

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MAKANA LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the financial statements of the Makana Local 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, cash flow statement and the statement of comparison of budget and actual amounts for the year ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 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 (ISA). Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain enough audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

#### Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment as documentation and calculations were not provided to confirm the balance at year end and to confirm the restatement of the prior year amounts. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment of R1,2 billion (2012: R1,2billion) as disclosed in note 9 to the financial statements.
5. In addition, the municipality did not correctly account for additions in accordance with GRAP 17 – *Property, plant and equipment* as capital assets under construction was incorrectly recorded as acquisitions of other assets. This resulted in other assets being overstated by R8,1 million and capital under construction being understated by the same amount. Furthermore capitalised leased assets were not included as acquisitions and capital under construction and acquisitions to other assets were recorded twice resulting in property, plant and equipment being overstated by R2,9 million and receivables from exchange transactions and lease liability being understated by R4,3 million and R1,4 million respectively. This also resulted in accumulated depreciation and depreciation expenses being understated by R1,2 million and R387 453 respectively.



### **Depreciation and amortisation**

6. I was unable to obtain sufficient appropriate audit evidence for depreciation and amortisation of property, plant and equipment as documentation was not provided to confirm the amount at year end and to confirm the restatement of the prior year amount. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to depreciation and amortisation of R46,6 million (2012: R45,6 million) as disclosed in note 33 to the financial statements.

### **Investment property**

7. I was unable to obtain sufficient appropriate audit evidence for investment property as documentation was not provided to confirm the balance at year end and to confirm the restatement of the prior year amounts. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to investment property of R226 million (2012: R227 million) as disclosed in note 11 to the financial statements.

### **Receivables from Exchange Transactions**

8. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions as well as the provision for impairment and the impairment losses as supporting documentation was not provided to confirm:

- the balance at year end;
- the journals processed in the current year;
- the unsupported differences identified between the annual financial statements and the receivables age analysis report ; and
- the restatement of prior year amounts.

I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to receivables from exchange transactions stated at R138 million (2012: R113,5 million), provision for impairment stated at R84 million (2012: R66 million) and the impairment and losses stated at R 18,6 million (2012: R16,2 million) as disclosed in notes 4 and 34 to the financial statements.

9. Furthermore, the municipality did not recognise all receivables from exchange transactions as per requirements of GRAP 1 – *Presentation of financial statements* resulting in understatement of receivables from exchange transactions by R2,8 million (2012: R10 million), understatement of payables from exchange transactions by R7,4 million, understatement of provision for impairment by R8,4 million (2012: R9,6 million) and overstatement of service charges by R1,8 million (2012: R1,2 million). This was due to the following:

- the ERF numbers of service debtors billed not included in valuation roll;
- receivables with credit balances included in receivables;
- errors in casting of provision for impairment performed by management;
- unexplained differences between the receivables age analysis report when compared to the debtor's statements.



## **Government grants and subsidies received as well as unspent conditional grants and receipts**

10. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts and for government grants and subsidies received as documentation was not provided to support the amounts at year end and to confirm the restatement of the prior year amounts. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to unspent conditional grants and receipts stated at R45 million (2012: R50,8 million) and government grants and subsidies received stated at R133,8 million (2012: R93 million) as disclosed in notes 18 and 26 of the financial statements.

## **Employee Related Costs**

11. I was unable to obtain sufficient appropriate audit evidence for employee related costs as supporting documentation was not provided to confirm the expenditure incurred for the year, the restatement of prior year amounts and the Pay as you Earn(PAYE) returns to South African Receiver of Revenue Services(SARS).

I was unable to confirm employee related costs by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to employee related costs stated at R112,4 million (2012: R111,4 million) as disclosed in note 31 to the financial statements.

12. Furthermore, the municipality did not recognise all employee related costs as per requirements of GRAP 1 – *Presentation of financial statements* resulting in overstatement of employee related costs by R2,9 million and payables from non-exchange transactions by R2,2 million and understatement of receivables from non-exchange transactions by R695 261 as a result of:-
- unexplained differences in PAYE deductions and SDL payments;
  - incorrect leave days used in calculation of leave accrual;
  - incorrect salary scales paid to employees and used for the calculation of overtime payments;
  - unexplained differences on leave payouts paid on termination.

## **Irregular expenditure**

13. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 46 to the financial statements is understated in respect of the amounts incurred during the year that were identified during the audit process amounting to R105,3 million (2012: R39,5 million). Due to the lack of systems, and the non-availability of sufficient appropriate audit evidence for all awards it was impracticable to determine the full extent of the understatement of irregular expenditure.

## **Commitments**

14. I was unable to obtain sufficient appropriate audit evidence for commitments as supporting documentation was not provided to confirm the commitments incurred for the year and for the restatement of prior year balance. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any further adjustments to Commitments of R92,4 million (2012: R56,9 million) as disclosed in note 48 to the financial statements were necessary



15. Furthermore the commitments disclosed in the financial statements were understated by R45,5 million as a result of, inconsistencies identified on comparison of the contract register and the commitments schedule submitted.

Due to the lack of an adequate contract management system for the identification and recognition of contract commitments, it is impractical to determine the full extent of the misstatement with regards to the identification and recognition of contracted commitments.

### **Payables from Non-exchange Transactions**

16. I was unable to obtain sufficient appropriate audit evidence for payables from non-exchange transactions as supporting documentation was not provided to confirm the balance at year end and to confirm the restatement of prior year amounts. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to payables from non-exchange transactions stated at R73,3 million (2012: R63 million) as disclosed in note 17 to the financial statements
17. Account balances relating to payables from exchange transactions were incorrectly allocated and disclosed as payables from non-exchange transactions. In addition, invoices dated before year end and paid after year end were not included in outstanding payables as at 30 June 2013. This resulted in an overstatement of payables from non-exchange transactions by R21,1 million and understatement of payables from exchange transactions and general expenditure by R24,1 million and 3 million respectively.

### **Bulk Purchases**

18. I was unable to obtain sufficient appropriate audit evidence for bulk purchases as supporting documentation was not provided to confirm the expenditure incurred for the year and to confirm the restatement of prior year amounts. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to bulk purchases stated at R69,2 million (2012: R74,3 million) as disclosed in note 36 to the financial statements.
19. Furthermore, the municipality did not recognise all bulk purchases as per requirements of GRAP 1 – *Presentation of financial statements* as invoices relating to the 2012 financial period were recorded in the current year. This resulted in an overstatement of bulk purchases amount and an overstatement of the accumulated surplus balance by R6,6 million.

### **Financial instruments**

20. The municipality did not comply with GRAP 104 – Financial Instruments, for the recognition of financial instruments. Consequently, errors amounting to R56.9 million were identified as follows:
- debtors with credit balances amounting to R11.9 million were incorrectly disclosed as a financial asset;
  - unspent conditional grants and receipts amounting to R45.1 million were not disclosed as a financial liability.
21. This resulted in the misstatement of financial assets and financial liabilities in the financial statements as disclosed in note 49, financial instruments.



## General Expenditure

22. I was unable to obtain sufficient appropriate audit evidence for general expenditure incurred during the year as supporting documentation was not provided to do so, The journals processed in the current year and the restatement of prior year amounts could also not be confirmed. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to general expenditure stated at R47,9 million (2012: R51 million) as disclosed in note 39 to the financial statements.
23. Furthermore, the municipality did not recognise all general expenditure as per the requirements of GRAP 1 – *Presentation of financial statements*: This resulted in an overstatement of general expenditure as well as payables from exchange transactions and an overstatement of accumulated surplus by R3.9 million(2012: R4 million), R1.5 million and R2.4 million respectively.

## Payables from Exchange Transactions

24. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions as supporting documentation was not provided to confirm the balance at year end and to confirm the restatement of prior year amounts. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to payables from exchange transactions stated at R28,6 million (2012: R22,8 million) as disclosed in note 16 to the financial statements.
25. Furthermore, the municipality did not recognise all payables from exchange transactions as per requirements of GRAP 1 – *Presentation of financial statements* as invoices were not recorded or were recorded at incorrect amounts resulting in an understatement of payables from exchange transactions by at least R265 million (2012: R21,5 million) and general expenditure by at least R232 million (2012: R6 million) and an understatement of VAT receivable by at least R32,5 million (2012: VAT payable overstatement by R858 000)

## Receivables from Non-exchange Transactions

26. I was unable to obtain sufficient appropriate audit evidence for receivables from non-exchange transactions as well as the provision for impairment and the impairment losses as supporting documentation was not provided to confirm these balances at year end and to confirm the restatement of prior year amounts. I was unable to confirm these balances by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to receivables from non-exchange transactions stated at R27 million (2012: R26,4 million), provision for impairment stated at R16,4 million (2012: R12,3 million) and the impairment and losses stated at R4,1 million (2012: R4,6 million) as disclosed in notes 5 and 34 to the financial statements.
27. Furthermore, the municipality did not recognise all recognise all receivables from non-exchange transactions as per the requirements of GRAP 1 – *Presentation of financial statements* resulting in an understatement of receivables from non-exchange transactions by R3,7 million (2012: R4,1 million), an understatement of payables from non-exchange transactions by R4,2 million and an understatement of property rates of R513 798. This is due to unsupported differences in the debtors age analysis when compared to the debtors statements and receivables with credit balances included in receivables from non- exchange balance.



## **Heritage assets**

28. I was unable to obtain sufficient appropriate audit evidence for heritage assets as documentation was not provided to confirm the balance at year end and to confirm the restatement of the prior year amounts. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary in respect of heritage assets, stated at a cost of R25,8 million (2012: R23,1 million) as disclosed in note 12 to the financial statements.

## **Repairs and Maintenance**

29. I was unable to obtain sufficient appropriate audit evidence for repairs and maintenance as supporting documentation was not provided to confirm the expenditure incurred for the year and the restatement of prior year amounts. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to repairs and maintenance stated at R18,7 million (2012: R13 million) as disclosed in the statement of financial performance in the financial statements.
30. Furthermore, the municipality did not recognise all repairs and maintenance as per requirements of GRAP 1 – *Presentation of financial statements* as invoices were recorded at incorrect amounts resulting in overstatement of repairs and maintenance and overstatement of payables from exchange transactions by R6,4 million.

## **Revenue from Non-exchange Transactions**

31. The municipality did not recognise all property rates in note 25 to the financial statements as per requirements of GRAP 1 – *Presentation of financial statements* resulting in understatement of both property rates and receivables from non-exchange transactions by R11,5 million. This was due to the following:
- Improvements and additions on buildings completed during the year not included in the supplementary valuation for billing;
  - Properties not included in the valuation roll for billing purposes;
  - Incorrect rates used for billing purposes.

## **Inventory**

32. I was unable to obtain sufficient appropriate audit evidence for inventory as documentation was not provided to confirm the:
- balance at year end;
  - restatement of prior year amounts and;
  - unsupported differences between the inventory listing, general ledger and the financial statements.

I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Inventory stated at R8,7 million (2012: R7,2 million) as disclosed in note 2 to the financial statements.

## **VAT receivable and payable**

33. I was unable to obtain sufficient appropriate audit evidence for the vat receivable account balance in the current year and the vat payable balance in the prior year as supporting documentation was not provided to confirm:
- the balance at year end;
  - the unsupported differences identified between the general ledger, vat returns and



- the financial statements; and
- the restatement of the prior year amounts.

I was unable to confirm these balances by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the vat receivable balance stated at R1,6 million as disclosed in note 6 to the financial statements and to the vat payable balance in the prior year of R4,5 million as disclosed in note 19 to the financial statements.

#### **Restatement of prior year annual financial statement**

34. I was unable to obtain sufficient appropriate audit evidence for the restatement of prior year annual financial statements as supporting documentation was not provided to confirm the adjustments processed by management. I was unable to confirm the restated amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the restated annual financial statements as disclosed as a correction of error in note 41 to the financial statements.

#### **Aggregation of immaterial uncorrected misstatements**

35. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position and the notes to the financial statements:-

- Current assets reflected as R176,7 million are understated by R5,8 million (2012: R761 815);
- Payables from Exchange Transactions reflected as R28,6 million are understated by R3,8 million (2012: R930 264);
- Non-current Investments reflected as R485 442 are overstated by R43 499.

36. In addition, sufficient appropriate evidence was not available to support the following balances and I was unable to confirm the 2013 balances by alternative means:-

- Cash and cash equivalent reflected as R9,8 million;
- Customer deposits reflected as R2,2 million.

#### **Material misstatements in comparative figures**

37. During 2011-12, I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements:

- disclosure note 25 for Property Valuation remains overstated by R736 million;
- The municipality did not recognise all Grants and Subsidies Paid resulting in misstatements in respect of the Grants and Subsidies Paid balance as well as the Receivables from Exchange Transactions balance by R11,3 million due to incorrect calculation of grants.

38. The auditor's report for the year ended 30 June 2012 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the 2012 audit. Certain matters that gave rise to the limitation, as described below, remain unresolved in the current year. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures. Sufficient appropriate audit evidence remained not available to support the following:

- Service Charges of R162 million;

- Cash and Cash Equivalent of R53 million;
- Non-current Investments of R1 million

Consequently I was unable to determine whether any adjustments to these balances were necessary.

#### **Statement of comparison of budget and actual amounts**

39. The municipality did not make the necessary disclosures as required by GRAP 24 – Presentation of Budget Information in Financial Statements. The municipality did not disclose the necessary explanations where material differences between the budget and actual amounts occurred.

#### **Material losses**

40. The municipality did not disclose any material distribution losses for water and electricity in the financial statements as required by section 125(2)(d)(i) of the MFMA. The municipality did not have a system in place for identifying, recognising and disclosure of the losses in respect of the distribution of water and electricity. I have not determined the correct disclosure amounts for the distribution losses for water and electricity as it was impracticable to do so.

#### **Disclaimer of opinion**

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

#### **Emphasis of matter**

42. I draw attention to the matter below. My opinion is not modified in respect of this matter.

#### **Going concern**

43. As disclosed in Note 58 to the financial statements, uncertainty exists regarding the municipality's ability to meet its obligations in the foreseeable future without financial support from government.

#### **Additional matters:**

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

#### **Unaudited supplementary schedules**

45. The supplementary information as set out on pages 137 to 152 does not form part the financial statements. We have not audited these schedules and accordingly we do not express an opinion thereon.

#### **Withdrawal from the audit engagement**

46. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. In addition the audit identified numerous misstatements in the financial statements. But for the legislated requirement to perform the audit of Makana local municipality, I would have withdrawn from the engagement in terms of the International Standards of Auditing.



## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

47. 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**

48. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 1 to 37 of the annual report.
49. 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*.
50. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
51. The material findings are as follows:

### **Usefulness of information**

#### **Measurability**

52. The FMPPI requires performance indicators to be verifiable, in that it must be possible to validate the processes and systems that produced the indicator. A total of 20% of the selected indicators were not verifiable. This was due to a lack of technical indicator descriptions and a lack of documented standard operating procedures for the management of indicators.

### **Reliability of selected programmes in the annual performance report**

#### **Programme: Technical and Infrastructure**

53. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of documented system descriptions for the accurate recording of actual achievements and technical indicator descriptions for the accurate measurement, recording and monitoring of the completeness of source documentation in support of actual achievements.



## **Additional matter**

I draw attention to the matters below.

### **Achievement of planned targets**

54. Of the total number of 136 targets planned for the year, 45 of targets were not achieved during the year under review. This represents 33% of total planned targets that were not achieved during the year under review. This was mainly as a result of the institution not considering the existence of relevant systems, evidential requirements and appropriate baselines for targets during the annual strategic planning process

### **Compliance with laws and regulations**

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

### **Strategic planning and performance management**

56. 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).
57. 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 Municipal Finance Management Act.

### **Budgets**

58. 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 Municipal Finance Management Act.
59. Sufficient appropriate audit evidence could not be obtained that monthly budget statements were submitted to the mayor and relevant provincial treasury of the parent municipality, as required by section 71(1) of the Municipal Finance Management Act.

### **Financial statements, performance and annual reports**

60. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.
61. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the Municipal Finance Management Act.
62. The 2012 annual report was not made public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the Municipal Finance Management Act.



63. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012 annual report was tabled, as required by section 129(1) of the Municipal Finance Management Act.
64. The council's oversight report on the 2012 annual report was not made public within seven days of its adoption, as required by section 129(3) of the Municipal Finance Management Act.

#### **Audit committees**

65. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the Municipal Finance Management Act.
66. The audit committee was not constituted, in the manner required by section 166(4)(a) Municipal Finance Management Act as it did not consist of at least three persons with appropriate experience, of whom the majority may not be in the employ of the municipality.

#### **Internal Audit**

67. The internal audit unit did not advise the accounting officer and/or report to the audit committee on matters relating to compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation, as required by section 165(2)(b)(vii) of the Municipal Finance Management Act.

#### **Procurement and contract management**

68. 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).
69. 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).
70. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
71. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
72. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
73. Sufficient appropriate audit evidence could not be obtained that 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.
74. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM Regulation 5.



75. Sufficient appropriate audit evidence could not be obtained that the performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
76. Sufficient appropriate audit evidence could not be obtained that the performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
77. 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.
78. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
79. Sufficient appropriate audit evidence could not be obtained that 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).

#### **Human resource management and compensation**

80. An acting municipal manager & CFO were appointed for a period of more than six months, in contravention of section 54A(2A) of the Municipal Systems Act (MSA).
81. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of Municipal Systems Act.
82. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
83. The municipal manager did not sign a performance agreement, as required by section 57(2)(a) Municipal Systems Act.
84. Sufficient appropriate audit evidence could not be obtained that the municipality submitted a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels regulation 14(2)(a).
85. Sufficient appropriate audit evidence could not be obtained that the annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels regulation 14(2)(b).
86. Sufficient appropriate audit evidence could not be obtained that the competencies of financial and supply chain management officials were 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 regulation 13.
87. The head of supply chain, finance officials at middle management and other senior managers did not have the higher education qualification as required by section 119 of the Municipal Finance Management Act and regulation 6 to 11 of the Municipal Regulations on Minimum Competency Levels.



### **Expenditure management**

- 88. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the Municipal Finance Management Act.
- 89. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the Municipal Finance Management Act.
- 90. An effective system of expenditure control, including procedures for the approval / authorisation / withdrawal / payment of funds, was not in place, as required by section 65(2)(a) of the Municipal Finance Management Act.
- 91. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred / accounted for creditors / accounted for payments made, as required by section 65(2)(b) of the Municipal Finance Management Act.
- 92. Reasonable steps were not taken to prevent unauthorized, irregular as well as fruitless and wasteful expenditure as required by section 62(1)(d) of the Municipal Finance Management Act.

### **Conditional grants received**

- 93. Sufficient appropriate audit evidence could not be obtained that the allocation for the Municipal Infrastructure Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the Division of Revenue Act (DoRa).
- 94. Sufficient appropriate audit evidence could not be obtained that the allocation for the Local Government Financial Management Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRa.
- 95. Sufficient appropriate audit evidence could not be obtained that the allocation for the Municipal Systems Improvement Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRa.

### **Revenue management**

- 96. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the Municipal Finance Management Act.
- 97. An effective system of internal control for revenue was not in place, as required by section 64(2) of the Municipal Finance Management Act.

### **Asset and liability management**

- 98. An adequate management, accounting and information system which accounts for assets and liabilities was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
- 99. An effective system of internal control for assets and liabilities was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.



100. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the Municipal Finance Management Act and Municipal investment regulation 3(1)(a) .
101. Sufficient appropriate audit evidence could not be obtained that all investments were made in accordance with the requirements of the investment policy (include details), as required by Municipal investment regulation 3(3).
102. Money was borrowed for the purpose of investment, in contravention of Municipal investment regulation 9(2).
103. Sufficient appropriate audit evidence could not be obtained to confirm that capital assets disposed were needed to provide the minimum level of basic municipal service, in contravention of section 14(1) of the Municipal Finance Management Act.
104. Sufficient appropriate audit evidence could not be obtained to confirm that capital assets disposed with the approval of the council and the accounting officer, as required by section 14(2)(a) of the Municipal Finance Management Act and Municipal asset transfer regulation 5 / 8.
105. Sufficient appropriate audit evidence could not be obtained that the right to use, control and manage a capital asset with a value in excess of R10 million was granted after a public participation process, in contravention of Municipal asset transfer regulation 34(1)(a) and 34(2) .
106. Sufficient appropriate audit evidence could not be obtained to confirm that the right to use, control and manage a capital asset was granted with the approval of the municipal council, in contravention of Municipal asset transfer regulation 34(1)(b).

#### **Consequence management**

107. Unauthorised expenditure and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the Municipal Finance Management Act.
108. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the Municipal Finance Management Act.
109. Sufficient appropriate evidence could not be obtained to confirm that council reported cases of alleged irregular expenditure to the South African Police Service, as required by section 32(6) and 32(7) of the Municipal Finance Management Act.
110. Sufficient appropriate evidence could not be obtained to confirm that cases of financial misconduct which constitute a crime were always reported to the South African Police Service, as required by section 62(1)(e) of the Municipal Finance Management Act.

#### **Internal control**

111. I considered internal control relevant to my audit of the financial statements, the 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



annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

112. Effective leadership based on ethical business practices and good governance, protecting and enhancing the best interest of the municipality was not demonstrated by top management. During the audit the Municipal Manager was dismissed due to matters relating to alleged fraud and was investigated.
113. The lack of accountability and vacancies in critical positions resulted in action plans to address audit findings relating to misstatements in the financial statements, compliance with laws and regulations and performance against predetermined objectives not being implemented and monitored adequately.
114. The leadership did not implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored. In addition, the documented systems in the policies and procedure manuals indicate how activities within the municipality should be carried out are not implemented or monitored by key officials.
115. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls in respect of financial management, compliance with laws and regulations and performance reporting. The lack of effective oversight and monitoring created a control environment that did not prevent or detect irregular expenditure, unauthorised expenditure and fruitless and wasteful expenditure.

### **Financial and performance management**

116. The municipality does not have proper record keeping and record management systems in place, resulting in documents supporting the transactions and balances in the financial statements not being properly filed and easily retrievable. This contributed to pervasive material scope limitations.
117. Quality and reliable financial statements and performance reports were not prepared as the municipality did not have staff with the necessary skills and competencies to apply the relevant accounting and performance reporting frameworks. As a result there was high reliance on the work of consultants, but due to the lack of skills within the municipality their work was not monitored adequately to ensure that it was performed to the expected standard.
118. The implementation of controls over daily and monthly processing and reconciliations of transactions were not effective and resulted in inaccurate financial reporting. As a result key daily and monthly processes including reconciling accounts, maintaining registers and clearing suspense accounts were not performed throughout the financial year.

### **Governance**

119. Appropriate risk management activities relating to financial reporting, performance reporting and compliance with laws and regulations have not been implemented during the financial year.



120. Cognisance is taken of the work done by the internal audit, but the effectiveness of the internal audit is hampered by the limited budget allocated to this important function and therefore directly impacts on their effectiveness and that of the audit committee.
121. Although an audit committee was established, the effectiveness of the committee was hampered by the internal capacity challenges faced by the municipality as a whole and specifically internal audit as reported above. The committee could not advise council properly in respect of compliance with laws as well as the credibility of the 2013 financial statements prior to submission for external audit purposes.

## OTHER REPORTS

### Investigations

122. There were a number of investigations conducted on request by the municipal council relating to the irregular appointment of consultants (Technical Services), irregular appointments of employees for the period between 1<sup>st</sup> of April 2013 to 31<sup>st</sup> December 2013, irregular donation expenditure, irregular payments of legal fees and lost personnel file of the previous Municipal Manager. All these investigations were still in progress at financial year end.

*Auditor-General*

East London

19 June 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*