustments to administrative costs and other receivables from exchange transactions in the financial statements were necessary.

Trade receivable from exchange transactions

12. The debt impairment provision of R173,4 million (2011: R153,5 million) as disclosed in note 2 to the financial statements has not been provided for correctly in terms of the International Accounting Standard, IAS 39, *Financial Instruments: Recognition and Measurement*. It was impracticable for me to determine the extent of the misstatement. In addition, sufficient appropriate audit evidence was not available for the amounts disclosed as trade receivables from exchange transactions with a net balance of R26,6 million (2011: R20,3 million) disclosed in note 2 to the financial statements. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine whether any further adjustments to the debt impairment provision and trade receivables from exchange transactions in the financial statements were necessary.
13. Furthermore, debt impairment expenditure of R28,8 million (2011: R57,5 million) in the financial statements was not supported by adequate documentation and schedules. The write-off of debtors was not supported by adequate approvals and was not set off against the prior year debt impairment provision. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any further adjustment to debt impairment expenditure in the financial statements was necessary.

Other receivables and revenue from non-exchange transactions

14. Property rates revenue of R47,8 million (2011: R39,3 million) as disclosed in note 16 and other receivables from non-exchange transactions of R9,5 million (2011: R5,2 million) as disclosed in note 3 to the financial statements are based on the general valuation, which does not reconcile to the municipality's billing system. Furthermore, properties were captured onto the billing system at incorrect values and not all land parcels had been captured. I was unable to confirm the other receivables and revenue balances by alternative means. Consequently, I was unable to determine whether any further adjustments to other receivables and revenue in the financial statements were necessary.

Interest received (trading)

15. Interest received (trading) of R8,6 million disclosed in note 20 to the financial statements could not be traced to the municipality's billing system. Sufficient appropriate audit evidence was not provided to support journal entries processed to reconcile the interest income to the billing system. I was unable to confirm the interest income by alternative means. Consequently, I was unable to determine whether any further adjustments to interest received (trading) in the financial statements were necessary.

Revenue from exchange transactions

16. Service charges disclosed as R155,8 million (2011: R130,5 million) in note 17 to the financial statements were not supported by adequate documentation pertaining to the billing of consumers, as meter readings were not available. In addition, returned cheques for the sale of prepaid electricity were processed to a suspense account. Sufficient appropriate audit evidence and explanations were not available for differences between the financial statements and the billing system. I was unable to confirm service charges by alternative means. Consequently, I was unable to determine whether any further adjustments to service charges in the financial statements were necessary.
17. Receipts relating to other income of R11,9 million disclosed in note 22, rentals of facilities and equipment of R2,5 million disclosed in note 18, and fines of R380 285 in the financial statements could not be traced to the general ledger. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments to other income, rentals of facilities as well as equipment and fines in the financial statements were necessary.

Cash and cash equivalents

18. Cash on hand amounting to R73,7 million included in cash and cash equivalents disclosed in note 1 to the financial statements does not reconcile to the bank confirmations by R33,9 million. The bank reconciliation does not reconcile to the financial statements and sufficient appropriate audit evidence for journal entries passed to cash and cash equivalents was not provided. I was unable to confirm cash and cash equivalents by alternative means. Consequently, I was unable to determine whether any further adjustments to cash and cash equivalents and related suspense accounts in the financial statements were necessary.

Employee related costs

19. Employee related costs amounting to R90,2 million (2011: R88,6 million) disclosed in note 23 to the financial statements did not reconcile to the payroll, and explanations from management could not be supported with sufficient appropriate audit evidence. Furthermore, the municipality's records pertaining to overtime, contract work, allowances, basic salaries and employee tax calculations could not be agreed to supporting documentation. I was unable to confirm employee related costs by alternative means. Consequently, I was unable to determine whether any further adjustments to employee related costs in the financial statements were necessary.

Unspent conditional grants and receipts

20. The municipality could not provide sufficient appropriate audit evidence to confirm recognised conditional grant revenue of R24,5 million and R8,1 million disclosed in notes 21.2 and 21.3, respectively, included in government grants and receipts totalling R136,9 million (2011: R155,3 million) disclosed in note 21 to the financial statements. In addition, the conditional grant revenue recognised was not inclusive of value-added tax (VAT), as required by Municipal Circular 48 issued in March 2009, and it was impracticable for me to determine the extent of the understatement.
21. Furthermore, sufficient appropriate audit evidence was not obtained regarding unspent conditional grants and receipts totalling R16,3 million (2011: R15,5 million) disclosed in note 12 to the financial statements. I was not able to determine whether conditional grants had been utilised for their intended purpose, which could have resulted in unauthorised expenditure. I was not able to confirm the income, expenditure and unspent conditional grant balance by alternative means.
22. Due to the matters above, I was unable to determine whether any adjustments to unspent conditional grants and receipts, government grants and subsidies as well as expenditure on conditional grants and subsidies in the financial statements were necessary.

Subsequent events

23. The municipality received a letter after year-end from the National Treasury regarding the repayment of R4,8 million relating to the prior year's unspent conditional grants as disclosed in note 12 to the financial statements. This amount has not been disclosed by the municipality as an adjusting subsequent event. Consequently, unspent conditional grants and receipts are overstated by R4,8 million and other creditors are understated by the same amount.

Capital commitments

24. The municipality did not have a contract management system for the identification and recognition of contracted commitments. Sufficient appropriate audit evidence was not available for the commitments of R16 million disclosed in note 41 to the financial statements. I was unable to confirm this disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to the commitments disclosure note were necessary.

Trade and other payables from exchange transactions

25. The municipality did not have a system in place to account for all trade creditors and supplier statements were not reconciled to the general ledger. In addition, sufficient appropriate audit evidence could not be provided relating to outstanding cheques in the bank reconciliation. Furthermore, an adjustment to the prior year balance of R4,7 million was made to the corresponding amount and no supporting documentation was provided for audit purposes in this respect. It was impracticable to determine the extent of the misstatement in trade creditors of R8.5 million, as included in trade and other payables, disclosed in note 9 to the financial statements. I was unable to confirm trade creditors by alternative means. Consequently, I was unable to determine whether any further adjustment to trade creditors in the financial statements was necessary.
26. The municipality did not provide explanations and sufficient appropriate audit evidence in support of advance payments: debtors of R8,9 million (2011: R4,7 million), included in trade and other payables from exchange transactions, as disclosed in note 9 to the financial statements. I was unable to confirm the advance payments balance by alternative means. Consequently, I was unable to determine whether any adjustment to the advance payments balances in the financial statements was necessary.
27. Leave pay of R11,9 million (2011: R10,2 million), included in trade and other payables from exchange transactions as disclosed in note 9 to the financial statements has been calculated using incorrect leave days. The employee files are not updated with leave records. I have not determined the correct amount of leave pay as it was impracticable to do so. I was unable to confirm the leave pay balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the leave pay balance and employee related costs in the financial statements were necessary.
28. A supporting schedule for other creditors of R386 074 (2011: R5,6 million) included in trade and other payables from exchange transactions, as disclosed in note 9 to the financial statements, was not submitted for auditing. I was unable to confirm the other creditors balance by alternative means. Consequently, I was unable to determine whether any further adjustments to other creditors in the financial statements were necessary.

Irregular expenditure

29. The municipality did not have adequate systems 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 38.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R16 million (2011: R6,1 million). Due to the lack of systems and sufficient appropriate audit evidence for all awards and employee related costs, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R3,5 million (2011: R37,7 million). I was unable to confirm irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure in the financial statements.

Value-added tax

30. The municipality is registered with the South African Revenue Service (SARS) on the payment basis, but accounted for VAT on the accrual basis in terms of section 15(2) of the Value Added Tax Act of South Africa, 1991 (Act No. 89 of 1991). Furthermore, the municipality did not claim VAT back on all vatable supplies. The amounts owing to SARS at year-end to the amount of R2,4 million as disclosed note 11 to the financial statements are hence overstated by R7,3 million and expenditure is overstated by the same amount. In addition, sufficient appropriate audit evidence was not obtained for revenue, expenditure and asset additions and it is therefore impracticable to determine the full extent of the misstatement. I was unable to confirm the payable balance by alternative means. Consequently, I was unable to determine whether any further adjustments to the VAT payable in the financial statements were necessary.
31. During the prior year audit, I was unable to obtain sufficient appropriate audit evidence for the VAT receivable amount of R1,5 million as disclosed in note 11 to the financial statements. I was unable to confirm the prior year VAT receivable balance by alternative means. Consequently, I was unable to determine whether any adjustments to the VAT receivable opening balance in the financial statements were necessary.

Disclaimer of opinion

32. 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 of an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

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

Restatement of corresponding figures

34. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered only during the current financial year.

Material losses

35. As disclosed in note 39 to the financial statements, the municipality incurred estimated electricity distribution losses of 42% (2011: 31%).

Additional matters

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

Unaudited supplementary schedules

37. 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.

Withdrawal from the audit engagement

38. The numerous misstatements identified in the financial statements are indicative of significant fraud, which calls into question the reliability of the evidence obtained and the genuineness of the accounting records and documentation. 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

39. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

40. I performed procedures to obtain evidence about the usefulness and reliability of the information in the performance report as set out on pages ... to ... of the annual report.
41. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned key priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
42. The reliability of the information in respect of the selected key priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
43. The material findings are as follows:

Usefulness of information

44. None (100%) of the improvement measures in the annual performance report were explained as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to the municipality not having a functioning performance management system.
45. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 54% of the reported objectives were not consistent with the objectives as per the approved integrated development plan. This was due to the lack of a performance management system to monitor actual results against planned objectives.
46. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 96% of the targets relevant to all the key priorities of the municipality were not specific in clearly identifying the nature and the required level of performance. This was due to the absence of a performance

management system and a lack of understanding the requirements of the FMPPI.

47. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 99% of the targets relevant to all the key priorities of the municipality. This was due to the absence of a performance management system and a lack of understanding the requirements of the FMPPI.
48. The FMPPI requires that the time period or deadline for delivery be specified. A total of 96% of the targets relevant to all the key priorities of the municipality were not time bound in specifying a time period or deadline for delivery. This was due to the absence of a performance management system and a lack of understanding the requirements of the FMPPI.
49. The FMPPI requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 89% of the indicators relevant to all the key priorities of the municipality were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the absence of a performance management system and a lack of understanding the requirements of the FMPPI.
50. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 89% of the indicators relevant to all the key priorities of the municipality were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to the absence of a performance management system and a lack of understanding the requirements of the FMPPI.

Reliability of information

51. The FMPPI requires that processes and systems that produce the indicator should be verifiable, accurate enough for its intended use and respond to changes in the level of performance; and that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity, accuracy and completeness of the actual reported performance relevant to all key priorities of the municipality. This was due to limitations placed on the scope of my work due to the absence of a performance management system and management's lack of understanding the requirements of the FMPPI.

Additional matter

52. I draw attention to the matter below. This matter does not have an impact on the audit findings on predetermined objectives reported above.

Achievement of planned targets

53. Only 10% of the planned targets were achieved during the year under review. This was due to the fact that indicators and targets were not suitably developed during the strategic planning process and the budget was not aligned to the integrated development plan. In addition, there was a lack of review and monitoring in respect of performance reporting

Compliance with laws and regulations

54. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *general notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

55. The municipality did not establish a performance management system, as required by section 38(a) of the MSA and Municipal Planning and Performance Management Regulation 7(2)(c), (e), (f) and (g).
56. The municipality did not perform, or did not implement, the following in respect of performance management:
- Set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan.
 - Monitor performance with regard to each of those development priorities and objectives and against the key performance indicators and targets set.
 - Measure and review performance at least once per year with regard to each of those development priorities and objectives and against the key performance indicators and targets set.
 - Take steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41 of the MSA.

Budgets

57. The accounting officer did not assess the performance of the municipality for the first half of the financial year, as required by section 72(1) of the MFMA.

Annual financial statements, performance report and annual report

58. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. 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 of audit opinion.
59. The annual performance report for the year under review did not include the names of external service providers and measures taken to improve performance, as required by section 46(1)(a) and (c) of the MSA.

Audit committee

60. The audit committee was not fully constituted for the entire financial year, as required by section 166(4)(a) of the MFMA, as there were only two members instead of the required three. The third member was appointed at the end of the financial year and did not attend any meetings.

61. The minutes of audit committee meetings did not adequately reflect the discussions held at the meetings and no other appropriate audit evidence was submitted to confirm whether the audit committee had discharged its duties in terms of the following:
- Internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
 - Advising the municipality on the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
 - Advising the municipality on compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(a)(vii) of the MFMA.
 - Responses 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.
62. A performance audit committee was not in place and the audit committee established in terms of section 166(1) of the MFMA was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

Internal audit

63. The internal audit unit did not function as required by section 165(2) of the MFMA, and the following deficiencies were noted:
- The risk-based audit plan was only approved in March 2012. The internal audit programme was not fully implemented and the risks identified per the internal audit plan were not adequately covered by the internal audits conducted.
 - Only three of the internal audits conducted during the year were finalised during the year.
 - As only three internal audit reports were finalised during the year, the internal audit unit was ineffective in advising the accounting officer and reporting to the audit committee on matters relating to internal controls, accounting procedures and practices as well as risk management.

Expenditure management

64. 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 MFMA.
65. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors and payments made, as required by section 65(2)(b) of the MFMA.
66. The accounting officer did not take effective steps to prevent fruitless and wasteful as well as irregular expenditure, as required by section 62(1)(d) of the MFMA
67. Irregular as well as fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

Conditional grants received

68. The municipality was unable to provide sufficient appropriate audit evidence regarding

compliance with conditional grants received as follows:

- The municipality did not submit quarterly performance reports to the transferring national officer, the Eastern Cape Provincial Treasury and the National Treasury within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
 - The municipality did not evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA.
 - The municipality could not confirm that the allocations for the municipal infrastructure grant, integrated national electrification programme grant, local government financial management grant and municipal systems improvement grant were not utilised for purposes other than those stipulated in the grant framework, in contravention of section 15(1) of DoRA.
 - The municipality did not submit timely project registration forms for projects it intended implementing in the financial year under review to the Department of Local Government, as required by the DoRA Framework issued in Gazette No. 34280.
 - The municipality did not submit its signed activity plan in the prescribed format to the Department of Cooperative Governance and Traditional Affairs (CoGTA), as required by the DoRA Framework issued Gazette No. 34280.
69. The following instances of non-compliance with the DoRA Framework issued in Gazette No. 34280 were identified:
- The municipality did not submit project implementation plans to CoGTA.
 - The municipality did not register its master plans for bulk infrastructure with the integrated national electrification programme.
 - Projects were not implemented in line with the details contained in the integrated development plan.

Revenue management

70. A tariff policy on the levying of fees for municipal services provided by the municipality was not implemented, as required by section 74(1) of the MSA and section 62(1)(f)(i) of the MFMA.
71. A credit control and debt collection policy was not maintained, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
72. An adequate management, accounting and information system was not in place to recognise revenue when it was earned and to account for debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.
73. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

Asset management

74. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

75. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
76. The municipality did not comply with Municipal Investment Regulation 9(1) (GNR.308 of 1 April 2005) as follows:
- The accounting officer, within 10 working days of the end of each month, did not submit to the mayor a report describing, in accordance with generally recognised accounting practice, the investment portfolio at the end of the month.
 - The investment portfolio was not monitored on a regular basis to assess whether the investments that no longer had the minimum acceptable credit rating needed to be liquidated as specified in its investments policy.

Liability management

77. A management, accounting and information system that adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
78. 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.

Procurement and contract management

79. Sufficient appropriate audit evidence was not provided relating to procurement and contract management and therefore I could not determine whether the municipality had complied with the following:
- Goods and services with a transaction value below R200 000 were procured by means of obtaining the required price quotations, as required by Supply Chain Management (SCM) Regulation 17(a) and (c).
 - Quotations were accepted from prospective providers who were registered on the list of accredited prospective providers and meet the listing requirements prescribed by the SCM policy, as required by SCM Regulations 16(b) and 17(b).
 - Goods and services with a transaction value above R500 000 were procured by means of inviting competitive bids and that the accounting officer only approved deviations if it was impractical to invite competitive bids, as required by SCM Regulation 19(a).
 - Bid specifications for the 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).
 - Bid specifications were drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM Regulation 27(3).
 - Invitations for competitive bidding were advertised for the required minimum period, as required by SCM Regulation 22(1) and (2).
 - Bids were evaluated by bid evaluation committees 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).

- Contracts and quotations were awarded to bidders based on points given for criteria that had been 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.
 - Bid adjudication was always done by committees composed in accordance with SCM Regulation 29(2).
 - Awards were not 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).
 - 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 of South Africa, (Act No. 5 of 2000) (PPPFA) and SCM Regulation 28(1)(a).
 - Contracts and quotations were awarded to suppliers based on preference points that had been allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
 - Contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of the PPPFA.
 - Contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
 - Extensions or modifications to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
 - Contract and quotations were awarded only to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM Regulation 43.
 - Contracts and quotations were awarded only to 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).
80. The performance of contractors and providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
81. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
82. Awards were made to providers who are persons in the service of other state institutions or whose directors are persons in the service of other state institutions, in contravention of SCM Regulation 44. Similar awards were identified in the prior year and no effective steps had been taken to prevent or combat the abuse of the SCM process in accordance with SCM Regulation 38(1).

Human resource management

83. 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.

84. Appointments were made in posts that were not provided for on the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
85. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by Municipal Regulation on Minimum Competency Levels 14(2)(b).
86. Sufficient appropriate audit evidence was not obtained regarding the municipality's prompt assessment of the competencies of financial and SCM officials in order to identify and address gaps in competency levels, as required by Municipal Regulation on Minimum Competency Levels 13.
87. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and the relevant provincial treasury, as required by the Municipal Regulation on Minimum Competency Levels 14(2)(a).

Internal control

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

Leadership

89. The leadership did not take full ownership of the internal control environment and did not insist on daily disciplines to ensure efficiency and effectiveness in financial management, service delivery execution and compliance with laws and regulations, thus not setting the correct tone for the credibility of all reports of the administration.
90. There was inadequate oversight by management due to a lack of regular reviews by management on monthly reporting. Certain staff members within the finance department did not understand the applicable financial reporting framework and there was also a lack of capacity at management level within the municipality.
91. The policies and procedures relating to human resource management, as well as an unsuitable organogram, rendered human resource management ineffective. Adequate and sufficiently skilled resources were not in place and the performance of municipal officials was not monitored by those charged with governance and leadership.
92. The established and communicated policies and procedures of the municipality were outdated and did not adequately support the municipality in complying with laws, regulations and reporting requirements of GRAP.
93. Although the municipality had developed an audit action plan, it was not monitored by the leadership to ensure that management was addressing internal control deficiencies.
94. An information technology (IT) governance framework was not established to support and enable the business, deliver value and improve performance.

Financial and performance management

95. Proper record keeping was not maintained by the municipality and this resulted in information that could not be confirmed as being credible. Information supporting financial and performance reporting was not available for auditing and, when it was, it was incomplete or did not support the information disclosed in the financial statements and the performance report.
96. The municipality's controls over daily and monthly processing and reconciling of transactions were non-existent. Reconciliations were performed for external audit purposes and not for management's monitoring and decision-making purposes. No reliance could be placed on the reconciliations performed by management.
97. Reliable information did not support the financial and performance reports prepared by the municipality. The municipality did not institute regular processes of collecting, collating and reporting on credible information, which could assist with decision-making and the direction of the municipality's financial and performance objectives.
98. Compliance with laws and regulations was not monitored and reviewed by management on a consistent basis throughout the year. Compliance reports could not be provided for audit purposes.
99. 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 evidenced by the lack of reconciliations between the IT system-generated reports and the amounts disclosed in the financial statements.

Governance

100. The municipality had a risk management strategy, but it had not been implemented and monitored by the municipality. In addition, IT risks and fraud prevention were not focus areas in the risk assessment performed by the municipality.
101. The reports issued by the internal audit function were not adequately addressed by management, which resulted in repeat internal and external audit findings. The internal audit plan was only approved in March 2012 and the internal audit unit finalised only three internal audit reports for the year.
102. As a result of the impaired functioning of the internal audit function, the audit committee could not effectively evaluate and monitor responses to risks and provide oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

OTHER REPORTS

Investigations

103. The following investigations relating to the municipality are in progress or have been completed:
 - An investigation into the unauthorised transfer of funds was finalised during the year and suspended employees were cleared of wrongdoing and reinstated by the municipality. Further investigations are being carried out by the South African Police Service.

- An internal investigation into the manipulation of wages paid during the financial year was completed after the end of the financial year. The employee involved was subsequently dismissed.

East London

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence