

# FOREWORD

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I present my first report as auditor-general of the Republic of South Africa, which deals with local government audit outcomes for the year ended 30 June 2013. This report covers the audit outcomes of municipalities and municipal entities, which had a combined total expenditure of R268 billion for the 2012-13 financial year, split as follows:

- Employment cost (including councillor remuneration)	R62 billion
- Goods and services	R166 billion
- Capital expenditure	R40 billion

This also marks my first report to the fifth parliament of the Republic of South Africa.

At the onset, it is important to note that our annual audits have once again examined the following three areas:

1. Fair presentation and absence of material misstatements in financial statements.
2. Reliable and credible performance information for purposes of reporting on predetermined performance objectives.
3. Compliance with all laws and regulations governing financial matters.

## Financially unqualified with no findings

Auditees that received a **financially unqualified opinion with no findings** (depicted in green in this report) are those that have passed the audit test in each of the abovementioned aspects. This is commonly referred to as a 'clean audit'. I am pleased to report that this year 30 auditees belong to this category, out of the 319 audited institutions comprising 278 municipalities (local, district and metropolitan) as well as 41 municipal entities. This constitutes an overall 9% as compared to the 5% obtained in 2012.

Amongst this year's 30 'clean audits', 13 sustained this achievement from 2011-12. Auditees in this category have demonstrated impeccable levels of discipline and oversight in their financial management and operational activities. At these auditees, the breakdown of controls is easily detected and corrected timeously. Such environments are characterised by readily available documentation. Most importantly they have accountable managers and leaders who are able to provide explanations and additional evidence in support of the transactions they are reporting on. They also have the support of strong oversight by mayors and councils that back the efforts of municipal managers and chief financial officers.



Kimi Makwetu  
**Auditor-General**



This figure shows 30 auditees with clean audits and their provinces

### Financially unqualified with findings

One hundred and thirty-eight auditees (41%) received a **financially unqualified opinion with findings** (depicted in yellow in this report). These are auditees that have passed the critical test of fair presentation of financial statements, which means that they have accounted accurately for the financial transactions they have carried out. However, the 'with findings' aspect suggests that these auditees may not have been transparent in the manner in which they carried out their activities as there were instances where they did not follow the required processes.

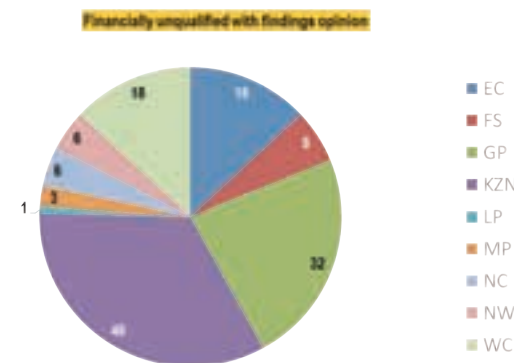
These deviations from internal controls were largely in the area of supply chain management. In this category there are a number of auditees that incurred unauthorised, irregular as well as wasteful and fruitless expenditure due to material deviations from internal controls that govern these transactions. Also, this is a category of auditees that submitted financial statements that were initially unreliable and incorrect. This was mainly due to absence of basic recording, approval, regular reporting and follow up on monitoring oversight controls.

The longer the auditees stay in this category, the more the unwanted practices settle and permeate the environment through on-going and uncorrected weaknesses in control. When these basic control deficiencies persist, they fester into the environment until there is nothing left to account for, and the funds are no longer available while there is limited or no provision of services.

When auditees start to conduct public business according to their own defined rules rather than those generally accepted and approved, poor governance becomes inevitable. This is usually prominent in environments where there is lack of transparency and consequence and subsequently no accountability.

It is our considered view that, when government business is conducted outside the controlled environment, in all likelihood it becomes a free for all where any transaction is capable of being executed without the related accountability. As a result, opportunities for realisation of service delivery objectives are lost and recovery becomes almost a nightmare.

It is desirable that the leadership of municipalities take this issue seriously as it is a condition prevalent in all categories of audit outcomes outside of the 'clean audit' environment.



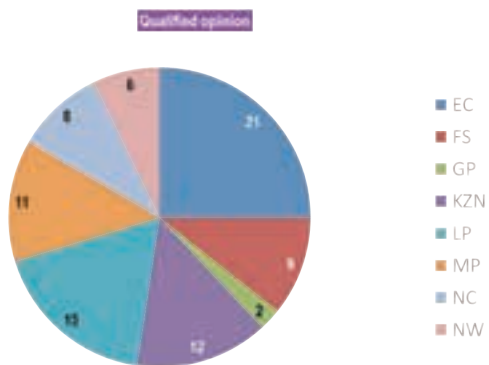
This figure shows 138 auditees that received an unqualified opinion with findings

### Qualified audit opinion

Eighty-four auditees (25%) received a **qualified audit opinion** (depicted in purple in this report), which means that they were unable to adequately and accurately account for all the financial effects of the transactions and activities they conducted. In this regard, the financial statements they presented were unreliable in certain areas.

Many auditees in this category furnished us with performance information that was either not useful or was unreliable, which compromised the ability to drive effective accountability. We also found out that a number of rules and regulations that apply to financial management and reporting matters were not observed as required in specific legislation.

In this regard, there were many instances where there were deviations relating to supply chain management and inappropriate reporting on performance.

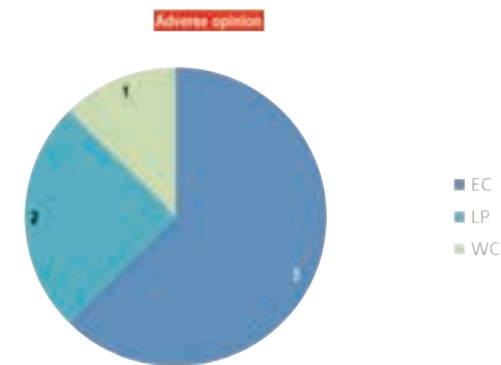


This figure shows 84 auditees that received a qualified audit opinion

### Adverse opinion

The eight auditees (2%) in the **adverse audit opinion** category (depicted in red in this report) performed similarly with the ones described above (under qualified opinion) with the exception that the conditions regarding to unreliable financial statements were common in most areas of the financial statements. This is unlike the qualified opinion where this is limited to certain areas. Auditees in this category have demonstrated extreme levels of lack of accountability for financial statements.

This is a classic example of controls that are broken everywhere. Here, all business cycles of the institution have deficient controls. Without a shadow of a doubt, this state of affairs increases the levels of financial exposure and multiplies the prospects for significant losses that could result in most service delivery and programme objectives not being achieved.



This figure shows eight auditees that received an adverse audit opinion

### Disclaimer of opinion

Fifty-nine auditees (18%) received a **disclaimer of audit opinion** (also depicted in red in this report). Auditees in this category were unable to provide the required evidence to enable the auditors to perform tests to satisfy themselves in the fair presentation of the financial statements. The stewardship over the financial affairs of the auditee is not at desirable and acceptable levels. Such environments are characterised by not providing credible evidence to support amounts and disclosures in financial statements.

The auditor is, inevitably, unable to conclude on any of the assertions that are made by management on the financial statements of the auditee. Anything could have happened to the financial resources entrusted upon the auditee and the auditor has significant uncertainty about the financial statements, and thus unable to express an opinion on whether the financial statements can be relied upon.



This figure shows 59 auditees that received a disclaimer of opinion

## Other significant audit observations

### Non-compliance with laws and regulations

In the current year, 90% of auditees had findings on non-compliance with laws and regulations, many of which related to the area of supply chain management. Irregular expenditure was reported at 265 auditees (83%), mainly due to the lack of basic controls and inadequate implementation of appropriate consequences where there has been poor performance or transgressions. The value of these controls cannot be emphasised enough as they are an important mechanism to narrow the space for widespread abuse of the public resources that are required to provide services to citizens.

### Ineffective use of consultants in financial reporting

I am concerned that 261 auditees (82%) were unable to produce financial statements that were free of material misstatements, with 110 auditees (35%) receiving financially unqualified opinions only because they corrected all the material misstatements identified during the auditing process. This is despite the fact that most municipalities used consultants (external service providers) to assist with the preparation of financial statements, with a total spend of R695 million. In many cases, this spending on external service providers was over and above the fixed cost of employment paid to those that are employed to fulfil financial

management and reporting responsibilities. It is evident that improvements in audit outcomes will be attained and sustained only if local government builds the institutional capacity required to maintain adequate internal controls, systems and processes.

### Irregular expenditure

As a result of significant breakdown in controls, municipalities and entities entered into transactions that were not carried out in accordance with regulations and other prescripts. We have classified these as irregular expenditure which totalled R11,6 billion for the period under review. We have ascertained through audit test that R8 billion of this amount represents goods and services that were received despite the normal processes governing procurement not being followed. The balance of R3,6 billion is at risk due to lack of supporting documentation, and we were therefore unable to confirm whether goods and services were received or not.

### Key actions by leadership

We remain hopeful that this situation can be turned around as evidenced by the efforts of those that advanced to clean audits. It is crucial to note that these auditees were commonly characterised by the following:

- Introducing basic accounting and daily control disciplines.
- Enforcing compliance with all legislation.
- Employing staff in accounting and financial management positions with the required level of technical competence and experience.
- Calling for information and reports regularly with a view to supervising implementation of financial management improvement plan.
- Allowing the chief financial officer to be in charge of the financial records and report thereon to the municipal manager.
- The council keeping the monitoring of the financial improvement plan on its quarterly meeting agenda.
- The municipal manager reviewing management accounts with the chief financial officer every month.

We are encouraged by the responses and commitments of the premiers, speakers, members of the executive council responsible for finance and local government, as well as the respective chairpersons of portfolio committees in all legislatures. All these leaders have recognised the importance of prioritising these basic but very significant actions for municipalities. Our office remains ready to intensify its effort to work closely with all of them towards achieving transparent and accountable financial management and governance.

It is for these reasons that we call upon all municipal councils across all the nine provinces to, at a minimum, adopt and follow the above examples diligently throughout the year. With these simple practical steps, the dawn of a substantially improved financial management and performance reporting in local government will be accelerated. This is a goal within reach and a key ingredient in building trust in the credibility and accountability of local government. This could add to the arsenal required to restore trust in local government's capacity to deliver services to citizens.

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We trust this report will provide some useful insights. We also take this opportunity to thank our employees and all our delivery partners for a sterling effort towards building public confidence.

A handwritten signature in blue ink that reads "Auditor-General".

**Auditor-General**  
**Pretoria**  
**July 2014**