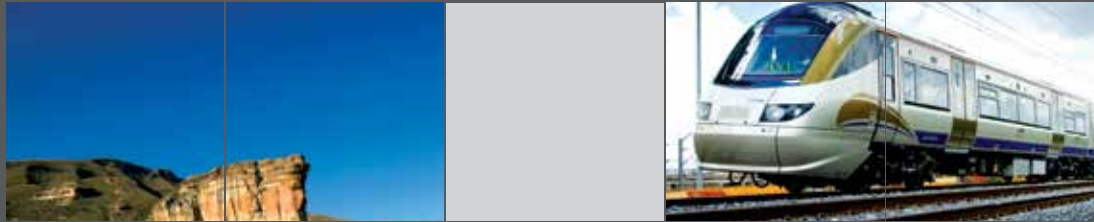
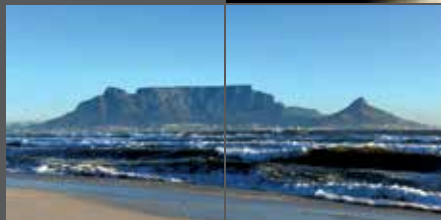
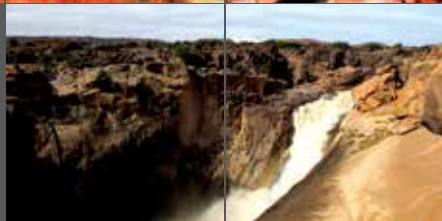


MFMA 2011-12



Consolidated general report on the LOCAL GOVERNMENT audit outcomes

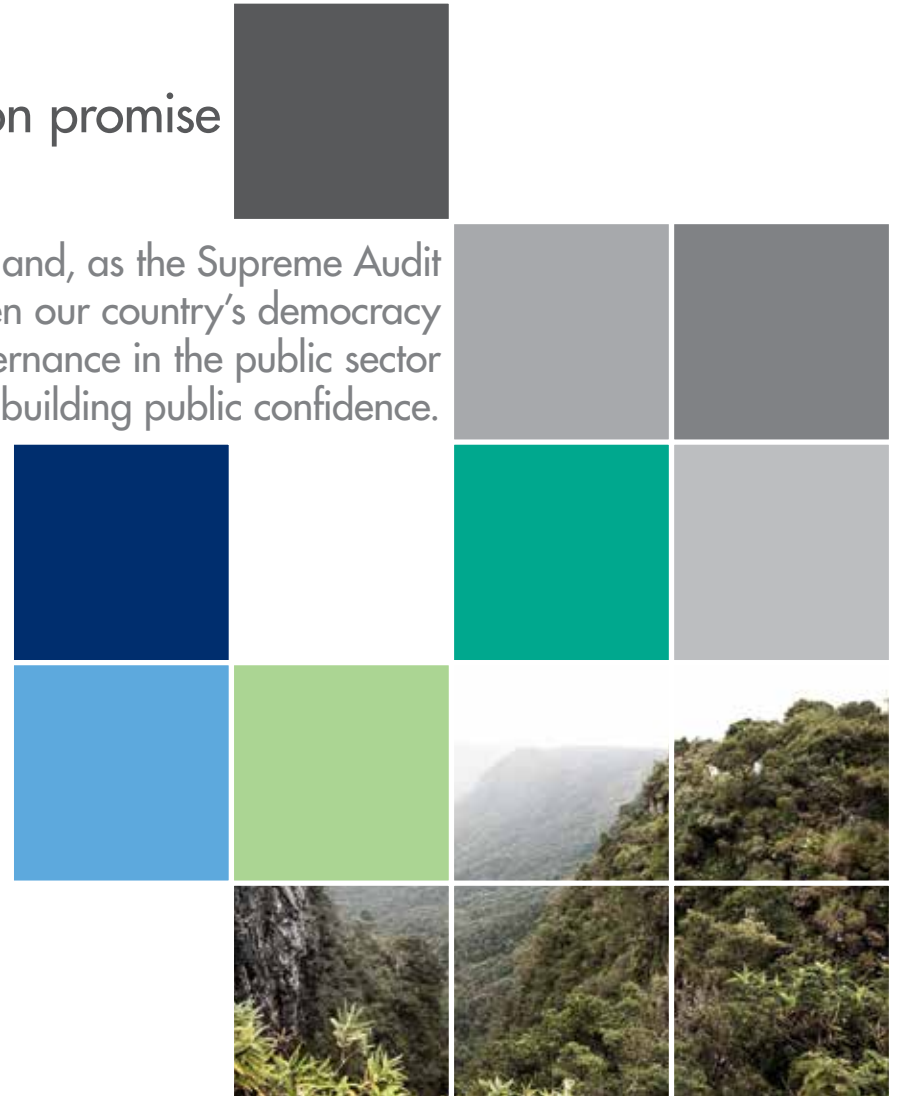
EXECUTIVE SUMMARY



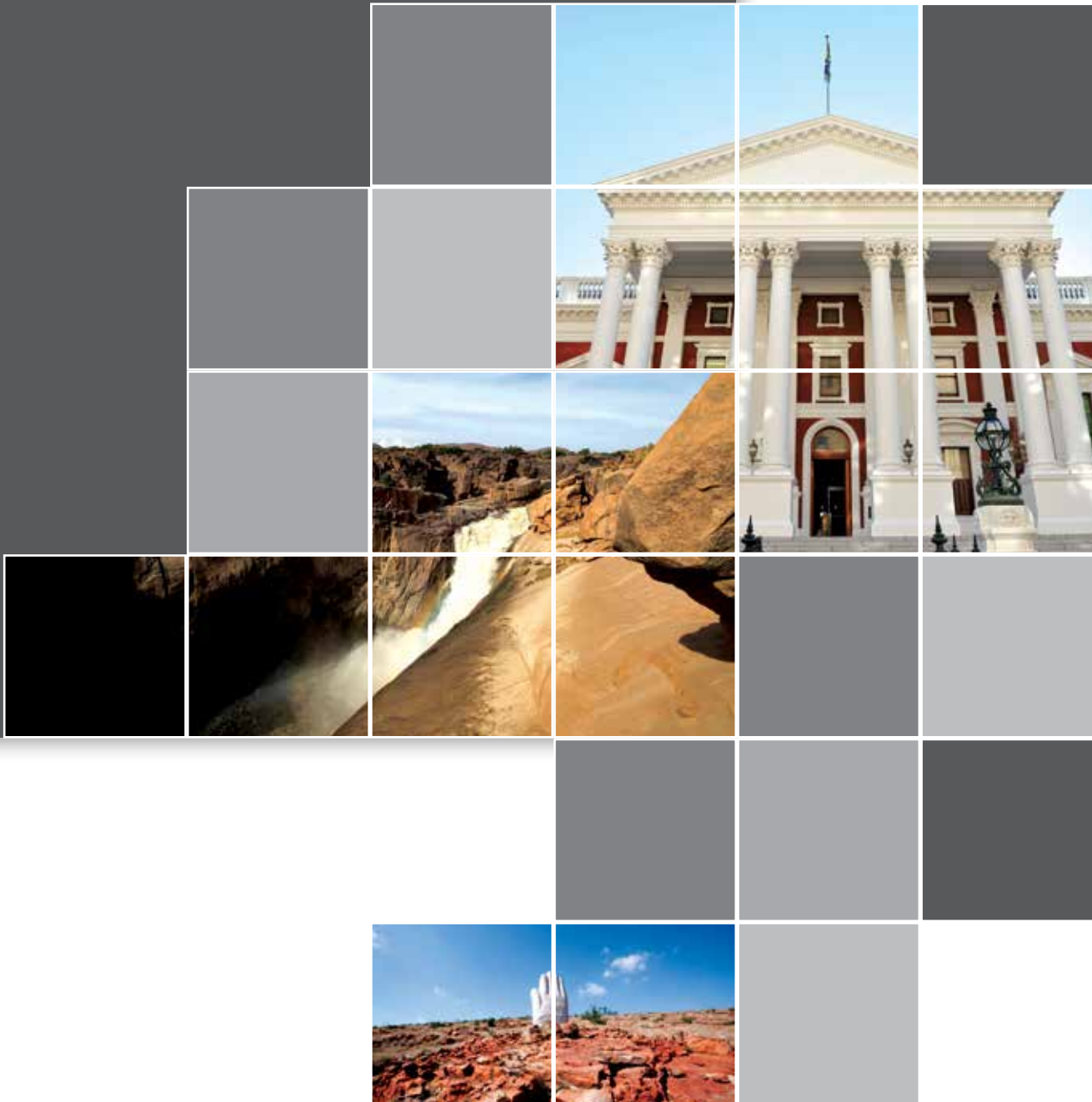
AUDITOR-GENERAL
SOUTH AFRICA

Our reputation promise

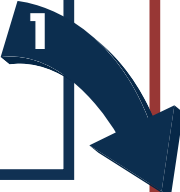
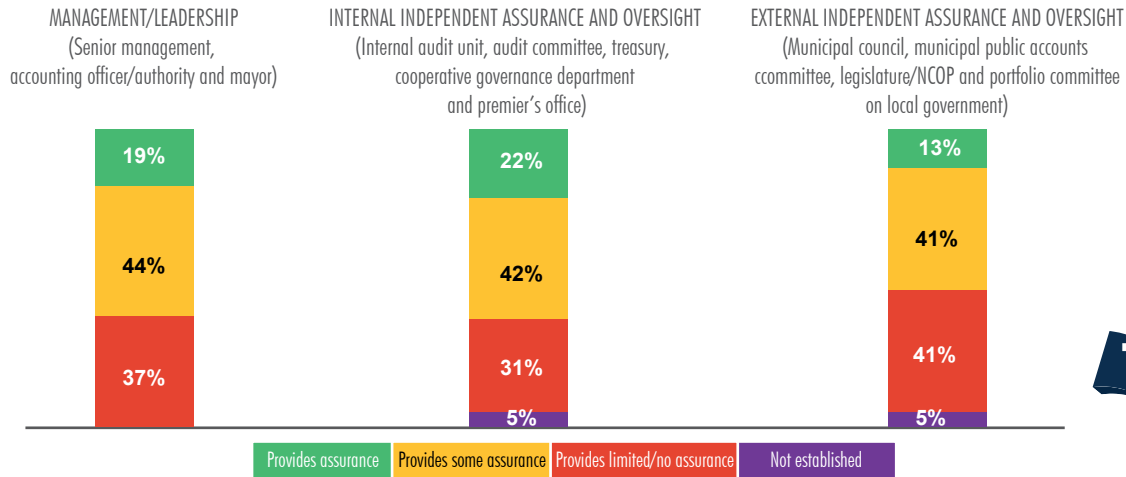
The Auditor-General has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.



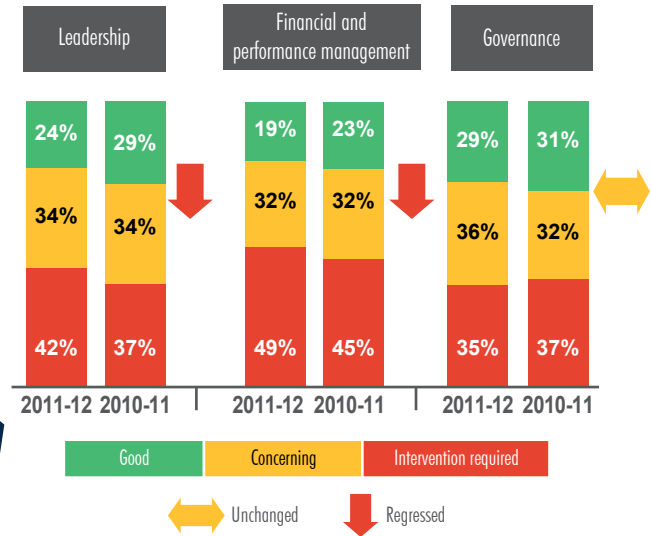
FOREWORD



KEY ROLE PLAYERS NOT PROVIDING ASSURANCE



DRIVERS OF KEY CONTROLS NOT IMPROVING



THE KEY ROLE PLAYERS NEED TO...

...TO ENSURE IMPROVED RESULTS...

...TAKE SOME VITAL ACTIONS...

...IN SIX KEY AREAS...

KEY RISK AREAS NOT RECEIVING REQUIRED ATTENTION



Concerning Intervention required

ROOT CAUSES NOT BEING ADDRESSED

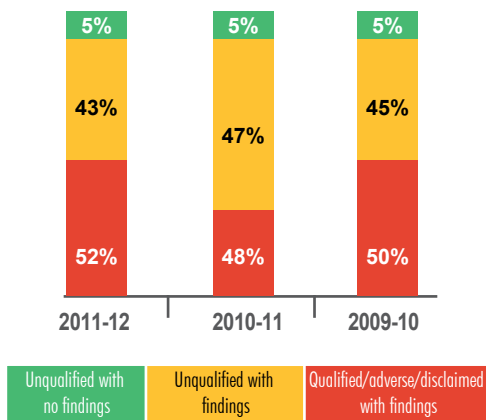
Key positions vacant or key officials lacking appropriate competencies
A root cause at **73%** of auditees (2010-11: 72%)

Lack of consequences for poor performance and transgressions
A root cause at **71%** of auditees (2010-11: 73%)

Slow response by political leadership in addressing the root causes of poor audit outcomes
A root cause at **76%** of auditees (2010-11: 57%)

Unchanged Regressed

REGRESSION IN AUDIT OUTCOMES



FOREWORD

I present my 2011-12 general report on local government audit outcomes to Parliament, the provincial legislatures and the municipal councils.

My 2010-11 general report drew attention to the root causes of poor audit outcomes and shared the commitments of oversight structures, provincial and national government as well as political leaders to support local government in a focused and cooperative manner to address these root causes.

Although the national, provincial and local spheres of government as well as oversight structures have started to implement actions to address the root causes, these initiatives have not yet had the desired effect on audit outcomes. Audit outcomes have regressed, with only 48% of the auditees being able to obtain financially unqualified audit opinions; most of which did so by correcting the mistakes identified through the audit process.

Except for the 5% that received clean audit opinions, all the auditees had material findings on either the usefulness or reliability of their annual performance reports or non-compliance with legislation, or findings on both these aspects. Even though I have consistently encouraged role players to urgently address the weaknesses in supply chain management, the quality of their annual performance reports and submitted financial statements, human resource management and information technology controls, this report shows that there has been little improvement. My report also highlights risks to the financial health of local government.

If local government attends to the key controls and addresses the risk areas and root causes I highlight in my report and sustain good practices, positive audit outcomes can be achieved and maintained. I call on municipal managers and mayors, the treasuries, the



cooperative governance departments, the offices of the premier and the South African Local Government Association to accelerate their efforts and cooperation to address the following root causes of the poor audit outcomes that I also highlighted in my 2010-11 report:

- The lack of capacity in local government is affecting its ability to account for the public resources it has to administer on behalf of society. At 73% of the auditees, vacancies in key positions and key officials without the minimum competencies and skills continued to make it difficult for these auditees to produce credible financial statements and performance reports. In order to fill this gap, 71% of the auditees depended on consultants to assist with financial reporting. Although capacity building and the professionalisation of local government is an ongoing, multi-year project, I am concerned that municipalities are not using all the opportunities available for skills development.

- Political leaders and municipal officials that deliberately or negligently ignore their duties and disobey legislation should be decisively dealt with through a formal performance management process that is complemented by the legislated consequences for transgressions. At just over 70% of the auditees, the lack of consequences for poor performance and transgressions slowed down the improvements in local government audit outcomes. Role players in local government often say that they do not know what remedies to apply to deal with transgressions. To help them, we have compiled a separate booklet on the legislation they can use, as a starting point for responsible leaders to set the correct tone.

I also call on the councillors of 76% of the auditees where I have encountered slow responses to addressing the poor audit outcomes to focus on the following:

- Prioritise their pursuit of the knowledge and skills they need to perform their oversight duties and insist on support from national and provincial government for their continuous development. If councillors do not feel equipped and enabled to effectively oversee municipal administration, they will not be able to hold municipal management to account and enforce consequences for poor performance and transgressions.
- Effectively and ethically apply the leadership skills that earned them the trust of their communities and strengthen their resolve to oversee and steer their municipalities towards achieving developmental objectives, adhering to legislation and accounting for actions in a credible and transparent manner.
- Further strengthen the municipal public accounts committees and support the important role they play.
- Insist, through their speakers, on sharing and reviewing regular and credible information on the status of the finances, service delivery and compliance activities of their municipalities.

The provincial legislatures' commitments to improve their oversight over local government in a cooperative manner have not been realised yet, but there is a renewed resolve to overcome the obstacles. I again invite legislatures to regularly cooperate with my office on local government matters.

National and provincial support and oversight for local government by treasuries and cooperative governance departments should be strengthened to improve municipalities' administrative and financial abilities. There needs to be a shift towards enabling municipalities in a practical and sustainable manner by providing operational guidelines and access to training and specialised skills. In this regard, district municipalities can play a larger part in fulfilling this role for municipalities struggling to find their own expertise. The legislation and initiatives recently announced by the ministers of public service administration and of cooperative governance should have a significant impact in strengthening local government, if supported at a municipal level and implemented in a coordinated and sustainable manner.

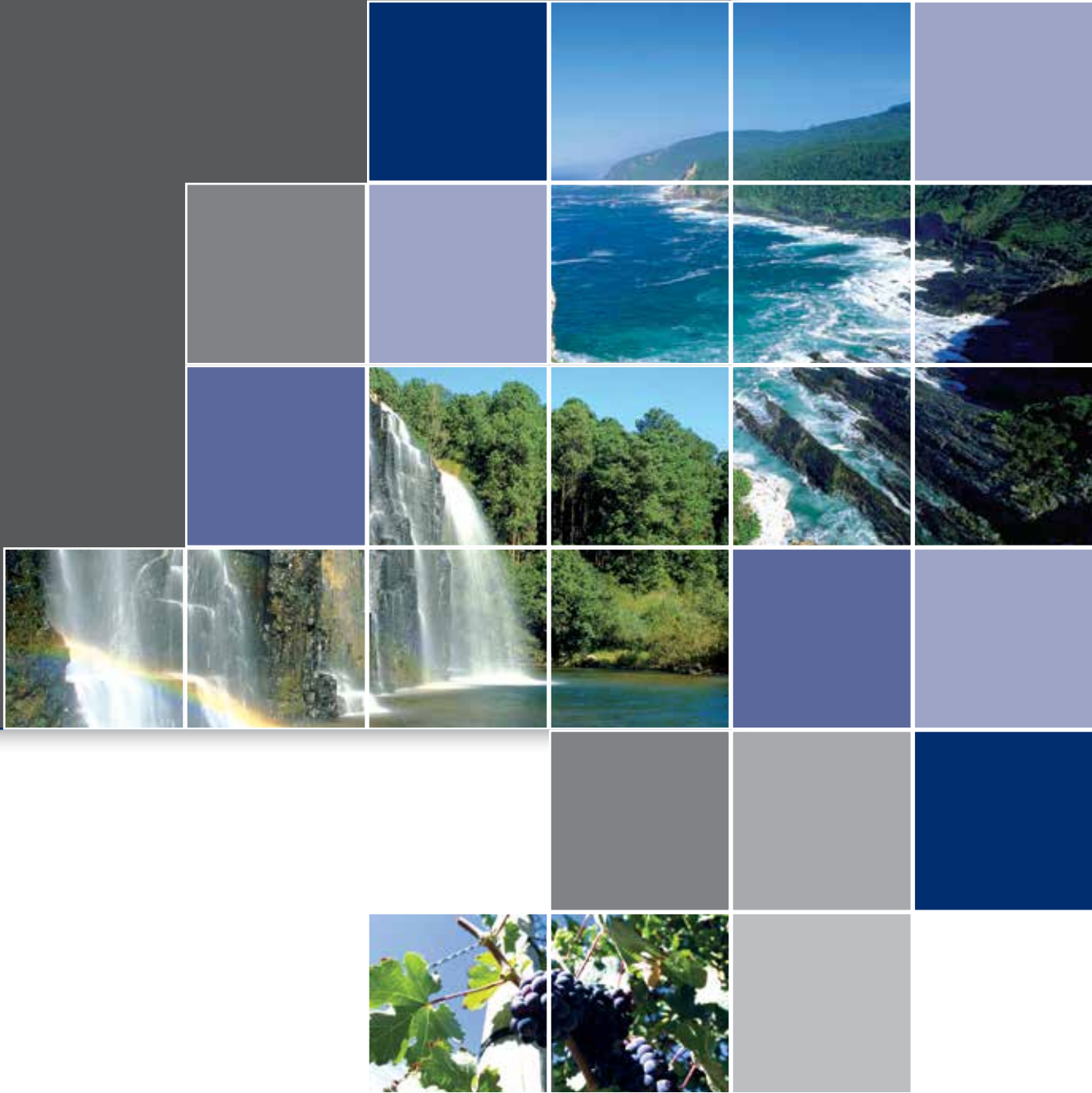
Although progress towards clean audits is slow, I am encouraged by examples across the country where the commitment of leaders and officials has resulted in examples of improved audit outcomes. I am confident that similar results can be achieved by the smallest local municipality to the biggest metro.

Together, we will continue to contribute towards strengthening our country's democracy.

Auditor-General

**Auditor-General
Pretoria
July 2013**

EXECUTIVE SUMMARY



SECTION 1 Executive summary

Our audit and reporting process

We audit every municipality and municipal entity in local government, also called *auditees* in this report, so that we can report on the quality of their financial statements and annual performance reports and on their compliance with legislation. We also assess the root cause of any error or non-compliance, based on the internal control that failed to prevent or detect it. We include these aspects in the following three types of reports:



We report our findings, the root causes and recommendations in management reports to the senior management and accounting officers or authorities of auditees, which are also shared with the mayors and audit committees. Our opinion on the financial statements, material findings on the performance report and non-compliance with legislation as well as significant deficiencies in internal controls are included in an audit report, which is published with the municipality's annual report and dealt with by the council.

Annually we report on the audit outcomes of all local government auditees in nine provincial reports and one consolidated general report (such as this one), in which we also analyse the root causes of poor audit outcomes. Before the general reports are published, we share the outcomes and root causes with the provincial legislatures and key role players in national and provincial government.

Our messages on key controls, risk areas and widespread root causes are shared with all role players

Over the past years, we have intensified our efforts to assist local government to improve its audit outcomes by identifying the key controls that should be in place at auditees; assessing these on a quarterly basis; and sharing the assessment with mayors, accounting officers or authorities, and audit committees.

We further identified the following six key risk areas in local government that need to be addressed, and we specifically audit these so that we can report on their status:

| | |
|---|---------------------------------------|
| Quality of submitted financial statements | Quality of annual performance reports |
| Supply chain management | Financial health |
| Information technology controls | Human resource management |

We identified the following three widespread root causes of the poor audit outcomes of local government in 2010-11. We said then, that if addressed, it will have a positive impact on the audit outcomes.

- Slow response by the political leadership to address the root causes of the poor audit outcomes of their municipalities.
- Vacancies in key positions, and key officials lacking the required competencies and skills.

- Lack of consequences for poor performance and transgressions by municipal officials and political leaders.

We have strengthened our relationship with mayors and councils as well as the role players in national and provincial government that support and oversee local government. We share our messages on key controls, risk areas and widespread root causes with them, and obtain and monitor their commitments for initiatives that can improve audit outcomes.

The key controls have regressed and the risk areas and widespread root causes were not fully addressed in 2011-12

The 2011-12 audits and the interactions with role players have shown that the recommendations we have made through our key messages have not yet been addressed. The following table summarises our findings.

Table 1
Summarised findings on local government

| Key findings | Good | Concerning | Poor |
|--|---|------------|------|
| Key controls | <p>The key controls of most auditees were not in place and the status thereof has regressed.</p> <p>The regression is most prominent in those controls that the leadership should implement to create a strong control environment and in the basic financial and performance management controls.</p> <p>The governance controls that have shown little improvement include effective audit committees and internal audit units.</p> | | |
| Risk areas | | | |
| Quality of submitted financial statements | <p>The quality of the financial statements submitted for audit purposes did not improve, with only 14% of the auditees submitting financial statements with no material misstatements.</p> | | |
| Quality of annual performance reports | <p>The quality of the annual performance reports remained poor, with 74% of the auditees having material weaknesses in the usefulness and reliability of the information in these reports.</p> | | |

| Key findings | Good | Concerning | Poor |
|----------------------------------|--|------------|------|
| Supply chain management | | | |
| | <p>We identified weaknesses in the procurement processes and contract management of even more auditees than last year, bringing the percentage of auditees with findings in this regard to 84%.</p> <p>We again identified contracts (with a value of at least R118 million) to employees and councillors, as well as uncompetitive or unfair procurement processes and inadequate contract management.</p> <p>Most of the weaknesses were also instances of non-compliance with legislation, which translated into irregular expenditure of R9,2 billion.</p> <p>In total, 94 auditees (30%) could not provide us with evidence that all their procurement processes had complied with legislation, as the supporting documentation either did not exist or could not be found as a result of poor document management.</p> | | |
| Human resource management | | | |
| | <p>Human resource management in local government has shown little sign of improvement. We identified weaknesses in the human resource management of 69% of the auditees. The implementation of legislated reforms to change the situation has been delayed.</p> <p>Our biggest concerns remain the management of vacancies and acting positions, the competencies of key personnel, and the management of performance.</p> | | |

| Key findings | Good | Concerning | Poor |
|--|---|------------|------|
| Information technology controls | | | |
| | <p>There has been minimal improvement in the information technology controls that should be ensuring the confidentiality, integrity and availability of local government information.</p> <p>Most auditees have challenges with the design of the controls and have not even begun to deal with the implementation and sustained effectiveness of the controls.</p> <p>A common reaction to such weaknesses is that the auditees' IT section or consultant should address it. However, the drivers of the weaknesses were the ineffective management and governance of information technology, which should be addressed by the municipal leadership with support from national and provincial role players.</p> | | |
| Financial health | | | |
| | <p>We have always considered the financial health of auditees in our audits, as their financial statements have to disclose if they might not be able to operate in the foreseeable future (termed <i>a going concern uncertainty</i>). Our audits showed that 23% of the auditees recognised such a going concern uncertainty.</p> <p>From this year, we also analysed auditees' financial management indicators at a high level, based on their financial statements. We analysed the financial statements of the auditees that did not have adverse or disclaimed opinions, and identified significant weaknesses in their budget and grant management, debtor and creditor management, financial performance and position as well as cash management.</p> | | |

| Key findings | Good | Concerning | Poor |
|---|---|------------|------|
| Root causes | | | |
| Response by political leadership | <p>In our interactions with councils and our regular engagements with mayors on the status of key controls, we consistently encouraged them to accept responsibility for guiding and directing the development and performance of the key controls.</p> <p>Although almost all mayors met with us, their influence in improving the key controls was generally not evident. In many instances (68%), mayors even met with us three times or more during the year. Councils have also not been able to provide the required level of oversight to improve the controls, while the municipal public accounts committees established in 2011 to improve the oversight function did not yet operate fully or effectively.</p> | | |
| | <p>Technical knowledge of financial management and reporting, performance management and legislation is not a prerequisite for elected office-bearers. Councillors might also not be familiar with the concepts of control and oversight. As a consequence, councillors often did not feel equipped and enabled to effectively deal with municipal administration, to enforce the required consequences for poor performance and transgressions, and to question the actions and decisions of municipal management and the information provided by them.</p> | | |
| | <p>We determined that the slow response by the political leadership to our message had a negative impact at 76% of the auditees (83% of municipalities and 49% of municipal entities).</p> | | |

| Key findings | Good | Concerning | Poor |
|-----------------------------------|---|------------|------|
| Vacancies and competencies | <p>Last year, we reported that vacant key positions and key officials lacking appropriate competencies was a cause of poor audit outcomes at over 70% of the auditees. This root cause was not addressed in 2011-12 and continued to have a negative impact at 73% of the auditees (76% of the municipalities and 58% of the municipal entities).</p> | | |
| | <p>In our audits, we gathered information on vacancies and competency levels at 30 June 2012 relating to the key positions of municipal manager, chief financial officer and head of the supply chain management unit. One or more of these positions were vacant at one in every five municipalities. Of the officials appointed in these positions, over a third did not yet have the qualifications or did not meet the competency requirements of the municipal regulations on minimum competency levels, which were to come into effect on 1 January 2013.</p> | | |
| | <p>We also found that consultants were used for financial reporting assistance at approximately 71% of the auditees, at an estimated R378 million. These consultants were used in addition to the direct support provided by the treasuries and the departments of cooperative governance.</p> | | |
| | <p>Consultants were almost always used to supplement the skills gap (89%), a trend similar to last year. We do expect that auditees will continue to rely on consultants, as there was limited or no transfer of skills at 61% of these auditees.</p> <p>The ineffective use of consultants remained a concern, as the additional expertise provided by them did not always translate into financial statements of a better quality. Overall, 75% of the auditees that had material misstatements in their submitted financial statements were assisted by consultants.</p> | | |

| Key findings | Good | Concerning | Poor |
|--|--|------------|------|
| <p>Consequences for poor performance and transgressions</p> | <p>We reported last year that at least 73% of the auditees showed signs of a general lack of consequences for poor performance and transgressions. We warned then that when officials and leaders are not held accountable for their actions, the perception is created that such behaviour and its results are acceptable and tolerated. Such an environment brings about low performance levels and disregard for legislation.</p> <p>This root cause remained widespread in 2011-12 at 71% of the auditees (74% of the municipalities and 58% of the municipal entities), due to performance management and evaluation processes not being well established. Auditees were also reluctant to act on transgressions, mostly because of a lack of knowledge of the steps to be taken and the remedies to be applied as well as pressure from the political and administrative leadership.</p> | | |

Key role players did not provide the level of assurance required to improve controls and address the risk areas and root causes

Role players across all three spheres of government should work towards improving the key controls, addressing the widespread root causes and ensuring that there is improvement in the six key risk areas, thereby providing assurance on the quality of the financial statements and performance reports as well as on compliance with legislation.

Based on our assessment, these role players were not providing the necessary assurance. Mayors, accounting officers or authorities and senior management were only providing assurance at just less than a fifth of the auditees.

The contribution by senior management needs the most improvement, as municipal managers and mayors need to be able to rely on the information provided by senior managers for their monitoring and oversight function.

The assurance provided by internal audit units, audit committees, treasuries, departments of cooperative governance and offices of the premier was also not at the required level (only 22%), and these role players still did not make a positive and sustainable contribution. We further assessed that the assurance provided through oversight by councils, municipal public accounts committees and provincial legislatures needs the most improvement, with only 13% of these role players providing assurance at the required level.

Key role players not addressing inadequate controls, root causes and risk areas resulted in a regression in the audit outcomes

The overall regression in the audit outcomes was due to key role players not providing the necessary assurance, combined with the lack of improvement in key controls, root causes and key risk areas. The table below summarises the significant aspects of the 2011-12 audit outcomes of 317 auditees. Due to auditees submitting financial statements late for audit purposes or not submitting financial statements at all, we had not finalised the audits of 21 auditees (6%) by 31 March 2013, which was the cut-off date for inclusion of audit outcomes in this general report.

Table 2

Significant aspects of the audit outcomes

| Key outcomes and trends | Good | Concerning | Poor | Key outcomes and trends | Good | Concerning | Poor |
|------------------------------------|--|------------|------|---|---|------------|------|
| Overall audit outcomes | | | | Financial statements | | | |
| Overall audit outcomes | <p>The overall audit outcomes regressed, as 41 auditees improved, but 50 auditees regressed.</p> <p>The progress towards clean audits has been slow, with the number of clean audits remaining at the same low level of 5% for the past three years.</p> <p>Almost half of the auditees that obtained a clean audit opinion were municipal entities, rather than municipalities. In the Free State, Gauteng and KwaZulu-Natal, almost all the clean audits were achieved by municipal entities, while in Limpopo, Mpumalanga and the Western Cape, all the clean audits were achieved by municipalities.</p> | | | Clean audits | <p>Six auditees progressed to a clean audit by addressing either their performance reporting weaknesses or their findings on non-compliance with legislation, or both these aspects.</p> <p>Eight auditees could sustain their clean audit status of the previous year.</p> <p>However, nine auditees could not retain their clean audit status. Eight of these auditees regressed to financially unqualified opinions with findings and one auditee in Limpopo regressed to a qualified audit opinion.</p> | | |
| Metropolitan municipalities | <p>None of the eight metros obtained a clean audit opinion, but half of them had financially unqualified opinions. The financial statements of three were qualified and one was disclaimed.</p> <p>All the metros had findings on non-compliance with legislation, while five had material findings on the usefulness and reliability of their performance reports. The audit outcomes of one metro improved but one regressed.</p> | | | Submission of financial statements | <p>The Municipal Finance Management Act requires auditees to submit their financial statements for audit purposes by 31 August (or 30 September in the case of consolidated audits).</p> <p>In total, 10% of the auditees submitted their financial statements late or did not submit financial statements at all (five in the Eastern Cape, seven in the Free State, three in Limpopo, two in Mpumalanga, 13 in the Northern Cape and four in the Western Cape).</p> <p>However, 11% more auditees than in the previous year submitted their financial statements on time. The biggest improvement in the timely submission of financial statements was in the North West, which showed a 78% improvement.</p> | | |
| Provincial audit outcomes | <p>The audit outcomes regressed in the Eastern Cape, KwaZulu-Natal, Limpopo and Mpumalanga, but improved in the Free State.</p> <p>It remained at the same level in the other provinces.</p> | | | | | | |

| Key outcomes and trends | Good | Concerning | Poor |
|---|--|------------|------|
| <i>Note: The percentages included in the rest of this table are based on the 317 completed audits</i> | | | |
| Unqualified opinions | <p>Only 161 auditees (51%) received an unqualified audit opinion on their financial statements.</p> <p>The quality of the financial statements submitted for auditing was poor, with only 14% of the auditees submitting financial statements with no material misstatements. In total, 117 auditees (37%) avoided qualified opinions by correcting the material misstatements identified during the audit process. If the misstatements had not been corrected, the percentage auditees with unqualified financial statements would have been only 14%, instead of 51%.</p> | | |
| Adverse or disclaimed opinions | <p>The number of auditees with adverse or disclaimed opinions remained high at 85 (27% of the auditees), with 60 auditees having the same opinion as in the previous year.</p> <p>Although 21 auditees that had adverse or disclaimed opinions in the previous year were able to improve, 25 regressed into this category.</p> | | |
| Qualified opinions | <p>Seventy-one auditees (22%) received a qualified audit opinion; an increase from the 62 in the previous year.</p> <p>Thirty-three auditees had the same opinion in the previous year and only 14 that were qualified in the previous year were able to improve. Seventeen auditees that had an unqualified opinion in the previous year regressed to qualified.</p> | | |

| Key outcomes and trends | Good | Concerning | Poor |
|---|--|------------|------|
| Unqualified with findings | <p>In total, 144 auditees (45%) received an unqualified audit opinion on their financial statements, but could not obtain a clean audit status, as they had material findings on either the usefulness or reliability of their annual performance reports or material findings on non-compliance with legislation, or material findings on both these aspects.</p> <p>Of the 144 auditees, 121 also had this opinion in the previous year, while 95 have been in this category for three years – unable to move to a clean audit status.</p> | | |
| Annual performance report | | | |
| Submission of annual performance reports | <p>Twenty-four auditees (8%) did not prepare annual performance reports and 13 auditees (4%) submitted their reports too late to be audited.</p> | | |
| Overall results | <p>We reported material findings on either the usefulness or the reliability, or both the usefulness and the reliability, of the annual performance reports in the audit reports of 235 auditees (74%). There has been no overall improvement since the previous year.</p> | | |
| Provincial results | <p>The number of auditees with material findings increased in the Eastern Cape, KwaZulu-Natal and Mpumalanga, but there was some improvement in the North West and the Western Cape.</p> <p>It remained at the same level in the other provinces.</p> | | |

| Key outcomes and trends | Good | Concerning | Poor |
|------------------------------------|---|------------|------|
| Compliance with legislation | | | |
| Overall results | <p>We reported material non-compliance with legislation in the audit reports of 299 auditees (94%) (96% of the municipalities and 86% of the municipal entities). There has been no overall improvement since the previous year.</p> <p>The most common findings were on material misstatements in the financial statements submitted for auditing, supply chain management as well as the prevention and follow-up of unauthorised, irregular as well as fruitless and wasteful expenditure.</p> | | |
| Provincial results | <p>The number of auditees with non-compliance findings increased in Gauteng, but there was some improvement in the Western Cape.</p> <p>It remained at the same level in the other provinces.</p> | | |

| Key outcomes and trends | Good | Concerning | Poor |
|---|--|------------|------|
| Unauthorised expenditure | <p>Unauthorised expenditure of R9,78 billion was incurred by 181 municipalities. This is nearly double than in the previous year. Most of the unauthorised expenditure was caused by budget overspending, which in part can be attributed to poor budget preparation, including estimates of non-cash items.</p> | | |
| Irregular expenditure | <p>Irregular expenditure of R9,82 billion was incurred by 266 auditees (84%). The amount increased by R2,8 billion (41%) from the previous year.</p> | | |
| Fruitless and wasteful expenditure | <p>Fruitless and wasteful expenditure of R568 million was incurred by 202 auditees (64%). This expenditure more than doubled from the previous year.</p> | | |

The effective implementation of commitments by key role players can have a positive impact on audit outcomes

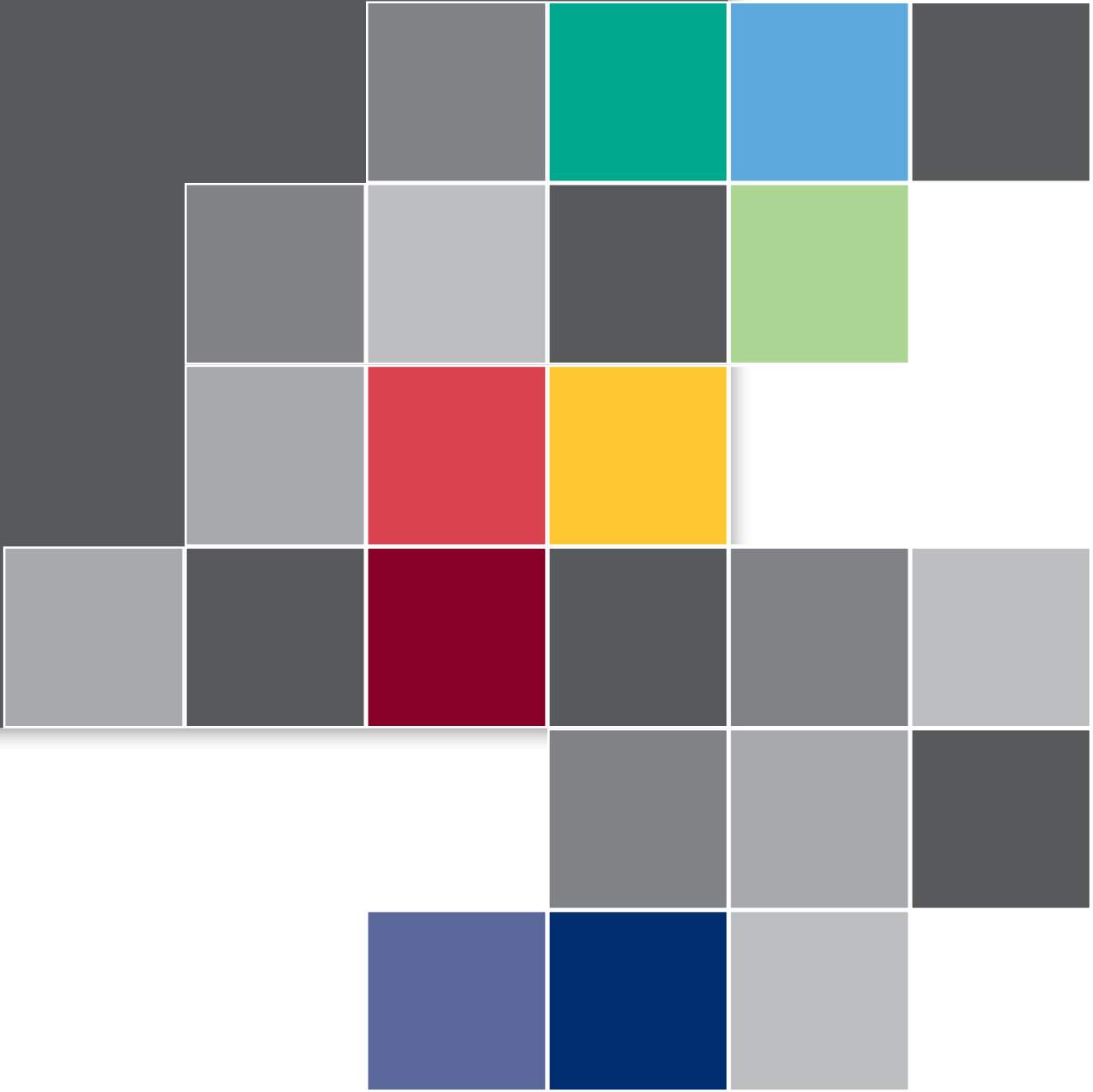
The ability of some auditees to consistently improve from year to year, and even to obtain clean audits, is encouraging and demonstrates that clean audits can be obtained. My provincial general reports include accounts from across the country where the commitments of the leadership and officials have resulted in improved audit outcomes. Examples include the support initiative by the premier and the member of the executive council for finance in the North West that resulted in a 100% submission rate of financial statements by the legislated date (including 14 financial statements from previous years) and the improvement in audit outcomes in the Free State as a result of enhanced oversight by mayors who were actively involved during the audit process.

In order to influence and inspire the leadership in local government, we have shared our key message on the actions needed to improve this year's audit outcomes with every accounting officer or authority, mayor and councillor through our reports and interactions with them. Through our roadshow on local government audit outcomes earlier this year, we have also shared it countrywide with legislatures, premiers and members of the executive council for finance and for local government. We also took our message to the Cabinet, the National Council of Provinces, the Association of Public Accounts Committees and the Speakers' Forum.

As part of the interactions, all these role players shared with us the progress of the commitments made in response to the previous year's audit outcomes. Although it is encouraging that most of the initiatives committed to last year either have been completed or are in progress, it clearly did not have an impact overall on improving the 2011-12 audit outcomes. Two of the reasons for the limited impact are that the initiatives committed to were implemented too late to have an impact and that the initiatives were not appropriate or sufficient to have an impact.

The initiatives committed to last year and the new ones in response to our 2011-12 messages should have a more visible impact on the upcoming audit outcomes if fully implemented in a coordinated manner and responded to by the auditees.

OVERVIEW OF
FULL REPORT





Qualified opinions avoided by correcting material misstatements identified during audit process
Section 2.2
Page 46

Message from the auditor-general

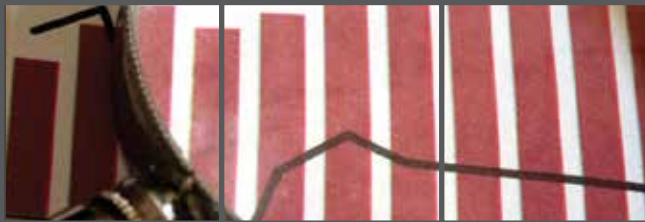
Page 9



Material non-compliance with legislation by 94% of auditees
Section 2.4
Page 56

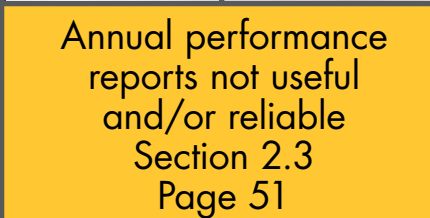
Contracts to the value of at least R118 million awarded to municipal officials and councillors
Section 2.4.3
Page 62

Regression in audit outcomes overall and in most provinces
Section 2.1
Page 24

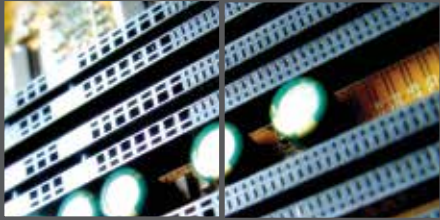


25% of auditees received disclaimed or adverse opinions and 21% qualified opinions
Section 2.1.1
Page 24

Annual performance reports not useful and/or reliable
Section 2.3
Page 51



Uncompetitive and unfair procurement processes, inadequate contract management and missing tender documentation
Section 2.4.3
Page 62



**Continued reliance on consultants
and ineffective management
of this resource**
Section 3.3.5
Page 114



**Increase in already high levels of
unauthorised, irregular as well
as fruitless and wasteful expenditure**
Section 2.4.4
Page 74



**Key role players did not provide
assurance to improve controls and
address risk areas and root causes**
Section 4.1
Page 138

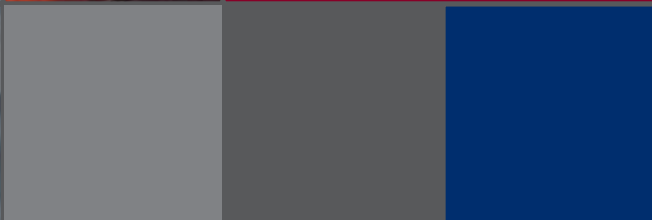


*Implementation and impact of commitments
and initiatives of role players*
Section 4.4
Page 151

**Root causes of the poor
audit outcomes**
Sections 3.1 – 3.3
Page 88



**Confidentiality, integrity
and availability of
information at risk**
Section 3.4
Page 119



**Financial statement analyses
show significant risks that
affect financial health of local
government**
Section 5
Page 170



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