

**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 and cash flows for the year then ended, 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 (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, 2011 (Act No. 6 of 2011) (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 enough audit evidence to confirm the balance of property, plant and equipment. The municipality could not provide the necessary supporting documents and calculations following their reconstruction of the asset register in order to rectify prior year (2011/2012) misstatements. This change affected the prior year closing balance as well as the current year opening balance. Further, the municipality did not provide adequate supporting documentation in support of assets purchased during the current year, and sufficient appropriate evidence was not available for additions in assets under construction (WIP) and land and building and other moveable assets. I was unable to obtain sufficient appropriate audit evidence to confirm the year-end as well as the opening balance for property, plant and equipment. Consequently, I was unable to determine whether any adjustments to property, plant and equipment disclosed in note 9 to the financial statements as R1,245 million (2011-12: R1,200 million) was necessary.
5. In addition, the municipality did not correctly account for its assets purchased during the year (additions) in accordance with GRAP 17 *Property, plant and equipment*. Additions to assets under construction are understated by R4,9 million, additions to land and building and other moveable assets are overstated by R7,9 million (2011-12: R225,4 million), receivables non-exchange transactions understated by R4,3 million, lease liability on capitalised leased assets is understatement by R1,4 million, accumulated depreciation is understated by R1,2 million and depreciation expenses is understated by R387 453.00 as a result of:-

- incorrect allocation of additions to assets under construction as moveable assets.
  - duplicate payments recorded on additions to assets under construction and land and moveable assets
  - capitalised leased assets not included in the asset register
5. Furthermore, it was not possible to determine the impact of these findings on depreciation and amortisation amounting to R46,6 million (2011-12: R45,6 million) as disclosed in note 33 to the financial statements.
6. In addition, comparative amounts for depreciation and amortisation of R45,6 million as disclosed in note 33 to the financial statements were restated to correct errors identified during the prior year. Sufficient appropriate audit evidence was not available for the adjustments made to comparative amounts and it was not possible to confirm whether any further adjustments were required.

#### **Investment property**

7. I was unable to obtain enough audit evidence to confirm the balance of investment property. Management did not provide supporting documentation for investment properties recorded in their reconstructed asset register (as reported above) for the current and the restated prior financial year. I was also unable to verify the balances by alternative means.
- Consequently, I was unable to determine whether any adjustment on investment property, stated at a cost of R226 million (2011-12: R227 million) disclosed in note 11 to the financial statements was necessary.

#### **Heritage Assets**

8. I was unable to obtain enough audit evidence to confirm the balance of heritage assets. Management did not provide supporting documentation for heritage assets recorded in their reconstructed asset register (as reported above) for the current and the restated prior financial year. I was also unable to verify the balances by alternative means.
- Consequently, I was unable to determine whether any adjustment on heritage assets, stated at a cost of R25,8 million (2011-12: R23,1 million) disclosed in note 12 to the financial statements was necessary.

#### **Journals**

9. I was unable to obtain enough audit evidence for the journals processed on the system during the current year. Supporting documentation for the journals processed on the system during the current year to the value of R258 million (2011-12: R27.6 million) was not submitted for audit purposes. I was unable to confirm the validity and accuracy of journals processed by alternative means. The journals impacted the following line items in the financial statements:-
- Property Rates
  - Receivables from Non-exchange transactions,
  - Receivables from Exchange transactions,
  - General expenditure
- Consequently, I was unable to determine whether any adjustments were necessary to Property Rates stated at R38 million (2012: R38,1 million), Revenue from Non-exchange transactions stated at R27 million (2011-12: R26,4 million), Receivables from Exchange Transactions stated at R138 million (2011-12: R113,5 million), and General expenditure stated at R47,9 million (2011-12: R51 million) as disclosed in the financial statements.

## VAT Receivable and Payable

10. I was unable to obtain enough audit evidence to confirm the balance of Vat Receivable. Supporting documentation was not submitted for audit purposes and unexplained differences between the general ledger, vat returns and the financial statements were identified. Due to a lack of document management system and adequate system in place to correctly account for vat transactions and vat reconciliation being implemented by management, I was unable to confirm the balance by alternative means as it was impracticable to determine the correct amounts for the outstanding VAT at year-end.  
Consequently, I was unable to determine whether any adjustments were necessary to Vat Receivable stated at R1,7 million [2011-12: R nil) per note 6 to the financial statements.
11. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure for Vat Payable as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Vat Payable corresponding figure stated at R4,5 million as disclosed in note 19 to the financial statements.

## Receivables from Exchange Transactions

12. I was unable to obtain enough evidence to confirm the balances and disclosure of Receivables from Exchange Transactions, the Provision for Impairment as disclosed in note 4 to the financial statements and the Impairment Losses expense as disclosed in the note 34 to the financial statements.  
Supporting documentation was not submitted for audit purposes and unexplained differences were also identified in the total receivables amount reported upon in comparison to the receivables age analysis report. Due to a lack of an adequate document management system by the municipality, I was unable to confirm the balance by alternative means.  
Consequently, I was unable to determine whether any adjustments were necessary to Receivables from Exchange Transactions stated at R138 million (2011-12: R113,5 million), Provision for Impairment stated at R84 million (2011-12: 66 million) and the Impairment and Losses expense stated at R 18,6 million (2011-12: 16,2 million) in the financial statements.
13. Furthermore, the municipality failed to recognise items that are classified as receivables from exchange transactions as per requirements of GRAP 1 – *Presentation of financial statements* resulting in understatement of receivables from exchange transactions by R1,3 million (2011-12: 1,2 million), understatement of payables from exchange transactions by R9,6 million, understatement of provision for impairment by R8,4 million and understatement of service charges by R50 726.00 as a result of:
- 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 receivables age analysis report in comparison to debtor's statements

14. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure to Receivables from Exchange Transactions, Provision for Impairment and Impairment Losses expense as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to corresponding figure for Receivables from Exchange Transactions stated at R113,5 million, Provision for Impairment stated at R66 million as disclosed in note 4 and Impairment Losses expense stated at 16,2 million as disclosed in note 34 to the financial statements

#### **Receivables from Non-exchange Transactions**

15. I was unable to obtain enough evidence to confirm the balances and disclosure of Receivables from Non-exchange Transactions, the Provision for Impairment as disclosed in note 5 to the financial statements and the Impairment Losses expense as disclosed in the note 34 to the financial statements. Supporting documentation was either not submitted for audit purposes or that which was submitted, was materially misstated. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to Receivables from Non-exchange Transactions stated at R27 million (2011-12: R26,4 million), Provision for Impairment stated at R16,4 million (2011-12: R12,3 million) and the Impairment and Losses expense stated at R4 million (2011-12: R4,6 million) in the financial statements.
16. Furthermore, the municipality failed to recognise items that are classified as receivables from non-exchange transactions as per the requirements of GRAP 1 – *Presentation of financial statements* resulting in understatement of receivables from non-exchange transactions by R20 million (2011-12: R20,6 million), understatement of property rates revenue by R11 million, understatement of payables from non-exchange transactions by R4,2 million, and overstatement of additions to property, plant and equipment and employee related costs by R4,3 million and R702 255 respectively as a result of:-
- improvements/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
  - unexplained differences in debtors age analysis versus the debtor's statements
  - duplicate payments recorded on additions to assets under construction and land and moveable assets
  - receivables with credit balances included in receivables
  - incorrect salary scales paid to employees and used for the calculation of overtime payments
  - unexplained differences on leave payouts paid on termination
17. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure to Receivables from Non-exchange Transactions, Provision for Impairment and Impairment Losses expense as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means.



Consequently I was unable to determine whether any further adjustment were necessary to corresponding figure for Receivables from Non-exchange Transactions stated at R26,4 million, Provision for Impairment stated at R12,3 million as disclosed in note 5 and Impairment Losses expense stated at R4,6 million as disclosed in note 34 to the financial statements.

### Payables from Exchange Transactions

18. I was unable to obtain enough evidence to confirm the balances of Payables from Exchange Transactions. Supporting documentation was either not submitted for audit purposes or that which was submitted, was materially misstated and also the municipality did not have a payables management system in place to compile a payables sub-ledger, keeping records of payment documents and correct identification and recognition of liabilities for goods and services received but not yet paid. It was therefore impractical to determine the full extent of the misstatements in Payables from Exchange Transaction and 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 (2011-12: R22,8 million) in note 16 to the financial statements
19. Furthermore, the municipality failed to recognise items that are classified as Payables from Exchange Transactions as per requirements of GRAP 1 – *Presentation of financial statements* resulting in understatement of payables from exchange transactions by atleast R295 million (2011-12: R7 million), understatement of general expenditure by R264 million, understatement of cash and cash equivalent by R3,6 million and overstatement of payables from non-exchange transactions and repairs and maintenance by R33.7 million and R6,4 million respectively as a result of:
- Trade payables were recorded on system at incorrect amounts as compared to supplier statements and invoices.
  - unpaid trade creditors at year end were incorrectly reflected as being paid, resulting in incorrect reconciling items of outstanding payments in the bank reconciliation
  - receivables with credit balances included in receivables
  - suspense accounts relating to payables from exchange transactions were incorrectly allocated and disclosed as payables from non-exchange transactions
20. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure for Payables from Exchange Transactions as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Payables from Exchange Transactions corresponding figure stated at R22,8 million as disclosed in note 16 to the financial statements.

## Payables from Non-exchange Transactions

21. I was unable to obtain enough evidence to confirm the balances of Payables from Non-exchange. Supporting documentation was not submitted for audit purposes and unexplained differences were also identified in receivables with credit balances included in payables from none exchange transactions in comparison to receivables age analysis report. Due to a lack of an adequate document management system by the municipality, 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 (2011-12: R63 million) in note 17 to the financial statements
22. Furthermore, the municipality failed to recognise items that are classified as payables from non-exchange transactions as per requirements of GRAP 1 – *Presentation of financial statements* resulting in overstatement of payables from non-exchange transactions by R19 million (2011-12: 14,5 million) and understatement of payables from exchange transactions by R24 million, understatement of receivables from non-exchange transaction by R4,2 million, overstatement of employee related costs by R2,2 million and understatement of general expenditure by R3 million as a result of:-
- suspense accounts relating to payables from exchange transactions incorrectly allocated and disclosed as payables from non-exchange transactions
  - receivables with credit balances included in receivables
  - subsequent payments of invoices dated before year end not included in outstanding payables at year end.
  - unexplained differences in PAYE deductions and SDL payments
  - incorrect leave days used in calculation of leave accrual.
23. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure for Payables from Non-exchange Transactions as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Payables from Non-exchange Transactions corresponding figure stated at R63 million as disclosed in note 17 to the financial statements.

## Inventory

24. I was unable to obtain enough evidence to confirm the balances of Inventory. Supporting documentation was not submitted for audit purposes and unexplained differences were identified on comparison of 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 to Inventory stated at R8,2 million (2012: R7,2 million), as disclosed in note 2 to the financial statements were necessary.

25. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure for Inventory as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Inventory corresponding figure stated at R7,2 million as disclosed in note 2 to the financial statements.

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

26. I was unable to obtain enough evidence to confirm the balance of the Unspent Conditional Grants and Receipts. The municipality did not have adequate systems in place to maintain proper records of unspent conditional grants and receipts. Unexplained differences of R9 million (2011-12: R10.3 million) were identified on comparison of the annual financial statements and the conditional grants reconciliation submitted by management for audit purposes. I was unable to confirm the balance by alternative means.  
Consequently, I was unable to determine whether any adjustments on Unspent Conditional Grants and Receipts stated at R45 million (2011-12: R50,8 million) disclosed in note 18 of the financial statements were necessary.
27. Further, I was unable to obtain enough evidence to confirm the actual conditional grant expenditure transferred to revenue in the Statement of financial performance. Supporting documentation was not submitted for audit purposes and unexplained differences on actual expenditure transferred to revenue were identified on comparison of the annual financial statements and the conditional grants reconciliation submitted by management for audit purposes. I was unable to confirm the amounts transferred by alternative means.  
Consequently, I was unable to determine whether any adjustments on Government Grants and Subsidies Received stated at R133.8 million (2011-12: R93 million) disclosed in note 26 of the financial statements were necessary.
28. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure Government Grants and Subsidies Received and Unspent Conditional Grants and Receipts as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Government Grants and Subsidies Received and Unspent Conditional Grants and Receipts corresponding figure stated at R93 million and R50,8 million as disclosed in note 26 and note 18 to the financial statements

39. Furthermore, the municipality failed to recognise items that are classified as employee related costs as per requirements of GRAP 1 – *Presentation of financial statements* resulting in overstatement employee related costs by R2,9 million and understatement of payables from non-exchange transactions and receivables from non-exchange transactions by R2,2 million and R702 255 respectively 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
40. In addition, I was unable to obtain enough audit evidence for the restatement of the corresponding figure for Employee Related Costs as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. Sufficient appropriate audit evidence was not available for the adjustments made to the comparative figures and I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment were necessary to Employee Related Costs corresponding figure stated at R111,4 million as disclosed in note 31 to the financial statements.

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

41. I was unable to obtain enough evidence for Property Rates disclosed in the statement of financial performance. Supporting documentation submitted for audit purposes was material misstated. The municipality did not have adequate systems in place to identify and correctly account for its Property Rates revenue stated at R38 Million as disclosed in note 25 to the financial statements resulting in the understatement of both Property Rates and Receivables from Non-exchange Transactions by R11 million (2011-12: R1,2 million) as a result of:-
- Improvements/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
  - Unexplained differences in debtors age analysis versus the debtor's statements.
- Consequently, I was unable to determine whether any adjustments were necessary to Property Rates stated at R38 million (2012: R38,1 million) as disclosed to the financial statements

#### **Irregular expenditure**

42. 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 of R105,3 million (2011-12: R28,7 million).
43. Due to the lack of systems, and the non-availability of sufficient appropriate audit evidence for contract management documentation awards and also identification of payments of council remuneration above the gazetted thresholds and unexplained differences on comparison of irregular expenditure disclosed in the financial statements to the schedule of irregular expenditure submitted for audit purposes, it



was impracticable to determine the full extent of the understatement of irregular expenditure. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure as disclosed in note 46 to the financial statements.

### **Unauthorised expenditure**

44. The municipality did not include all particulars of any unauthorised expenditure in the notes to the financial statements as required by section 122(1) of the MFMA. The municipality exceeded the budget per vote, which was not disclosed as unauthorised expenditure as follows:-
- Donations paid and not budgeted for,
  - employee appointment in posts not included in the organisational structure

This had the resulted in unauthorised expenditure disclosed in note 46 to the financial statement being understated by R1,6 million (2011-12: R285,7 million).

### **Fruitless and wasteful expenditure**

45. The municipality did not include particulars of any fruitless and wasteful expenditure in the notes to the financial statements as required by section 122(1) of the MFMA. The municipality did not submit their SARS returns within the stipulated timeframes and failed to disclose the interest and penalties incurred to the amount of R349 262, resulting in fruitless and wasteful expenditure being understated.

### **Commitments**

46. I was unable to obtain enough evidence to confirm the disclosure of Commitments in the financial statements. Supporting documentation was not submitted for audit purposes. Also due to lack of adequate contract management system for the identification and recognition of contract commitments being implemented by the municipality, it is impractical to determine the full extent of the misstatement with regards to the identification and recognition of contracted commitments. I was unable therefore 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
47. Furthermore the commitments disclosed on the financial statements were understated by R45.5 million as a result of:
- inconsistencies identified on comparison of the commitments register and the commitments schedule submitted for audit purposes
  - errors in casting of the commitments schedule submitted as the underlying document for the commitments disclosed in the financial statements

## Financial instruments

48. The municipality did not comply with GRAP 104 for the recognition of financial instruments. Consequently, errors amounting to R57 million were identified in the disclosure note 49 for financial instruments as follows:-
- Debtors with credit balances of incorrectly disclosed as a financial asset,
  - Unspent conditional grants and receipts not disclosed as a financial liability.

## Accumulated surplus

49. I was unable to obtain enough audit evidence to confirm the balance of Accumulated Surplus. Sufficient appropriate audit evidence was not available to support the opening accumulated surplus *balance as at 1 July 2011* as well as changes made due to prior year restatements following the reconstruction of the asset register and other restatements to account balances in transactions in order to rectify prior year (2011/2012) misstatements as disclosed in the statement of changes in net assets. Also numerous material misstatements and none submission of information relating to current year transactions as well as none submission of information relating to Appropriations Made as disclosed in the statement of changes in net assets were identified. I was therefore unable to confirm the movements to accumulated surplus as well as the closing balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to accumulated surplus stated at R1,4 Billion (2012: R1,4 Billion) in the financial statements.
50. Furthermore, the municipality failed to correctly account for items that are classified in accumulated surplus per requirements of GRAP 1 – *Presentation of financial statements* resulting in overstatement accumulated surplus by R8,8 million (2011-12: R230 million) and overstatement statement of bulk purchases and by 6,6 million, overstatement of general expenditure by R2,4 million, overstatement of service charges by R1 million, understatement of accumulated depreciation by R808 489 and understatement of vat receivable by R56 733 as a result of:-
- invoices relating to 2011/12 financial period recorded in the current year
  - accumulated depreciation on capitalized leased assets not recorded in the asset register.
  - incorrect treatment of transactions recorded in accumulated surplus
  - journals relating to service charges revenue recorded in the incorrect financial period

## Material losses

51. The municipality did not disclose material losses for water and electricity in the financial statements as required by section 125(2)(d)(i) of the MFMA. I have not determined the correct disclosure amounts for material losses for water and electricity as it was impracticable to do so.

### **Restatement of corresponding figures**

52. As described in note 41 to the financial statements, material restatements to prior year amounts were made in order to rectify prior year misstatements. Sufficient appropriate audit evidence was not available for the adjustments made to comparative amounts as follows:-
53. Cash and cash equivalents as disclosed at R52.9 million in the statement of financial position and note 7 to the financial statements,
54. Non-current investments as disclosed at R1 million in the statement of financial position and note 13 to the financial statements
55. Retirement benefit liabilities as disclosed at R47,8 million in the statement of financial position and note 21 to the financial statements,
56. Impairment losses as disclosed at R20,8 million in the statement of financial performance and note 34 to the financial statements
57. The restatement was made in order to rectify prior year misstatements. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the account balances as disclosed in the financial statements was necessary.

### **Disclaimer of opinion**

58. 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.

**Additional matters:**

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

**Unaudited Supplementary schedules**

60. The supplementary information as set out on pages 137 to 151 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**

61. 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.

**Conditional grant funds are not cash backed**

62. As disclosed in note 18 to the financial statements, there is a conditional grant liability of approximately R45 million. However, the unspent conditional grants were not cash backed by an amount of R34,8 million . This indicates that conditional grant funds are being used for other expenditures not in terms of the grant.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

63. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.



## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

64. 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

65. 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.
66. 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*.
67. 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).
68. The material findings are as follows:

### **Usefulness of information**

#### **Measurability**

69. The National Treasury's *Framework for managing programme performance information* (FMPPI) requires the following:
70. Performance indicator must be verifiable, meaning 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.
71. This was due to the fact that there were no documented standard operating procedures for the management of indicators. In addition the indicators did not have technical indicators descriptions as required by National Treasury Framework for strategic plans and annual performance plans.

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

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

72. 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. Overall, 30% of the targets were not valid, accurate and complete when compared to the source information or evidence provided. This was due to the lack of record management as the department does not have a filing system that provides for the maintenance of information that supports the reported performance information.

### **Additional matter**

73. I draw attention to the matters below. My conclusion is not modified in respect of this matter:

### **Achievement of planned targets**

74. 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**

75. 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**

76. 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).
77. 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**

78. 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.
79. 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**

80. 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.
81. 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.
82. 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.
83. The 2011/12 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.
84. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2011/12 annual report was tabled, as required by section 129(1) of the Municipal Finance Management Act.
85. The council's oversight report on the 2011/12 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**

86. 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.
87. The audit committee was not constituted, in the manner required by section 166(4)(a) Municipal Finance Management Act as the following requirements were not adhered to:-  
-consist of at least three persons with appropriate experience, of whom the majority may not be in the employ of the municipality or municipal entity, as the case may be.

### **Procurement and contract management**

88. 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).
89. 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).
90. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
91. 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.

92. 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)
93. 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.
94. 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.
95. 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.
96. 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.
97. 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.
98. 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).
99. 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**

100. 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).
101. 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.
102. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
103. The chief financial officer did not have the higher education qualification as required by sec 83 of the Municipal Finance Management Act and reg 4 and 5 of the Municipal Regulations on Minimum Competency Levels.
104. The municipal manager did not sign a performance agreement, as required by section 57(2)(a) Municipal Systems Act.



### **Expenditure management**

105. 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.
106. 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.
107. 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.
108. 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.
109. Reasonable steps were not taken to prevent unauthorised expenditure / irregular expenditure / fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.

### **Conditional grants received**

110. 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).
111. 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.
112. 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**

113. A credit control and debt collection policy was not adopted and implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of Municipal Finance Management Act.
114. 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.

### **Asset and liability management**

115. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act

116. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.
117. 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).
118. 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).
119. Sufficient appropriate audit evidence could not be obtained that investments were made with proper care being exercised (include details), as required by Municipal investment regulation 5.
120. Money was borrowed for the purpose of investment, in contravention of Municipal investment regulation 9(2).
121. Capital assets were permanently disposed that were needed to provide the minimum level of basic municipal service, in contravention of section 14(1) of the Municipal Finance Management Act.
122. Capital assets were permanently disposed without 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.
123. 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).
124. The right to use, control and manage a capital asset was granted without the approval of the municipal council, in contravention of Municipal asset transfer regulation 34(1)(b).
125. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
126. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

#### **Consequence management**

127. Unauthorised 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.
128. 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.

129. 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.
130. The accounting officer and council 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) and 32(7) of the Municipal Finance Management Act.
131. Cases of financial misconduct which constitute a crime were not always reported to the South African Police Service, as required by section 62(1)(e) of the Municipal Finance Management Act.

### **Internal control**

132. 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**

133. 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.
134. There is insufficient focus on quality, and is not understood to be a prerequisite. This is evident because of the significant findings on internal controls, compliance with laws and regulations, financial management and reporting on predetermined objectives. Furthermore the misstatements of the prior financial year have not been addressed and are repeated in the current year. This was also the case in previous financial years with the result that the misstatements of at least the prior two financial years have not been sufficiently addressed.
135. Management was not able to implement effective human resource management to ensure that adequate and sufficient skilled resources are in place and that performance is monitored. There was an Acting CFO for the half of the financial year. The Management did not ensure that there was CFO with adequate financial background and qualifications to act as a CFO. This contributed to the significant number of material misstatements identified in the financial statements, findings on the predetermined objectives and non-compliance with laws.
136. The accounting officer did not exercise adequate oversight responsibility over reporting and compliance with laws and regulations and internal control because there are a number of findings relating to internal control environment and compliance with laws and regulations in general but specifically related to procurement (SCM). As a result unauthorised, irregular as well as fruitless and wasteful expenditure was incurred as disclosed in the annual financial statements.
137. Although management did develop an action plan to address the external audit findings of the prior years, the implementation of the plan was not adequately monitored resulting in similar findings occurring in the current financial year.
138. The municipality does not have an adequately documented and approved information technology (IT) governance framework in place to provide comprehensive guidelines

for IT decision making. In addition, the IT risk framework and IT strategic plan are inadequately documented, implemented and approved.

139. These deficiencies are attributed to the fact that IT governance was not a priority for the municipality, as attempts to address prior year findings were inadequate.

#### **Financial and performance management**

140. 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, twenty one none acceptance letters were issued and a number of material suspense accounts not reconciled at year-end. Management did not respond to a number of communication of audit findings and request for information.
141. Quality and reliable financial statements and performance reports have not been prepared because the entity did not have staff knowledgeable about GRAP reporting framework and performance management requirements. There is high reliance on the work of consultants and the work of the consultant was not monitored by a staff member who is sufficiently senior and had the relevant skills to ensure that work was performed to the expected standard. This was evidenced by the number of material findings raised during the audit. Furthermore the financial statements were submitted late on the 20th December 2013 and were not in compliance with section 122(1)(a) of the MFMA .
142. The implementation of controls over daily and monthly processing and reconciliations of transactions are not effective and resulted in inaccurate financial reporting. Suspense accounts are not reconciled, suppliers are not reconciled to statements, fixed asset register, investments, bank and VAT reconciliations are not adequately prepared and are not prepared with sufficient frequency.
143. The review and monitoring of compliance with laws and regulations is not effective as there were numerous instances of non-compliance.
144. The IT control environment was generally weak, mainly due to the fact that this area has not been a priority of the municipality.

#### **Governance**

145. Appropriate risk management activities relating to financial reporting, performance reporting and compliance with laws and regulations have not been implemented during the financial year. There is also no approved IT risk and control framework in place, and no IT risk register.
146. 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. The annual performance report submitted for audit was not reviewed by internal audit and reported on to the audit committee.



## OTHER REPORTS

### Investigations

147. There were numerous investigations conducted on request by the municipal council relating to Irregular appointments 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.

Signature

East London  
30 April 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

