

**King Sabata Dalindyebo
Municipality
Audit Report**

Report for the year ended 31 March 2014

**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 financial statements of the King Sabata Dalindyebo Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and cash flows for the year then ended, statement of comparison of budget and actual amounts, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (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

Unauthorised expenditure

4. The municipality did not provide a schedule of the current year unauthorised expenditure and did not have adequate systems in place to identify and disclose all unauthorised expenditure. Supporting documentation was not submitted for audit purposes for the unauthorised expenditure of R1,2 billion (2012: R96,9 million) as disclosed in note 51 to the financial statements.
5. An amount of R5,7 million unauthorised expenditure was identified during the audit process. Consequently, I was unable to determine whether any further adjustments were necessary to unauthorised expenditure as disclosed in note 51 to the financial statements.

Irregular expenditure

6. The municipality did not provide a schedule of the current year irregular expenditure and did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. I was unable to confirm the disclosure by alternative means.
7. In addition to the above, no evidence was provided to support the council write-off of irregular expenditure of R59,7 million in the prior year as disclosed in note 53 to the financial statements.
8. Consequently, I was unable to determine whether any further adjustments were necessary to irregular expenditure of R154,9 million (2012: R61,8 million) as disclosed in note 53 to the financial statements.

Related parties

9. Sufficient appropriate audit evidence was not available to support related parties disclosed in note 46 to the financial statements. Supporting documentation was not submitted for audit purposes and I was unable to confirm the related parties by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to related parties of R168 315 as disclosed in note 46 to the financial statements.

Fruitless and wasteful expenditure

10. The municipality did not provide a schedule of the current year fruitless and wasteful expenditure and did not have adequate systems in place to identify and disclose all fruitless and wasteful expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The fruitless and wasteful expenditure disclosed in note 52 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R330,3 million. Due to the lack of systems, and non-availability of sufficient appropriate audit evidence, it was impracticable to determine the full extent of the understatement of fruitless and wasteful expenditure disclosed at R1,1 million. Consequently, I was unable to determine whether any further adjustments were necessary to the fruitless and wasteful expenditure disclosure note.

Councillors' and staff arrear consumer accounts

11. As disclosed in note 54 to the financial statements, councillors accounts are in arrears to the amount of R272 000 (2012: R187 000). The arrear amounts that are more than 90 days is disclosed as R250 000. In addition, at least five councillors were identified that were in arrears for the 2010/11, 2011/12 and 2012/13 financial years. The total of the staff age analysis that was obtained included a total credit balance of R1,1 million for all staff debtors. As a result of sufficient appropriate audit evidence not being available to substantiate receivables from non-exchange transactions of R11 million and receivables from exchange transactions of R82,3 million, I was unable to confirm the factual correctness of the disclosure.

Contingencies

12. GRAP 19: *Provisions, contingent liabilities and contingent assets* require a description of the nature of the contingent liability to be disclosed. The contingent liability in respect of the wage agreement was not disclosed in note 45 to the financial statements. The employee's job evaluation were not completed and paid in accordance to the wage scale and rates in the wage curve agreement. It was not practicable to measure the financial effect of the contingent liability with sufficient reliability.
13. Furthermore the municipality did not identify and disclose all contingencies as not all third party legal confirmations were received and for those that were received the amount differed from what was disclosed in the financial statements. This resulted in contingencies being understated by R3,4 million. In addition, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as contingencies in note 45 to the financial statements and I could not confirm the disclosure by alternative means. Consequently I was unable to determine whether any further adjustments to contingencies stated at R12 million (2012: R417,3 million) in the financial statements were necessary.

Property, plant and equipment

14. Property, plant and equipment with a carrying value of R1,5 billion (2012: R1,5 billion) is disclosed in note 5 to the financial statements and statement of financial position. Included in this figure is Land with a carrying value of R92,2 million (2012: R96,4 million), Buildings of R301,8 million (2012: R314,1 million), Infrastructure of R534,6 million (2012: 587,3 million), Community of R331,6 million (2012: R344,1 million), Other property, plant and equipment of R7,8 million (2012: R5,4 million), Work in progress of R253,9 million (2012: R150,2 million)

and Specialised vehicles of R2,9 million (2012: R2,6 million). The following are the findings that relate to this note:

Non-compliance with statements of GRAP

15. The municipality adopted the revaluation method in terms of GRAP 17: *Property, plant and equipment* as the subsequent measurement basis for its land and buildings. This standard requires revaluations to be carried out with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at reporting date. Indicators exist that if a revaluation has been performed, the value of land and buildings would have differed materially. In addition the incorrect accounting policy is disclosed for subsequent valuation of land and buildings.
16. The municipality did not provide sufficient appropriate audit evidence to verify that it performed impairment testing on property, plant and equipment as required by GRAP 21: *Impairment of non-cash-generating assets*. Indicators exist that an impairment loss should have been recognized.
17. Heritage assets of R2,5 million is included in Community. In terms of GRAP 103: *Heritage assets* these assets should be presented as a separate line item on the face of the statement of financial position.
18. The municipality did not disclose a change in accounting estimate for the change in useful lives for inconsistencies in the useful lives for Buildings, Other property, plant and equipment and Infrastructure as required by GRAP 3: *Accounting policies, estimates and errors*.

Asset register not complete

19. Land and buildings to the value of R72,8 million and infrastructure (roads) to the value of R3,9 million which were included in the municipality's records in the previous years have subsequently been removed from the asset register.
20. Properties registered in the name of the municipality with the deeds office are not recorded in the asset register.
21. Furthermore, library books which should form part of community assets are not recorded in the asset register.

Assets could not be verified

22. Assets to the value of R19,7 million which are included in the asset register could not be verified.

Transfer of assets

23. Included in community assets and work in progress are health care assets (clinics) which per an agreement between The Eastern Cape Department of Health and the municipality were to be transferred to the department. Furthermore sufficient appropriate audit evidence was not presented for transfer of properties made.

Allocation errors

24. Allocation errors between cost and accumulated depreciation are included in the 2012 figures in note 5 for the following classes:
 - Buildings of R9,8 million
 - Community of R9,1 million
25. In addition, there are allocation errors in note 5 in the current year whereby:
 - Revaluations (land) is overstated and disposals (land) are understated by R4,2 million.
 - Additions and transfers are understated by R17,2 million.

Differences in figures disclosed

26. Impairment loss of R91,7 million is disclosed for 2012 in the statement of financial performance. This amount does not agree to the amount disclosed in note 5 to the financial statements of R96,6 million. Due to the limitations described above, I was unable to determine which amount is correct.
27. The fair value adjustment of R57 million disclosed in note 5 to the financial statements does not agree to the amount disclosed in the statement of changes in net assets of R69,7 million.

Infrastructure

28. The municipality used the depreciated replacement cost for the valuation of Infrastructure assets (electricity) and I was not presented with sufficient appropriate audit evidence to support the replacement costs used in the valuation of these assets. Furthermore, I was unable to obtain sufficient appropriate audit evidence for the costs per unit of items used in the fair valuing of Infrastructure assets (roads). Inconsistencies and differences were identified between components recorded in the fixed asset register and valuation report provided. In addition it was identified that value added tax (VAT) was included as part of the unit costs for some of the components.
29. I was unable to obtain sufficient appropriate audit evidence for all additions made.

Work in progress

30. No supporting documentation was provided to satisfy myself for the valuation of Work in progress's opening balance of R150,2 million (2012: R67,5 million). Furthermore, no support could be provided for adjustments made of R20,8 million. There were no alternate audit procedures that I could perform as the contract register, commitments register and tender register was incomplete.
31. I was unable to obtain sufficient appropriate audit evidence for all additions made. Furthermore, a project was identified where the municipality acts as an agent but the specific project is included as part of work in progress.
32. As a result of the above, I was unable to perform any alternative procedures in these circumstances. Consequently, I was unable to determine whether any adjustments are required to property, plant and equipment as disclosed in note 5 to the financial statements of R1,5 billion (2012: R1,5 billion) and depreciation of R97 million (2012: R69,7 million) disclosed in note 5 to the financial statements.

Investment property

33. Investment property with a carrying value of R124,5 million (2012: R103,2 million) is disclosed in the statement of financial position and note 4 to the financial statements. The fair value model per GRAP 16: *Investment property* requires investment property to reflect market conditions at reporting date. Errors in the valuation calculations were noted which resulted in investment property being understated by R12,5 million and fair value adjustments understated by the same amount.
34. Properties were identified in the name of the municipality which are not accounted for in the accounting records of the municipality. Consequently, investment property as disclosed is understated. It was however impracticable to determine the full extent of the misstatement.

Revenue from exchange transactions

35. Included in revenue from exchange transactions is decrease in provisions of R149,1 million as disclosed in the statement of financial performance. Sufficient appropriate audit evidence could not be obtained to confirm the nature and amount of this revenue. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R149,1 million.
36. Rental of facilities and equipment are disclosed as R13,6 million in the statement of financial performance. This is understated by R322 000, receivables from exchange transactions (excluding VAT) is overstated by R306 000 and VAT receivable is overstated by R16 000 therefore it is not adequately recognised in accordance with GRAP 9: *Revenue from exchange transactions* as a result of:
 - the receipts did not agree to the receipt book,
 - amounts billed for rental did not agree to the rental amounts disclosed in the rental agreement,
 - output VAT was not charged on rentals,
 - rental was not billed at the correct rate.
37. Sufficient appropriate audit evidence to support rental of facilities and equipment could not be obtained. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R13,6 million (2012: R12,5 million) as disclosed in the statement of financial performance.
38. Sufficient appropriate audit evidence to support other income could not be obtained. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R12,8 million (2012: R10,8 million) as disclosed in the statement of financial performance.
39. Licences and permits are disclosed as R11,4 million in the statement of financial performance. This is understated by R5,8 million and receivables from exchange transactions is overstated by R5,8 million therefore it is not adequately recognised in accordance with GRAP 9: *Revenue from exchange transactions* as a result of:
 - incorrect tariffs were billed,
 - amounts recorded in the licencing reports did not agree to amounts recorded in the general ledger.
40. Sufficient appropriate audit evidence to support licences and permits could not be obtained. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R11,4 million (2012: R11 million) as disclosed in the statement of financial performance.
41. Interest received – investment disclosed as R30,4 million in the statement of financial performance included an amount of R20,8 million for interest charged on trade and other receivables as per note 33 to the financial statements. The interest charged on trade and other receivables is overstated by R14,2 million, receivables from exchange transactions are understated by R 7,1 million and receivables from non-exchange transactions is understated by R7,1 million therefore it is not adequately recognised in accordance with GRAP 9: *Revenue from exchange transactions* as a result interest was not accurately calculated on outstanding receivables.
42. Service charges are disclosed as R258,6 million in note 24 to the financial statements. Included in service charges is sale of electricity of R231 million. The sale of electricity is understated by R12,1 million, receivables from exchange transactions (excluding VAT) is overstated by R11,9 million and VAT receivable is overstated by R200 000 therefore it is not

adequately recognised in accordance with GRAP 9: *Revenue from exchange transactions* as a result of:

- recalculated amount of conventional electricity consumed as per the meter readings did not agree to the amount recorded on the billing system,
- electricity and output VAT on the electricity was not accrued for before year end,
- electricity not billed to the debtor and output VAT not claimed.

Revenue from non-exchange transactions

43. Property rates are disclosed as R131,8 million in the statement of financial performance. This is overstated by R3,7 million and receivables from non-exchange transactions is understated by R3,7 million therefore it is not adequately recognised in accordance with GRAP 23: *Revenue from non-exchange transactions* as a result of no rates being charged on some of the properties.
44. Sufficient appropriate audit evidence to support property rates could not be obtained. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R131,8 million (2012: R128,5 million) as disclosed in the statement of financial performance.
45. Government grants & subsidies as disclosed in note 25 to the financial statements of R274,4 million is understated by R15 million and the related unspent conditional grants is overstated by R15 million therefore it is not adequately recognised in accordance with GRAP 23: *Revenue from non-exchange transactions*. This is as a result of the total amounts indicated as withdrawals on the grants register not agreeing with the amount disclosed as grants & subsidies on the statement of financial performance.
46. Sufficient appropriate audit evidence to support fines could not be obtained. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this revenue of R2,1 million (2012: R1,6 million) as disclosed in the statement of financial performance.

Revenue

47. All other revenue disclosed in the statement of financial performance is understated by R123 000, all other receivables was overstated by R123 000 therefore it is not adequately recognised in accordance with GRAP 23: *Revenue from non-exchange transactions* and GRAP 9: *Revenue from exchange transactions* as a result of credit notes not being traced to the municipality's financial system.

Receivables from exchange transactions

48. Receivables from exchange transactions is disclosed as R82,3 million in note 10 to the financial statements. This is understated by R2,8 million, the related impairment loss of receivables from exchange transactions is overstated by R2,4 million, employee cost is overstated by R206 000, service charge revenue is overstated by R13,4 million, revenue from rental of facilities and equipment is understated by R305 000, revenue from interest on receivables is understated by R7,1 million and revenue from licences and permits is understated by R5,8 million as a result of:
 - employees that were overpaid,
 - receipts processed in the financial system in the incorrect financial year,
 - recalculated amount of conventional electricity consumed as per the meter readings did not agree to the amounts recorded on the billing system,
 - amounts billed for rental did not agree to the rental amounts disclosed in the rental agreement,
 - rental was not billed at the correct rate,

- electricity and output VAT on the electricity was not accrued for before year end,
- electricity not billed to the debtor and output VAT not claimed,
- amounts disclosed in the licence report does not agree to the general ledger,
- interest was not accurately calculated on outstanding debtors,
- the note to the financial statements does not cast.

49. In addition, sufficient appropriate audit evidence was not available for both the current and the comparative years and sufficient appropriate audit evidence in support of receivables from exchange transactions could not be obtained. I was unable to confirm this balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from exchange transactions of R82,3 million (2012: R52,7 million) as disclosed in note 10 to the financial statements.

Receivables from non-exchange transactions

50. Sufficient appropriate audit evidence was not obtained to support receivables from non-exchange transactions disclosed in note 11 to the financial statements. I was unable to confirm this balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to receivables from non-exchange transactions of R11,6 million (2012: R27,6 million) as disclosed in note 11 to the financial statements.

Expenditure

51. Expenditure is disclosed in the statement of financial performance and notes to the financial statements of:

- General expenses in note 28 as R111,4 million (2012: R498,1 million)
- Management fees in note 31 as R1,2 million (2012: R3,2 million)
- Contracted services in note 40 as R17,2 million (2012: R17,3 million)
- Grants and subsidies paid in note 41 as R27,9 million (2012: R26,2 million)
- Bulk purchase in note 42 as R162,5 million (2012: R164,9 million)

This expenditure and the related payables are understated by R252,1 million as a result of the municipality not having adequate systems in place to identify and account for expenditure.

52. Sufficient appropriate audit evidence to support the expenditure mentioned above could not be obtained. I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to expenditure of R355,8 million (2012: R326,6 million) as disclosed in the statement of financial performance and notes 28, 31, 40, 41 and 42 to the financial statements.
53. As disclosed in note 54 to the financial statements, material electricity losses of 14%, translating into R34 million, were incurred. The rand value is not disclosed which is required by MFMA section 125(2)(d)(i) and GRAP 1: *Presentation of financial statements*.

Personnel

54. Sufficient appropriate audit evidence was not available to support personnel expenditure disclosed in note 29 to the financial statements of R244 million (2012: R227 million). I was unable to confirm personnel expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to personnel costs.

Payables from exchange transactions

55. Sufficient appropriate audit evidence could not be obtained for payables from exchange transactions disclosed in note 19 to the financial statements of R376,8 million (2012: R100,5

million). I was unable to confirm the payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to payables from exchange transactions.

56. Furthermore, the municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end and therefore did not include all outstanding amounts meeting the definition of a liability as per GRAP 1: *Presentation of financial statements*. This has resulted in an understatement of payables from exchange transactions and the related expenditure by R6,4 million. Due to the lack of systems in place and material findings in other transactions, balances and disclosures, it was impracticable for me to determine the full extent of the understatement in payables from exchange transactions.

Revaluation reserve

57. The municipality was unable to provide sufficient appropriate audit evidence for the opening balance of the revaluation reserve. There were no satisfactory alternative audit procedures that I could perform in these circumstances. Consequently, I was unable to determine whether any further adjustments to revaluation reserve stated at R132,2 million (2012: R132,7 million) in the financial statements were necessary.

Consumer deposits

58. The municipality was unable to provide sufficient appropriate audit evidence for journals and un-reconciled differences between the consumer deposit listing and the financial statements. I was not able to confirm consumer deposits by alternative means. Consequently, I was unable to determine whether any adjustments are required to consumer deposits of R3 million (2012: R2 million) as disclosed in note 20 to the financial statements.

Cash flow statement

59. The municipality did not provide supporting calculations for the figures as disclosed in the cash flow statement for the current and prior year. I was unable to confirm the cash flows by alternative means. Consequently, I was unable to determine whether any adjustments are required to the cash flows as disclosed in the cash flow statement.

Statement of comparison of budget and actual amounts

60. The municipality did not adequately disclose the statement of comparison of budget and actual amounts as per the requirements of GRAP 24: *Presentation of budget information in financial statements*. The original budget amounts and final budget amounts disclosed in the statement of comparison between budget and actual amounts did not agree to the amounts recorded in municipality's approved budgets as a result:
- The original budget figures for revenue disclosed in the statement of comparison of budget and actual amounts are overstated by R358 million.
 - The original budget figures for expenditure disclosed in the statement of comparison of budget and actual amounts are overstated by R180,4 million.
 - The final budget figures for revenue disclosed in the statement of comparison of budget and actual amounts are overstated by R146,8 million.
 - The final budget figures for expenditure disclosed in the statement of comparison of budget and actual amounts are understated by R30,7 million.
61. In addition, sufficient appropriate audit evidence was not available and documentation in support of the recalculated variances between the final budget amounts and the actual amounts was not submitted for audit purposes.

Commitments

62. Approved and contracted for commitments and approved but not yet contracted for commitments are disclosed in note 44 to the financial statements of R144,6 million (2012: R94,1 million) and R41,9 million (2012: R60,8 million) respectively. The municipality did not have a contract management system in place for the identification and recognition of contracted commitments. Sufficient appropriate audit evidence was not available for the commitments disclosed. 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 are necessary.

Provisions

63. Provisions of R26,3 million (2012: R26,3 million) is disclosed in the statement of financial position and note 18 to the financial statements. GRAP 19: *Provisions, contingent liabilities and contingent assets* requires that provisions shall be reviewed as each reporting date. Differences were identified between the calculation provided by the experts and the recalculation performed, resulting in provisions being overstated by R10,5 million and decrease in provisions being understated by the same amount.
64. Management did not provide sufficient appropriate audit evidence to support the unit costs used in the calculation of this provision for the current year. As a result of the above, there were no satisfactory alternative audit procedures that I could perform in these circumstances. Consequently, I was unable to determine whether any further adjustments to provisions were necessary.

Investments

65. The municipality did not disclose the short term investments in accordance with GRAP 1: *Presentation of financial statements*. The short term investments should be disclosed under cash and cash equivalents and not under investments. Consequently, investment disclosed in note 7 to the financial statements is overstated by R216,9 million and cash and cash equivalent is understated the same amount.

Unspent conditional grants and receipts

66. The municipality did not recognise all revenue from non-exchange transactions although the conditions of the grants were met in accordance with GRAP 23: *Revenue from non-exchange transactions*. Consequently, revenue from non-exchange transaction is understated by R15 million and unspent conditional grants and receipts is overstated by the same amount.
67. Sufficient appropriate audit evidence to support the unspent conditional grants and receipts could not be obtained. I was unable to confirm this unspent conditional grants and receipts by alternative means. Consequently, I was unable to determine whether any adjustments to unspent conditional grants and receipts of R142,8 million (2012: R98,2 million) in the financial statements were necessary.

VAT receivable

68. The VAT effect of the numerous limitations in other transactions and balances could not adequately been determined. There were no satisfactory alternative audit procedures that I could perform in these circumstances. Consequently, I was unable to determine whether any further adjustments to VAT receivable stated at R14,8 million (2012: R5,6 million) in the financial statements were necessary.

Finance lease obligation

69. The municipality was unable to provide sufficient appropriate audit evidence relating to all leases in their name. Consequently it was not possible to determine whether classification between finance and operating leases is correct. It was however not practical to determine the full extent of the misstatement as there was no alternate procedures that I could perform.

As a result I could not satisfy myself as to the completeness of finance lease obligation disclosed in the statement of financial position and note 15 to the financial statements of R149 000 (2012: R257 000).

Accumulated surplus

70. The municipality could not account for an un-reconciled difference of R157,3 million between the financial statements and the accounting records. This resulted in an overstatement of accumulated surplus as disclosed in the statement of financial position and statement of changes in net assets. Due to the lack of systems in place, it was impracticable for me to determine the full effect of the overstatement in accumulated surplus of R1,3 billion (2012: R1,2 billion).

Events after reporting period

71. The municipality received financial assistance from provincial treasury of R200 million which is repayable over a five year period. The loan is in relation to the legal claim included in note 19 Payables from exchange transactions to the financial statements. GRAP: 14 *Events after the reporting date* indicates that the municipality should disclose material non-adjusting events after reporting date. The above is not disclosed in note 1.30 Events after reporting period to the financial statements.

Correction of errors

72. Sufficient appropriate audit evidence was not submitted to support correction of errors as disclosed in note 47 to the financial statements. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the correction of errors disclosure note.
73. The municipality did not disclose the nature of the correction of error for each correction in accordance with GRAP 3: *Accounting policies, changes in accounting estimates and errors* in note 47 to the financial statements. Consequently, the financial statements have not been prepared in accordance with all the requirements of the standard.

Management representation letter

74. The accounting officer did not submit a management representation letter for the current and prior year confirming that management fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement. It has further not been confirmed that management have provided me with all relevant information and access as agreed in the terms of the audit engagement and that all transactions have been recorded and are reflected in the financial statements. I am unable to confirm the above by alternative means. Consequently, I am unable to determine the possible effects of non-compliance with the above on the financial statements.

Aggregation of immaterial uncorrected misstatements

75. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, and the statement of financial performance, and the notes to the financial statements:
- Inventories as disclosed in the statement of financial position is understated by R1,2 million.
 - Other financial liabilities as disclosed in the statements of financial position is overstated by R1,9 million.

In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm or verify the following elements by alternative means.

- Inventories of R2 million included in the disclosed amount of R3 million in the statement of financial position.

As a result, we were unable to determine whether any further adjustments to these elements were necessary.

Disclaimer of opinion

76. 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 the financial statements.

Additional matter

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

Financial sustainability

78. Accounting policy note 1.31 to the financial statements disclosed that the financial statements have been prepared on the going concern basis. The municipality has considerable negative future cash flows which may impact on the quality of service delivery.
- The municipality received financial assistance from provincial treasury of R200 million which is repayable over a five year period. The loan is in relation to the legal claim. The balance of this claim was paid out of the operational grant (R30 million) and reserves (R70 million).
 - The municipality did not implement the wage curve agreement which may potentially result in additional liabilities of R53 million.
 - A VAT audit holds a probable material liability.

Material under spending of the conditional grant

79. No spending of project funds to the value of R17,1 million is included in unspent conditional grants and receipts disclosed in the statement of financial position and note 16 to the financial statements. As a consequence, the municipality has not achieved its objectives on the infrastructure program.

Withdrawal from the audit engagement

80. The numerous limitations identified in the financial statements are indicative of potential fraud which calls into question the reliability of evidence obtained and the credibility of the accounting records and documentation. But for the legislated requirement to perform the audit of municipality, I would have withdrawn from the engagement in terms of the International Standards on Auditing (ISAs).

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

81. 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

82. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
83. 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 objectives. 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 Framework for managing programme performance information*.

The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

84. The material findings are as follows:

Usefulness of information

Presentation

85. Section 46 of the MSA requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for all measures taken to improve performance as disclosed in the annual performance report. The municipality records did not permit the application of alternative audit procedures.
86. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

Consistency

Reported indicators and targets not consistent with planned indicators and targets

87. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes included 95% of planned indicators that were not consistent with the actual performance and 93% of targets specified in the annual performance the year under review were not consistent or complete when compared to the planned targets. This was due to the lack of review and monitoring of the completeness of reporting documents by management, audit committee and internal audit.

Changes to indicators and targets not approved

88. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in terms of section 34 and remains in force until an integrated development plan is adopted by the next elected council. Therefore, if the integrated development plan is changed in-year this process has to take place in accordance with the process as prescribed per section 34 of the MSA.
89. A total of 100% of indicators and targets reported in the annual performance report were changed in-year without following the process as prescribed in section 34 of the Municipal Systems Act and without adoption by the council of the municipality. This was due to lack of monitoring by management.

Measurability

Performance targets not specific

90. The Framework for Managing Programme Performance Information (FMPPI) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 96% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance targets not measurable

91. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 98% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary

training to enable application of the principles.

Performance targets not time bound

92. The FMPPI requires that the time period or deadline for delivery be specified. A total of 100% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance measures and indicators not well defined

93. The FMPPI requires that indicators and measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators and were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Indicators and measures not verifiable

94. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.

Reliability of information

95. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. The following findings relate to this requirement:

Development priority: Public Safety and Development priority: Infrastructure

96. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to Development priority: Public Safety and Development priority: Infrastructure.
97. This was due to limitations placed on the scope of my work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the information presented with respect to the Development priority: Public Safety and Development priority: Infrastructure. The municipality's records did not permit the application of alternative audit procedures.

Compliance with laws and regulations

98. 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:

Financial misconduct

99. Allegations of financial misconduct against senior managers were not always tabled before council, as required by Disciplinary Regulations for Senior Managers 5(2).

Expenditure Management

100. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure as required by section 62(1)(d) and 95(d) of the MFMA.
101. Unauthorised, irregular, fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

102. The accounting officer did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6), 32(7) and 102(2) of the MFMA.

Asset Management

103. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) and 96(2)(a) of the MFMA.
104. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) and 96(2)(b) of the MFMA.

Budget

105. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
106. Monthly budget statements were not submitted to the relevant provincial treasury, as required by section 71(1) of the MFMA.

Revenue Management

107. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue were not in place, as required by section 64(2)(e), 97(h) of the MFMA.
108. An effective system of internal control for debtors and revenue were not in place, as required by section 64(2)(f), 97(e) of the MFMA.

Grant Received

109. Sufficient appropriate audit evidence could not be obtained that the allocation for the Urban Settlements Development Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
110. The municipality did not submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 11(6)(a) of the DoRA.

Human Resource

111. The municipal manager did not sign performance agreements, as required by section 57(2)(a) Municipal Systems Act.
112. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
113. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels reg 13.

AFS and annual report

114. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
115. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
116. The accounting officer did not make the 2011/12 annual report public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.

117. The municipal council did not adopt an oversight report, containing comments on the annual report, within two months from the date on which the 2011/12 annual report was tabled, as required by section 129(1) of the MFMA.
118. The accounting officer did not make public the council's oversight report on the 2011/12 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

Internal audit

119. The internal audit unit did not advise the accounting officer and/ or report to the audit committee on matters relating to compliance with the MFMA, the DORA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

120. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
121. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
122. Sufficient and appropriate evidence was not received to establish if measures to combat the abuse of the SCM system were implemented as per the requirements of SCM regulation 38(1), because awards were made to providers who:
 - during the last five years, failed to perform satisfactorily on a previous contract with the municipality or municipal entity or other organ of state;
 - committed a corrupt or fraudulent act in competing for the contract;
 - abused the SCM system of the municipality;
 - had been convicted of fraud or corruption during the past five years.
123. Sufficient appropriate audit evidence could not be obtained to confirm that:
 - Goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids or that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation 19(a) and 36(1).
 - Bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
 - Bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
 - Invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).
 - Bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
 - Contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations (PPR).
 - If awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).

- 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 (PPPFA) and SCM regulation 28(1)(a).
 - Contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
 - Contracts and quotations were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA.
 - Contracts and quotations were awarded only to bidders who 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).
 - Contract and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order as required by SCM regulation 43.
 - All contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as there are inadequate processes in place for SCM record management.
124. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
 125. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
 126. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.
 127. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
 128. 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.
 129. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
 130. Awards were made to providers who are persons in the service of the municipality and whose directors' principal shareholders are persons in service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers/ officials involved.
 131. Awards were made to providers who are persons in the service of an organ of state and whose directors' principal shareholders are persons in service of an organ of state in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of an organ of state, as required by SCM regulation 44. Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers/ officials involved.
 132. 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).

Strategic planning and performance management

133. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
 134. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
 135. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulation 12(1) and 12(2)(e).
 136. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
 137. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
 138. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
 139. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal planning and performance management regulation 14(1)(a).
 140. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1)(b)(iii).
 141. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal planning and performance management regulation 14(1)(c).
 142. The annual performance report for the year under review does not include a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1) of the MSA.
 143. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.
-

Internal control

144. I considered internal control relevant to my audit of the financial statements, annual 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 disclaimer of opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

145. Leadership did not take its oversight responsibilities regarding the implementation and monitoring of internal controls, as well as compliance with applicable legislation, seriously.

This was due to inadequate oversight by senior officials to ensure that policies, procedures and controls are implemented correctly and lack of commitment and accountability.

146. Together with the lack of oversight and accountability, management did not respond to prior year external audit findings, which has resulted in numerous repeat audit findings. Further, Council did not follow up on the prior year audit findings to ensure that these were addressed which contributed to the poor audit outcome
147. Responsibilities and accountability were not appropriately assigned which resulted in inadequate monitoring of the audit action plan for prior year audit findings. The monitoring of the requests for information and responses to our audit findings raised during the audit were not adequate. The municipality has a culture of not holding individuals accountable for non- and or poor performance.
148. The accounting officer and council did not ensure that the Human Resources unit manages the staffing requirements within the municipality through the appointment and retention of adequate and sufficiently skilled resources within an updated and approved operational organisational structure. An assessment of human resource management identified the following deficiencies:
 - The chief financial officer (CFO) was on forced leave for an extended period of time. In her absence, members from the BTO acted as CFO. Staff were not employed in the BTO in the place of the acting CFO. This, together with the high vacancy rate in the BTO resulted in an understaffed accounting function.
 - There was a lack of leadership and accountability in the SCM unit due to the CFO's absence.
149. The municipality did not have key controls to address the systems of collection, collation, verification and storage of performance information. Sufficient supporting documentation could not be provided to support the data recorded in the annual performance report and this resulted in a limitation of scope on the audit.
150. The municipality had not made progress in addressing previous years' findings. As a result there were deficiencies in user access controls, security management controls, program change management controls, Information Technology (IT) service continuity controls and IT governance practices. This was due to management not providing the ICT department strategic priority as they did not understand the value derived from IT in achieving business objectives.
151. Segregation of duties was not adequately maintained as the network administrator also performed the role of system administrator and application administrator. The IT manager has been acting in the post for the past three years. This was attributed to management not providing strategic priority to the ICT department.

Financial and performance management

152. During the course of the audit the municipal manager attended 59% of audit steering meetings, the CFO 41% and directors within their different portfolios only 20%. No evident effort is taken by management to steer the municipality into the right direction for clean administration. The municipality remains reliant on the use of consultants to perform financial administration and reporting functions that should be performed by the staff employed by the municipality. The over reliance that is currently being placed on consultants is a direct result of the municipality's inability to adequately fill the knowledge gap within the human resource function and overall lack of commitment from staff. A poor control environment over financial reporting exists – manual reconciliation of accounting records and supporting schedules is required at year end as these controls are either not performed or reviewed on a regular on-going basis during the year.
153. In the prior and current year consultants were used for the preparation of the fixed asset register and the annual financial statements. The fixed asset register is supposed to include

infrastructure assets and working in progress. For both years sufficient appropriate supporting documentation was not submitted for the opening balance of infrastructure assets and work in progress. Tender documentation was also not available for all current work in progress projects. The fixed asset register do not reconcile to the financial statements. Although the financial statements were signed by the accounting officer, it is clear that the necessary oversight controls were not in place for proper review. This is due to the municipality's unstable financial control environment.

154. Weaknesses were identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation or the supporting documentation is not readily available. The annual performance report was not supported by complete, relevant and accurate information. Records management was inadequate and not systematically and regularly monitored by management to ensure that information is easily retrievable and available for audit purposes. This is mainly attributed to lack of delegation of duties within the municipality.
155. The municipality lacked operational financial management and leadership for the major part of the reported period. This is to a large extent because the post of the CFO was acted by the General Manager: Revenue, while fulfilling his own position as well.
156. The municipality does not have processes in place to ensure compliance with laws and regulations, and therefore did not monitor and address non-compliance with all the requirements of the MFMA, in a timely manner.

Governance

157. The municipality did not conduct a risk assessment as required by the MFMA and do not have a risk committee to monitor the implementation of controls to address the risks identified. Consequently, a number of control deficiencies were identified.
158. The municipality's fraud prevention plan was a draft and was not approved by council as it was not presented before council for approval.
159. Insufficient action was taken by the governance structures within the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial information as well as performance objectives were addressed. Management did not implement the recommendations based on prior year audit. This has contributed to repeat audit findings in a number of areas.
160. The audit committee has not reviewed the financial statements before submission due to inadequate oversight of the preparation thereof.

OTHER REPORTS

Investigations

161. An internal investigation was conducted into the procurement of the CCTV surveillance cameras. The investigation was initiated based on complaints from some interested parties. The investigation recommended that this report be presented to council for consideration. We could not verify that this had been done.
162. In the prior year an investigation was initiated based on suspected procurement irregularities by the office of the former executive mayor. The investigation was finalised by the consulting firm on 1 August 2011. Sufficient audit evidence was not provided to confirm that follow up was made on the findings by the municipality.

163. An investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on allegation of possible cover quoting and manufacturing of quotations to be used in this cover quotation. The investigation recommended that disciplinary actions be taken against the implicated municipal officials. No information was supplied to indicate that any actions had been taken.

Auditor-General.

East London

30 November 2013



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence