



CONSOLIDATED GENERAL REPORT
on the audit outcomes of
LOCAL GOVERNMENT
2010-11

RP216/2012
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The information and insights presented in this flagship publication of my office are aimed at empowering oversight structures and local government and provincial leaders to focus on those issues that will result in reliable financial statements, credible reporting on service delivery and compliance with laws and regulations. This publication also captures the commitments that leaders have made to improve audit outcomes.

Auditor-General: Terence Nombembe



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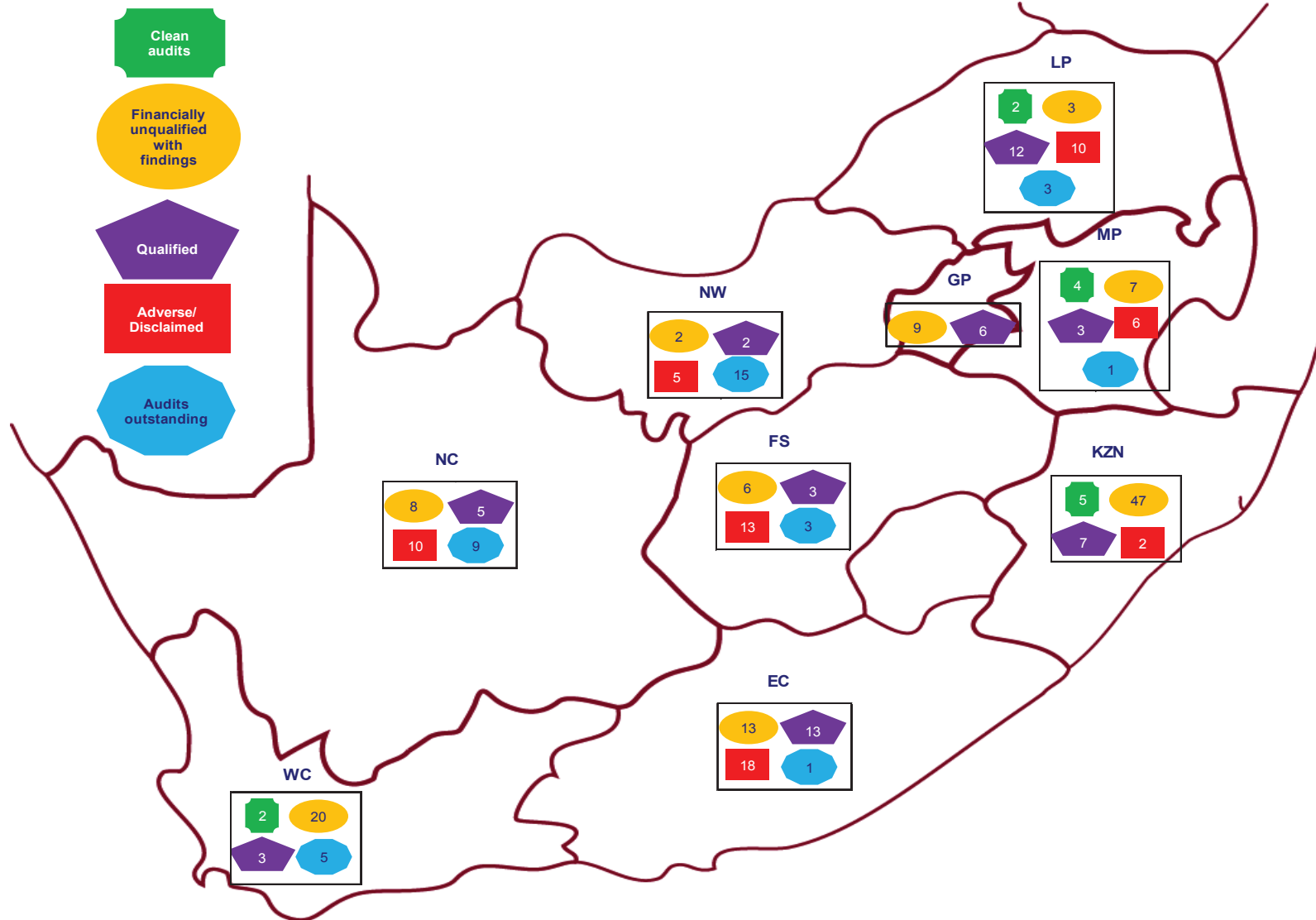



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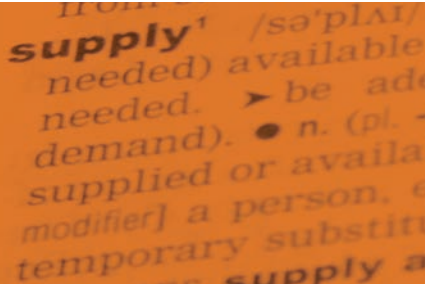
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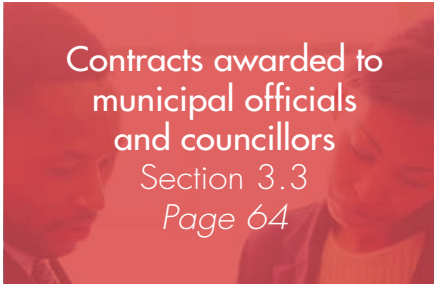
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Clean audit reports 2010-11

**Umzinyathi District
Municipality**

**eMadlageni Local
Municipality**

**Richmond Local
Municipality**

**Umdoni Local
Municipality**

**Umtshezi Local
Municipality**

**Waterberg District
Municipality**

**Swartland Local
Municipality**

**West Coast District
Municipality**

**Victor Khanye Local
Municipality**

**Steve Tshwete Local
Municipality**

**Gert Sibande District
Municipality**

**Ehlanzeni District
Municipality**



Fetakgomo Local Municipality

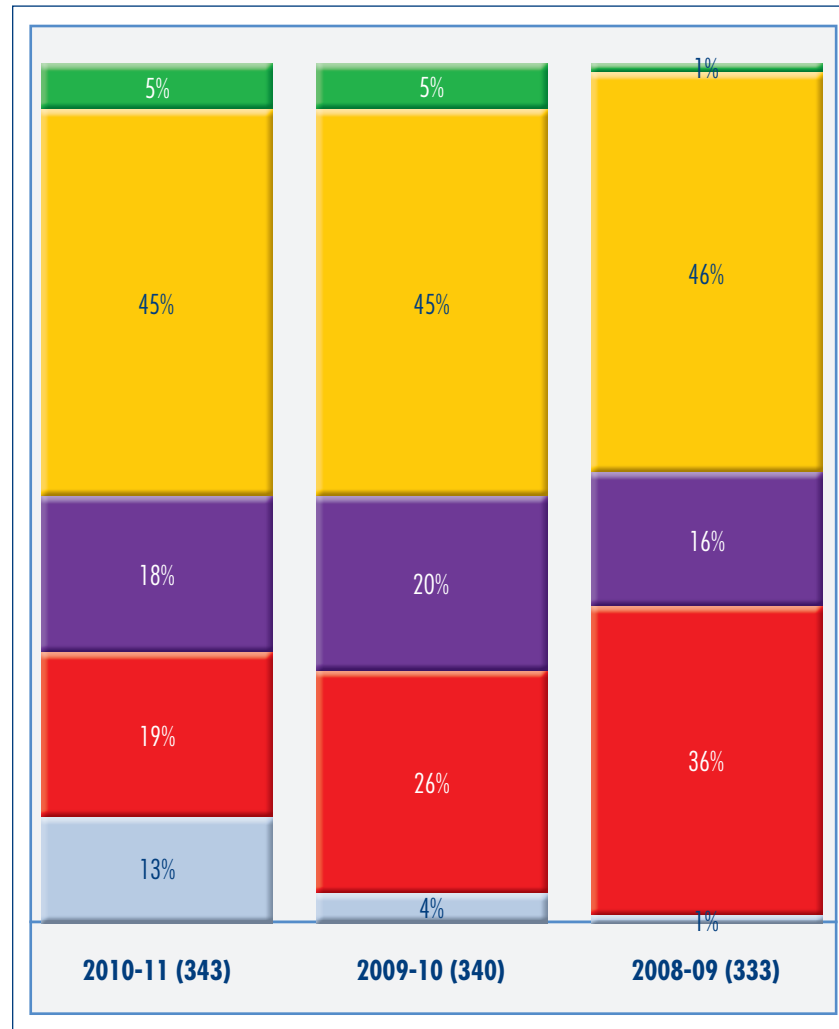




Our reputation promise/mission

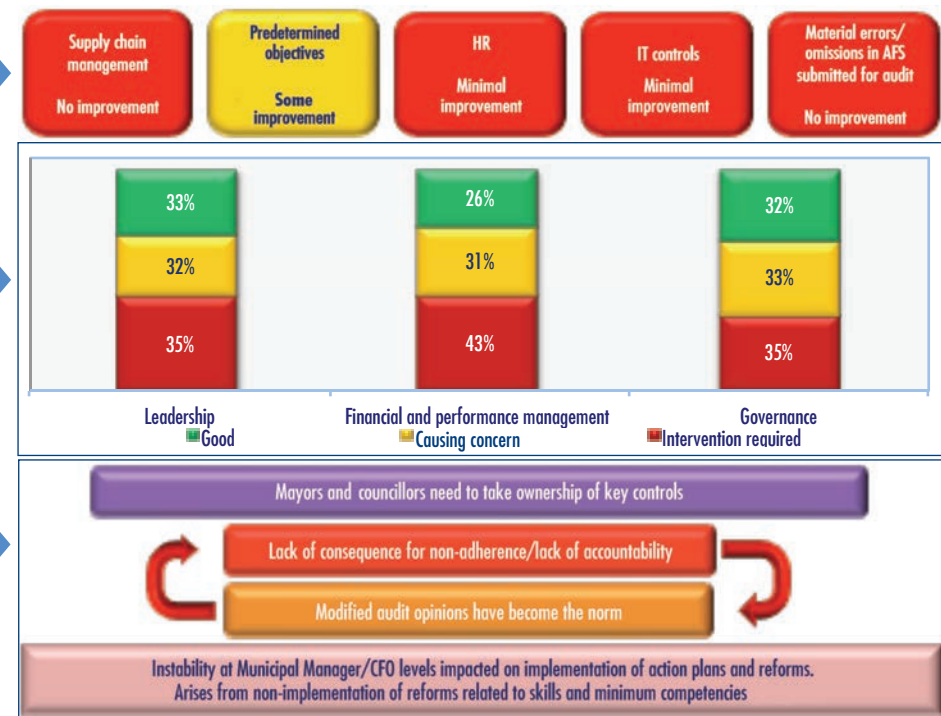
The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

Slow progress towards clean audits and a high proportion of financial statements remained financially qualified.

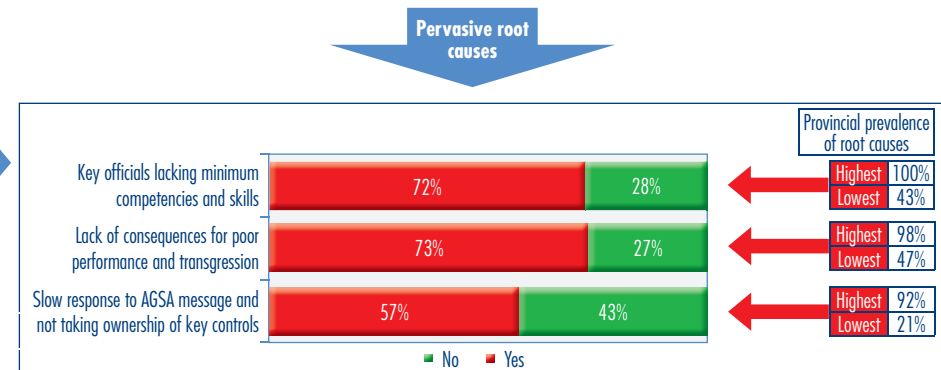


■ Financially unqualified with no findings (clean audit opinion)
 ■ Financially unqualified with findings
 ■ Audits outstanding
 ■ Qualified with/without findings
 ■ Disclaimed/Adverse with/without findings

Limited progress made in addressing internal key control deficiencies, their impact on the five risk areas and the root causes thereof.



Stagnated audit outcomes are due to high prevalence of the root causes.





FOREWORD

I hereby present to National Parliament, provincial legislatures and municipal councils my 2010-11 general report on local government audit outcomes. I use this opportunity to take stock of *Operation clean audit*, and the most significant risks we face in our administrations.

Operation clean audit was launched by government in 2009 to address the poor audit outcomes of local government. Although many advances had been made in transforming local government since 1994, the legislative reforms and the financial and performance reporting practices had not been institutionalised. *Operation clean audit* inspired focus, and over the past three years initiatives were launched to support the achievement of the clean audit goal. My office and I also responded with the introduction of quarterly assessments of the key controls of our auditees in the areas of leadership, financial and performance management and governance. We sought meaningful engagements with political leaders on a quarterly basis to share our assessments and identify risks and we invited commitments to address the stumbling blocks in the way of clean audits.

At these meetings across our country, I have said that in spite of all these initiatives and commitments, the progress towards clean audits has been slow. The 2010-11 audit outcomes did not show improvement, with about 50% of auditees unable to submit their annual financial statements in time or obtain financially unqualified audit opinions. The majority of those that received financially unqualified audit opinions achieved it by correcting the mistakes identified through the audit process. This is not a sustainable practice. Except for the 5% that received clean audit opinions, all the auditees had material findings on their service delivery reporting and/or non-compliance with laws and regulations. Even though I have consistently stressed the urgent need to address the weaknesses in supply chain management, service delivery reporting, human resource management and information technology controls, there has been very limited improvement.

The desired progress to clean audits is at risk, if the following three root causes are not addressed:

- Officials in key positions at more than 70% of the auditees do not have the **minimum competencies and skills** required to perform their jobs. While a lack of dedicated capacity is at the root of the weaknesses in service delivery reporting, the skills gap is most pronounced in the financial discipline. There is an opportunity to turn around the situation. The provision of dedicated resources for service delivery reporting, the implementation of the legislation on minimum competency levels and the recent amendments to the Municipal Systems Act are important interventions. It will, however, require coordination and commitment from all political structures and government to ensure the success of these legislative reforms.
- At least 73% of the auditees showed signs of a general **lack of consequences for poor performance**. This is evidenced by the fact that modified audit opinions remained the norm. When officials and political leaders are not held accountable for their actions, the perception could be created that such behaviour and its results are acceptable and tolerated. This could make even those people that are giving their best under trying circumstances despondent.
- I found that more than half of our auditees can attribute their poor audit outcomes to mayors and councillors that are not responsive to the issues identified by the audits and do not take our recommendations seriously. They are slow in taking up their responsibilities and **do not take ownership of their role in implementing key controls**. If this widespread root cause is not addressed, it will continue to weaken the pillars of governance.

The honouring of the commitments made in response to these audit outcomes is crucial. In this regard, I single out the commitment to elevate cooperation and strengthen the working relationship between public accounts and portfolio committees, as well as to cement their regular engagements with my office. The coordination of the capacity building support between the Premiers' offices, treasuries and cooperative governance departments at national and provincial levels, together with the South African Local Government Association (SALGA), is a precondition for the goals of *Operation clean audit* to be realised. I have seen a few examples across the country of commitment by leaders and officials which

translated into improved audit outcomes and I am confident that similar results can be achieved from the smallest local municipality to the largest metros.

In conjunction with the relevant departments, my office has actively participated in providing input into the development of solutions to the challenges highlighted in this report. I believe that all that is needed is the sustained involvement of the leadership in utilising those solutions.

I wish to thank the audit teams from my office and the audit firms that assisted for their diligent efforts in providing useful and relevant information and insights that promote oversight and accountability in government. Together, we will continue to contribute towards the strengthening of our country's democracy through auditing.

Auditor-General

Auditor-General
Pretoria
June 2012















SECTION 1: SIGNIFICANT ASPECTS OF THE 2010-11 AUDIT OUTCOMES




Significant aspects of audit outcomes for the year under review are summarised in the table that follows.

Table 1 : Significant aspects of the 2010-11 audit outcomes

Aspect	Indicator	Key outcomes and trends
Overall audit outcomes		<ul style="list-style-type: none"> Five district municipalities, eight local municipalities and four municipal entities received clean audit reports. These auditees, however, represent only 5% of auditees in the country.
		<ul style="list-style-type: none"> None of the municipalities in the Eastern Cape, Free State, Gauteng, Northern Cape and North West received clean audit reports.
		<ul style="list-style-type: none"> Fifty-two (17%) auditees improved on their 2009-10 audit outcomes, but 38 (13%) regressed.
		<ul style="list-style-type: none"> One hundred and twenty-nine auditees (46%) were able to retain a financially unqualified audit opinion but these auditees failed to make any further progress towards clean audit reports for the year under review.
Submission of financial statements and annual performance reports for audit		<ul style="list-style-type: none"> The rate of timely submission of financial statements (80%) and annual performance reports (86%) for audit did not improve significantly compared to the prior year.
		<ul style="list-style-type: none"> The non-submission or late submission of financial statements was the highest in the North West (61%) and Northern Cape (34%). Both provinces also did not have any clean audit reports.
		<ul style="list-style-type: none"> Thirty-eight (10%) auditees did not submit their annual performance reports for audit, while 15 (4%) auditees submitted their annual performance reports after the legislated deadline.

Aspect	Indicator	Key outcomes and trends
Opinions on financial statements		<ul style="list-style-type: none"> The number of financially unqualified audit opinions increased by only four auditees to constitute 50% of auditees.
		<ul style="list-style-type: none"> KwaZulu-Natal (87%), Gauteng (76%) and the Western Cape (76%) continued to have the highest number of financially unqualified audit opinions.
		<ul style="list-style-type: none"> The Eastern Cape and Free State recorded an increase of 13% and 11% respectively in financially unqualified audit opinions. The majority of audit opinions in these provinces, however, remained financially qualified.
		<ul style="list-style-type: none"> Limpopo and the North West recorded a reduction of 13% and 9% respectively in the number of financially unqualified audit opinions.
		<ul style="list-style-type: none"> The prevalence of material misstatements in the financial statements submitted for audit increased from 85% to 91% of auditees.
		<ul style="list-style-type: none"> One hundred and forty-seven (49%) auditees were able to achieve a financially unqualified audit opinion because they used the opportunity provided by the AGSA to correct all misstatements identified during the audit.
		<ul style="list-style-type: none"> Of the 127 (42%) auditees that received disclaimed, adverse or qualified audit opinions, 29 opinions had regressed from the previous year while 80 (63%) remained disclaimed, adverse or qualified.
		<ul style="list-style-type: none"> Thirty-one (10%) auditees have received disclaimed or adverse audit opinions for the past six years. The Eastern Cape (seven), Free State (eight) and Northern Cape (seven) account for 71% of such auditees.
		<ul style="list-style-type: none"> Sixty per cent of the auditees that received financially unqualified audit opinions engaged consultants to assist them with accounting-related services and/or preparation of financial statements. Eighty-five per cent of the auditees with qualified, adverse or disclaimed opinions had assistance from consultants.

Aspect	Indicator	Key outcomes and trends
Reporting on predetermined objectives (PDO)	   	<ul style="list-style-type: none"> The number of auditees with findings on their reporting on predetermined objectives (PDO) decreased from 274 (84%) in the previous year to 210 (70%). All provinces showed a reduction in the level of PDO findings except the Free State and Northern Cape. Gauteng remained unchanged and is still the province with the lowest level of PDO findings. Findings on non-compliance with PDO-related legislation decreased by 30%. Sixty-three per cent of auditees had findings on the usefulness and reliability of the information in their annual performance reports.
Findings on non-compliance with laws and regulations	  	<ul style="list-style-type: none"> Ninety-three per cent of auditees had findings on material non-compliance with laws and regulations. Further deteriorations in terms of non-compliance occurred in KwaZulu-Natal, North West, Mpumalanga and the Northern Cape. None of the other provinces showed significant improvement. Unauthorised, irregular or fruitless and wasteful expenditure was incurred by 86% of auditees. Eighty-four per cent of the auditees did not take reasonable steps to prevent this type of expenditure.
Supply chain management (SCM) contraventions	  	<ul style="list-style-type: none"> Procurement to the value of R3,5 billion could not be audited because the required information or documentation was not made available by auditees. At 46% of auditees, contracts were awarded to employees, councillors or other state officials. Unfair or uncompetitive procurement processes were followed at 65% of the auditees.

Aspect	Indicator	Key outcomes and trends
Human resource management findings	 	<ul style="list-style-type: none"> Inadequate management of vacancies and acting positions was identified at 34% of the auditees. Key personnel at more than 70% of the auditees did not have the required competencies to perform their duties.
Risks related to the use of information technology (IT)		<ul style="list-style-type: none"> No significant progress was made in addressing exposures in the IT environment of auditees. More than 90% of auditees audited had IT findings. Concerns remain around planning for the optimal use of IT, recovery in the event of a disaster and restricting access to computers to authorised officials only.

Further details of findings and trends are presented in the balance of this report.





SECTION 2: OVERVIEW OF AUDIT OUTCOMES

This general report summarises key aspects of the 2010-11 audit outcomes of local government, which are contained in separate general reports issued for each of the provinces (available on www.agsa.co.za).

A **summary of the overall audit outcomes** is provided in section 2.1. This section concludes with a five-year history of audit outcomes and an analysis of the impact that root causes have had on the audit outcomes of the year under review. Sections 2.2 to 2.4 provide details on findings arising from the audit of the financial statements, reporting by auditees against their predetermined objectives and compliance by auditees with laws and regulations. **Root causes of audit findings and recommended best practices** are also analysed in the respective sections. Section 3 provides further details of findings arising from the audit of supply chain management.

An analysis of the drivers of audit outcomes is presented in section 4 of this general report, after which section 5 records the commitments received from the provincial executive leadership and oversight structures and other national and provincial role players in response to the 2010-11 audit outcomes. This section also highlights other current and emerging matters requiring attention.

2.1 Summary of overall audit outcomes

This section describes the overall audit outcomes, gives detail on the auditees that could not be audited, analyses the improvements and regressions in the current year's outcomes and provides a five-year history of audit outcomes.

2.1.1 Summarised audit outcomes

Local government comprises eight metros, 46 district municipalities, 229 local municipalities (totalling 283 municipalities) and 60 municipal entities. The number of municipal entities has increased from 57 to 60 since the 2009-10 financial year due to the establishment of four new municipal entities, namely three in the Eastern Cape and one in Limpopo, and the closure of one municipal entity in the Western Cape. The audits of 243 municipalities and 57 municipal entities that submitted financial statements by 31 August 2011 (30 September in the case of consolidated

financial statements¹) were completed within the legislated time frame of three months from receipt by the AGSA of the financial statements.

Arising mainly from non-submission or late submission of financial statements for audit, the audits of 40 (14%) municipalities and three (5%) municipal entities had not been finalised as at 31 January 2012, which is the cut-off date set by the AGSA for inclusion of their audit outcomes in this general report.

The audit outcomes and outstanding audit reports (current and prior year) are summarised in table 2.

Where applicable, audit opinions relate to the consolidated financial statements of auditees. 'With findings' denotes findings on predetermined objectives and/or compliance with laws and regulations.

Table 2: Summary of audit outcomes for current and prior year

Audit outcomes	Municipalities		Municipal entities	
	2010-11	2009-10	2010-11	2009-10
Financially unqualified with no findings	13	7	4	10
Financially unqualified with findings	115	122	41	30
Financially unqualified financial statements	45%	46%	75%	70%
Qualified opinion, with findings	53	61	9	8
Adverse opinion, with findings	7	7	0	0
Disclaimer of opinion, with findings	55	77	3	6
Number of audit reports not issued by 31 January 2012	40	9	3	3
Outstanding audits and financially qualified financial statements	55%	54%	25%	30%
Total number of audits	283	283	60	57

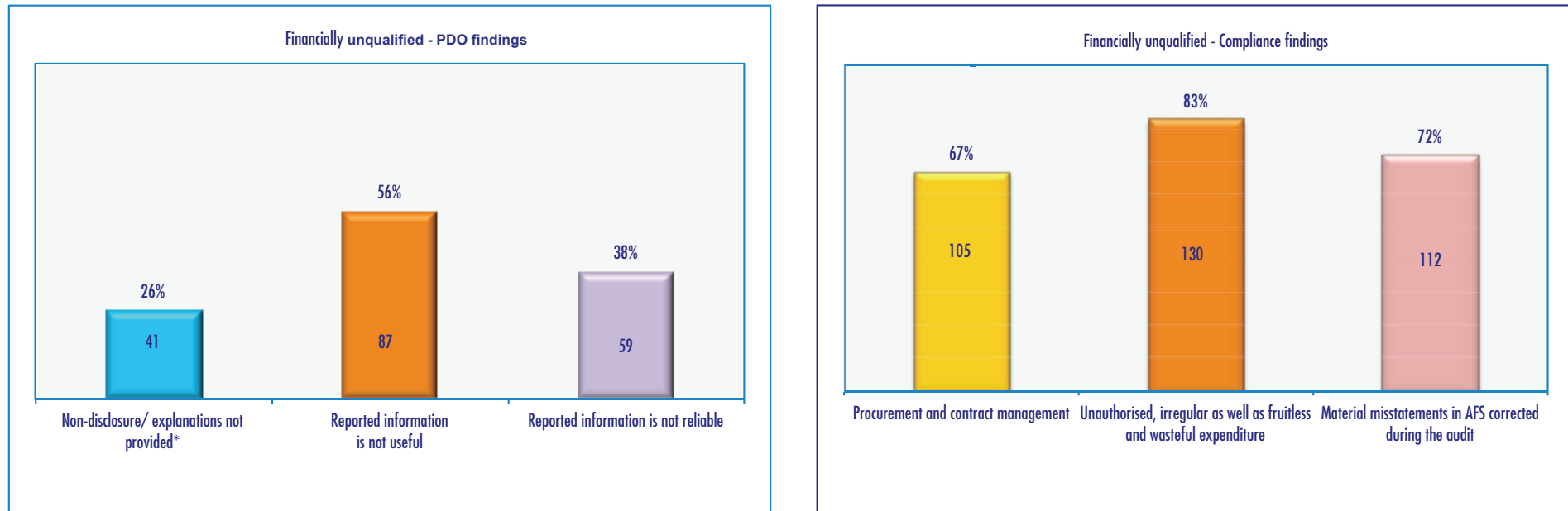
Annexure 1 to this report lists all auditees with their current and prior year audit outcomes.

¹ In the case of 36 auditees, the audit opinion was expressed on the consolidated financial statements of the municipalities concerned and municipal entities under their control.

The urgency of interventions required at auditees whose financial statements were subject to qualified, adverse or disclaimed opinions is apparent.

The following figure gives an indication of the extent of internal control weaknesses still to be addressed by the 156 auditees that received financially unqualified audit reports but with findings on predetermined objectives and/or compliance with laws and regulations.

Figure 1: Extent of remaining challenges faced by auditees that received financially unqualified audit reports with findings



* Measures taken to improve performance not disclosed and reasons for differences between planned and actual service delivery not explained.



2.1.2 Movements in audit outcomes for the year under review

The following two figures analyse the overall movement in local government audit outcomes between the current and previous financial year.

Figure 2: Movements in overall audit outcomes




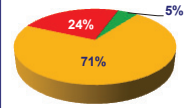


Movements in audit outcomes from 2009-10						
Audit opinion	Improvement	Unchanged	Regressed	New auditees	Total auditees reported on	Outstanding audits prior year opinion
Financially unqualified with no findings	↑ 10	↔ 6		1	17	
Financially unqualified with findings	↑ 25	↔ 120	↓ 9	2	156	3
Qualified, with findings	↑ 17	↔ 28	↓ 17		62	10
Adverse/ Disclaimed, with findings		↔ 52	↓ 12	1	65	18
Total	52	206	38	4	300	43 (31 + 12 outstanding from 2009-10)

Figure 3: Movements in findings on predetermined objectives and compliance with laws and regulations

Type of findings	Movements from 2009-10 in number of auditees with findings				
	Improvement	Unchanged		Regressed	New auditees
		With findings	With no findings		
Reporting on predetermined objectives	↑ 54	↔ 192	↔ 31	↓ 21	2
Compliance with laws and regulations	↑ 16	↔ 251	↔ 7	↓ 23	3

The table below provides a summary of the progress made by provinces towards obtaining clean audit reports. It reflects the specific progress made towards financially unqualified audits – an important but not final milestone towards clean audits.

Table 3: Progress made by provinces towards obtaining clean audit reports for all auditees

Provinces	Summary of movement in audit outcomes	Progress towards financially unqualified	
		Direction of movement from 2009-10 financially unqualified reports	2010-11 results
 Eastern Cape	Clean audit reports: Joe Gqabi Economic Development Agency The province recorded a marginal improvement of 11% towards financially unqualified audit reports. Had there not been eight regressions there would have been a net improvement of 29% in the audit outcomes, which raises concerns regarding sustainability of improvements. Only a small municipal entity with limited transactions, reported on for the first time during the year under review, received a clean audit.	↑ 11%	
 Free State	Clean audit reports: Fezile Dabi District Municipality Trust A dormant trust received the first clean audit report in the Free State. All five district municipalities, one local municipality and one municipal entity received financially unqualified reports with other findings. Three municipalities and two municipal entities were qualified, one local municipality received an adverse opinion and opinions on 12 municipalities (including the metro) and one municipal entity were disclaimed. While four auditees had improved their audit outcomes from the previous year, overall, 73% of municipalities and 50% of municipal entities failed to obtain financially unqualified audit reports. Thirteen municipalities did not move away from a disclaimed or adverse opinion.	↑ 10%	
 Gauteng	Clean audit reports: Johannesburg Civic Theatre and Johannesburg Social Housing Company Overall, there were regressions in the audit outcomes. One municipality that had a clean audit outcome in the previous year regressed to being financially unqualified with findings and three municipalities and five municipal entities regressed. The only improvements came from five municipal entities. Two municipal entities maintained their clean audit outcomes. There were no adverse or disclaimed opinions.	↔ 2%	
 KwaZulu-Natal	Clean audit reports: eMadlageni Municipality, Richmond Municipality, Umdoni Municipality, Umtshezi Municipality and Umzinyathi District Municipality In total, 10 improvements were recorded in KwaZulu-Natal. Five municipalities received clean audit reports. Forty-seven municipalities and seven municipal entities received financially unqualified audit opinions with findings, while seven municipalities received qualified audit opinions. One disclaimer and one adverse opinion were recorded for the province. The province recorded six regressions, of which five municipalities had been financially unqualified in the previous financial year.	↔ 1%	
 Limpopo	Clean audit reports: Fetakgomo Municipality and Waterberg District Municipality Overall there were regressions in the audit outcomes. One municipality managed to sustain its clean audit opinion and one improved to move into this audit category. Two municipalities that had received disclaimers in the prior year improved to qualifications due to the assistance provided by consultants. The audit outcomes of six municipalities and one municipal entity regressed. Seventeen municipalities and one municipal entity maintained their audit opinions. Overall, 82% (2009-10: 69%) of the auditees in Limpopo had modified audit opinions for the year under review.	↓ 13%	






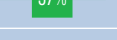
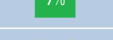




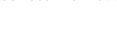
Provinces	Summary of movement in audit outcomes	Progress towards financially unqualified	
		Direction of movement from 2009-10 financially unqualified reports	2010-11 results
 Mpumalanga	<p>Clean audit reports: Ehlanzeni District Municipality, Gert Sibande District Municipality, Steve Tshwete Municipality and Victor Khanye Municipality</p> <p>Overall there was no movement in the number of financially unqualified audit opinions. Four municipalities in the province received clean audit reports. Seven municipalities received unqualified audit opinions with findings while three municipalities received qualified audit opinions. Two of these municipalities improved their audit outcome from a disclaimer of opinion to a qualified opinion. Six municipalities received disclaimers of opinion. Four of these municipalities failed to improve their disclaimer of opinion. Two municipalities regressed from qualified, and financially unqualified with findings respectively, to a disclaimer of opinion.</p>	 0%	
 Northern Cape	<p>None of the 21 municipalities reported on received clean audit reports. Eight (38%) municipalities received unqualified opinions with other findings. Five (24%) municipalities received qualified opinions and eight (38%) municipalities received disclaimers of opinion. Four (19%) municipalities improved and three (14%) regressed. The audit outcomes of 14 (67%) municipalities remained unchanged. Overall, the statistics on audit outcomes reflect that the province has stagnated.</p>	 0%	
 North West	<p>None of the 11 auditees whose audits were finalised before the cut-off of 31 January 2012 for this report, received clean audit reports. As a result of the late submission of financial statements, only 39% (nine municipalities and two municipal entities) of the auditees in the North West are reported on. With respect to previous years, nine audits for 2009-10 and one for 2008-09 remain incomplete. Of the 11 audits that were completed three obtained financially unqualified opinions with other findings, three were qualified and five received a disclaimer of opinion, which were recurring.</p>	 4%	
 Western Cape	<p>Clean audit reports: Swartland Municipality and West Coast District Municipality</p> <p>Two municipalities in the province achieved clean audit outcomes and three others improved to financially unqualified with findings. The metro and one of its municipal entities regressed from clean audit outcomes to financially unqualified with findings. The overall audit outcomes remained unchanged.</p>	 1%	

■ Financially unqualified with no findings
 ■ Financially unqualified with findings
 ■ Financially qualified, adverse or disclaimed with findings

Section 2.1.4 provides details of the provinces' five-year progress towards financially unqualified audit opinions.

Clean audit reports are only issued when financial statements are unqualified and no audit findings have been raised in respect of either reporting on predetermined objectives (PDO) or compliance with laws and regulations. The following table provides a provincial analysis of findings on PDO and compliance with laws and regulations.

Table 4: Provincial analysis of movements in PDO and/or compliance findings

Province	Total number of audits reported on	PDO findings			Compliance findings		
		Number	%	Trend	Number	%	Trend
Eastern Cape	54	40	74%		53	98%	
Free State	27	23	85%		26	96%	
Gauteng	42	22	52%		38	90%	
KwaZulu-Natal	68	39	57%		61	90%	
Limpopo	30	28	93%		28	93%	
Mpumalanga	20	13	65%		15	75%	
Northern Cape	21	20	95%		21	100%	
North West	11	10	91%		11	100%	
Western Cape	27	20	74%		25	93%	

 Reduction in findings  Increase in findings  Reduction/increase less than 5%

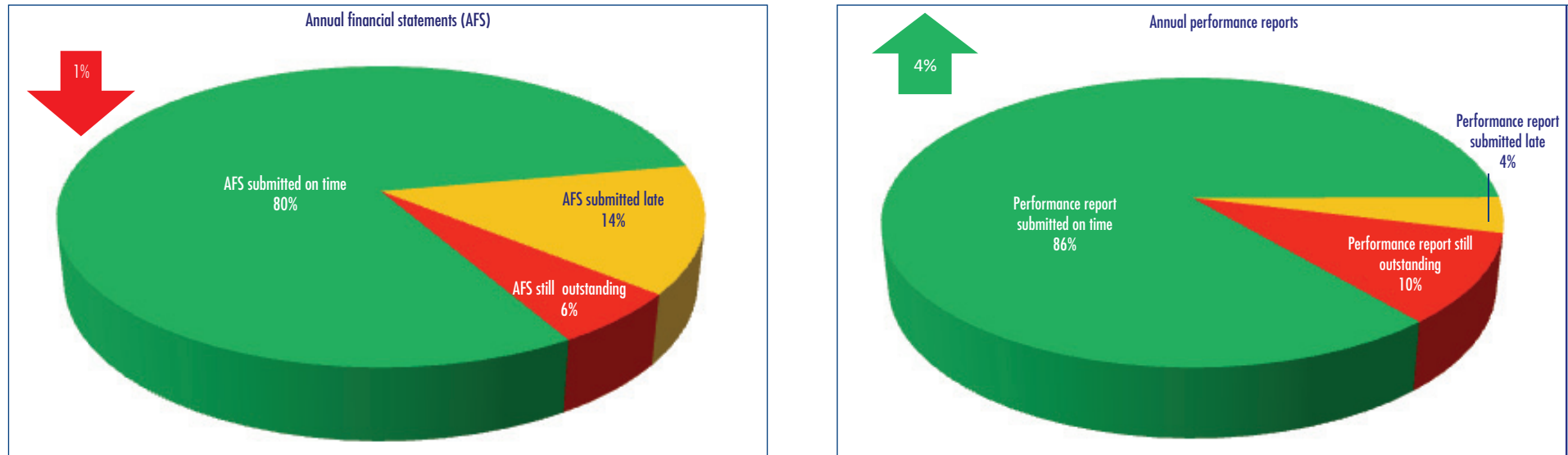
Some provinces have clearly shown that a significant reduction in PDO findings is indeed possible. The reduction in both PDO and compliance findings registered by two of the provinces indicates that the leadership did not limit their focus to findings related to financial statements.

2.1.3 Status and outcomes of audits not finalised by 31 January 2012

As can be seen in the following figure, a total of 74 (20%) auditees were still unable to meet the legal requirement for timely submission of financial statements, with 53 (14%) in the case of performance reports.



Figure 4: Timely submission of financial statements and annual performance reports for audit



Between 31 January 2012, the date set by the AGSA for inclusion of audit outcomes in the general report, and the time of this report, 20 (19 municipalities and one municipal entity) further audits were finalised, but their outcomes are not included in the analysis contained in this report. This reduces the number of audits outstanding in respect of the 2010-11 financial year to 23, of which 21 are municipalities.

The audit outcomes of the 20 audits finalised since 31 January 2012 are depicted below.

Table 5: Outcomes and movements of audits finalised after 31 January 2012

Audit outcomes	Improved	Unchanged	Regressed	Total audits finalised after 31 January 2012
Financially unqualified with findings		2 (WC)		2
Qualified, with findings	1 (WC)	3 (1 LP, 1 NC, 1 NW)		4
Adverse/ Disclaimed, with findings		9 (1 EC, 1 FS, 5 NC, 2 NW)	5 (1 FS, 2 LP, 2 NC)	14
Total	1	14	5	20

The net result of the completion of these audits is that the proportion of financially unqualified audit reports for municipalities increased marginally from 45% (128) to 46% (130).

The following table depicts the reasons for the audits being outstanding at the date of this report. The table further indicates the prior year's audit outcomes of these outstanding audits.

Table 6: Prior outcomes of audits outstanding at the date of this report (applicable provinces)

Province	Number of auditees	Reason not finalised		Audit outcome of audit last finalised				
		AFS not yet received	Late receipt of AFS	Adverse/ Disclaimed	Qualified	Financially unqualified with findings	Financially unqualified with no findings	Audits outstanding
<i>Municipalities</i>								
Free State	1	1		1				
Mpumalanga	1	1		1				
Northern Cape	3	1	2	3				
North West	13	10	3	7	4	2		
Western Cape	3		3	2	1			
<i>Municipal entities</i>								
Free State	1	1			1			
North West	1	1						1
Total	23	15	8	14	6	2	0	1

Three of the outstanding audits in the North West are expected to be finalised by July 2012. The expected date for finalising the audits of 10 auditees that had not submitted their financial statements for audit could not be determined at the date of this report.

No financial statements have been received for the Moretele Development Agency in the North West since its establishment. The audits of three Northern Cape auditees are expected to be finalised after October 2012 due to the late submission.

2.1.4 Five-year progress towards producing unqualified financial statements

The five-year progress of local government towards producing unqualified financial statements is depicted in the following figure, followed by a provincial analysis. The target set by the Department of Cooperative Governance and Traditional Affairs for the 2010-11 financial year, namely no adverse or disclaimed audit opinions



for local government, has not been achieved. It also appears unlikely that the *Operation clean audit 2012* milestone of 60% financially unqualified audit reports will be achieved by all provinces.

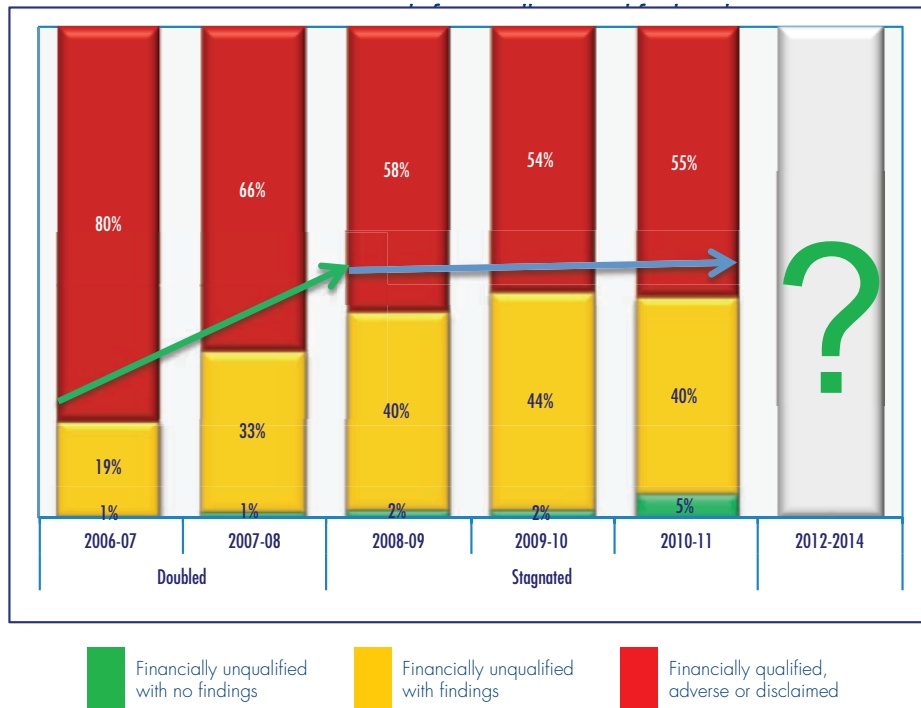
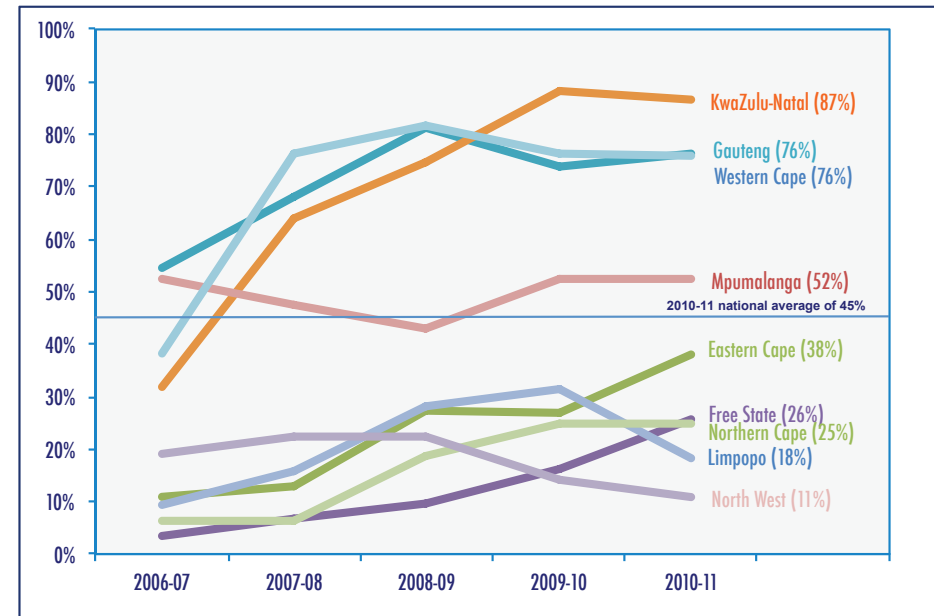


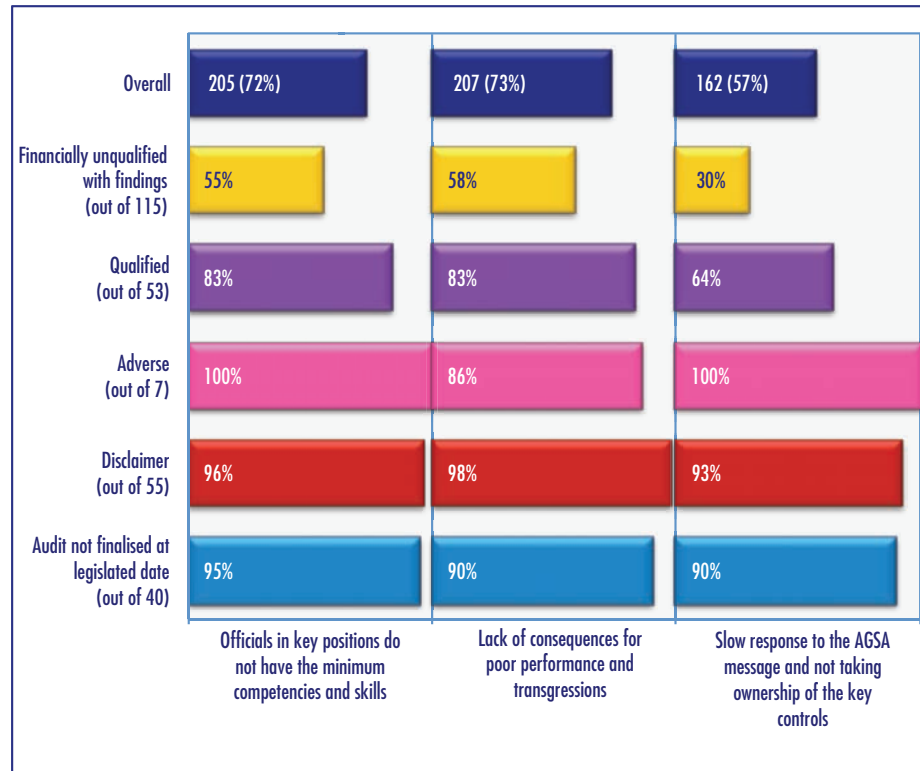
Figure 6: Provinces' five-year progress towards financially unqualified audit opinions



2.1.5 Impact of the most prevalent root causes on the current year's audit outcomes

Our analysis has identified an opportunity to turn around the audit outcomes of local government if (i) key positions are filled with officials who have the required minimum competencies and skills; (ii) there are consequences for officials and political leaders due to unsatisfactory audit outcomes and (iii) mayors and councillors timeously respond to the AGSA's messages and take ownership of the implementation of key controls. The figure below depicts the impact of the most prevalent root causes on the current year's audit outcomes.

Figure 7: Impact of the most prevalent root causes on the current year's audit outcomes (municipalities only)



2.2 Findings arising from the audit of financial statements

After providing the background to the audit of financial statements, this section of the report:

- analyses the quality of financial statements submitted for audit (section 2.2.2)
- analyses trends in disclaimed, adverse or qualified audit opinions (section 2.2.3)
- summarises the nature and causes of financial statement qualifications (section 2.2.4)
- provides details of assistance provided by consultants in connection with the preparation of financial statements (section 2.2.5).

Section 2.2.6 analyses root causes of findings and best practices and recommends measures to address material misstatements (errors and omissions) in financial statements on a sustainable basis.

2.2.1 Background to the audit of financial statements of municipalities and municipal entities

- The purpose of financial statements is to present the users with information on the state of financial affairs of the municipalities and municipal entities controlled by them. Financial statements also disclose information required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) to enhance transparency and accountability. This includes the extent of unauthorised, irregular as well as fruitless and wasteful expenditure incurred by auditees.
- In order for the information in the financial statements to be relevant, reliable, comparable and understandable, all auditees are required to prepare their financial statements in accordance with the *Standards of generally recognised accounting practice* (GRAP).
- The purpose of the annual audit of the financial statements is to provide the users with an opinion on whether the financial statements fairly present, in all material respects, the financial position (statement of financial position) and results of an auditee's operations (statement of financial results) and



cash flows for the period in accordance with GRAP and the requirements of the MFMA. The audit provides the users with assurance on the degree to which the financial statements are reliable and credible.

2.2.2 Quality of the financial statements submitted for audit

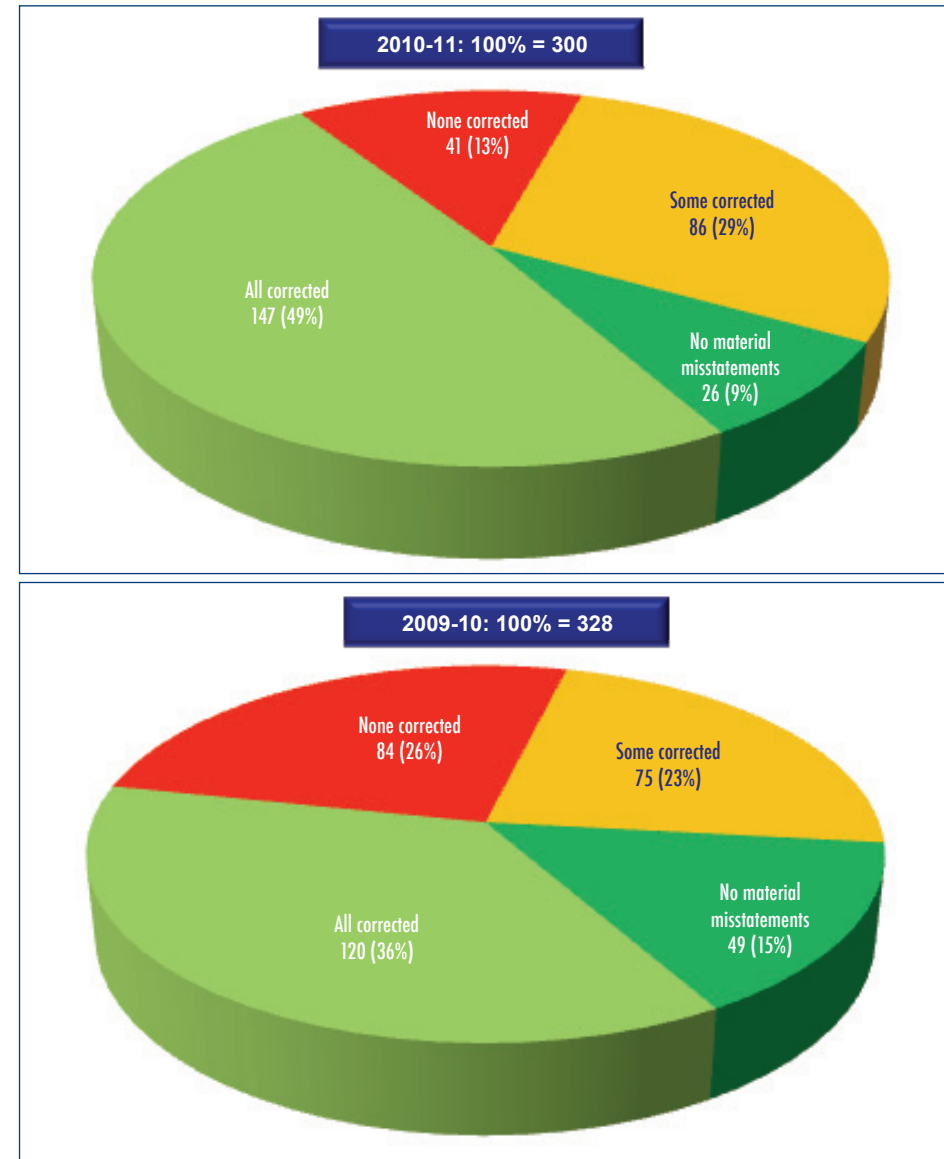
As in prior years, many auditees submitted financial statements that contained material misstatements in one or more areas. Only 26 (9%) auditees submitted financial statements that required no material adjustments, compared to 49 (15%) auditees in the prior year.

- One hundred and forty-seven (49%) auditees were able to achieve a financially unqualified audit outcome because they used the opportunity provided by the AGSA to correct all misstatements identified during the audit.
- Some auditees were not willing and/or able to correct all the misstatements and therefore could not avoid the qualification of their financial statements.

The non- or partial correction by auditees of misstatements was primarily due to the unavailability of information or documentation required to determine the correct amounts that should be reflected in the financial statements.

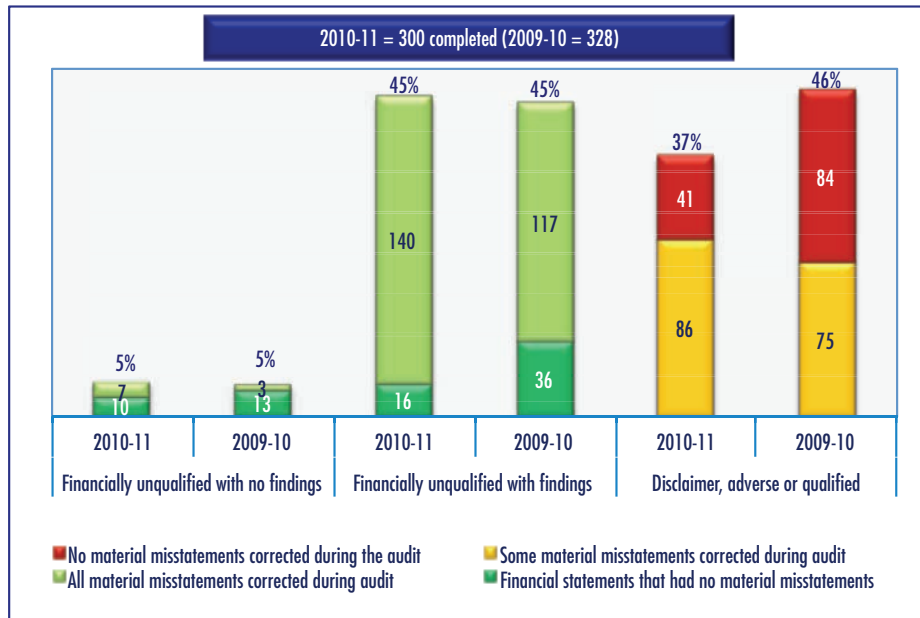
The extent of material misstatements in financial statements submitted for audit for the year under review is depicted in the following figure.

Figure 8: Material misstatements in financial statements submitted for audit



Disclaimed, adverse or qualified audit opinions resulted from misstatements that were either not corrected or only partially corrected in the financial statements of 127 (37%) auditees, as depicted in the following figure.

Figure 9: The effects on audit outcomes of management correcting material misstatements in financial statements during the audit



- A history of material adjustments (excluding adjustments for unauthorised, irregular or fruitless and wasteful expenditure) made during each annual audit in areas that do not require significant technical interpretation of the accounting standards or difficult estimations, resulted in non-compliance with the MFMA being reported in the audit reports of 231 (77%) auditees. Section 2.4 provides further details.
- The fact that auditees were able to make these material adjustments during the audit points to a situation where financial statements are being submitted simply to meet the legislated deadline, while auditees continue to rely on the audit process to identify material errors and omissions in the financial statements.

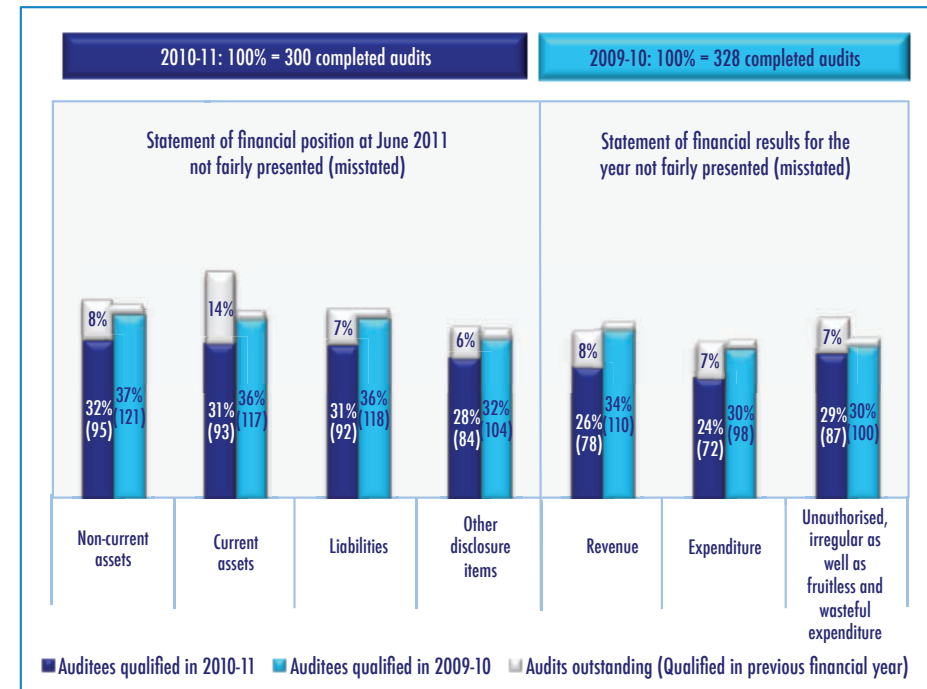
- Reliance on the auditors to identify corrections to be made to the financial statements in order to obtain an unqualified audit opinion is not a practice that should be encouraged and these unqualified opinions may therefore not be sustainable.

2.2.3 Disclaimed, adverse or qualified audit opinions for the year under review

The following figure depicts the areas that were materially misstated (i.e. 'incorrect') in the financial statements of the 127 auditees (2009-10: 159) that received disclaimed, adverse or qualified audit opinions.

In order to avoid a possible distortion in the comparative figures, the prevalence of previous qualifications in audits outstanding is also depicted. The overall lack of progress in remedying the defects of the prior year's financial statements is evident.

Figure 10: Transversal areas of financial statement qualifications





The table that follows further depicts the progress made by auditees, or lack thereof, in addressing their financial statement qualifications of the prior year. Only completed audits are depicted.

Table 7: Progress made by auditees in addressing financial statement qualifications of the prior year

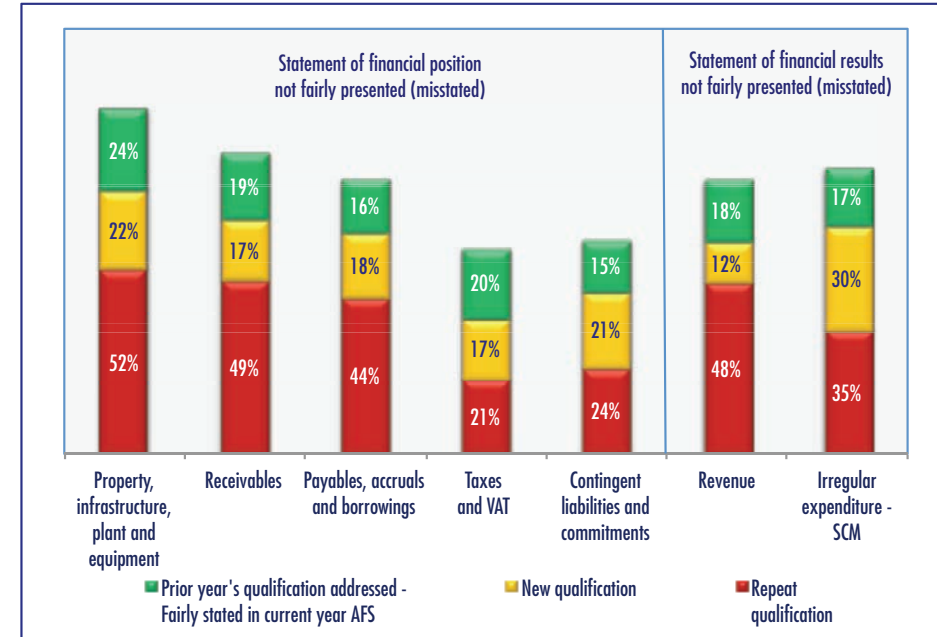
Current year's movement	Areas of financial statement qualifications						
	Statement of financial position				Statement of financial results		
	Non-current assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I, F & W expenditure
Repeat qualifications	68	69	70	56	62	54	58
New qualifications	27	24	22	28	16	18	29
Misstated in 2010-11 AFS	32%	31%	31%	28%	26%	24%	29%
Qualifications addressed	29	25	26	29	25	22	21
No prior year findings	176	182	182	187	197	206	192
Fairly stated in 2010-11 AFS	68%	69%	69%	72%	74%	76%	71%

As is evident from the above table, little overall progress had been made in addressing areas of financial statement qualifications for the prior year. New qualifications indicate that accounting processes and procedures had not been fully embedded at some auditees at the previous financial year-end.

2.2.4 Nature and causes of financial statement qualifications

Depicted next are movements in the most prevalent detailed areas of qualification. At this detailed level the overall lack of progress is also evident.

Figure 11: Most prevalent detailed areas of financial statement qualification






The tables that follow provide additional detail on the account balances most commonly misstated in the financial statements of completed audits and the reasons for these qualifications.



Non-current assets Qualification area	2010-11	Movement from prior year	2009-10
Property, infrastructure, plant and equipment	31%	← -3% →	34%
Investment property	14%	← 3% →	11%




Non-current assets remained a major area in which the financial statements of 95 (32%) auditees [2009-10: 121 (37%)] were qualified. Common reasons for the qualifications included the following:

- The residual values and useful lives of non-current assets were not reviewed and adjusted in auditees' financial statements where necessary in accordance with GRAP 17, *Property, plant and equipment*.
- The carrying value of non-current assets was not correctly accounted for in accordance with GRAP 17, *Property, plant and equipment* following the expiry of the transitional provisions in this regard.
- Supporting documentation was unavailable to substantiate the values at which assets were recorded in financial statements.
- Fixed asset registers were incomplete and not updated with acquisitions, disposals or scrappings, which resulted in the inability to confirm the existence, completeness and valuation of the assets recorded in the financial statements.

Current assets Qualification area	2010-11	Movement from prior year	2009-10
Receivables	28%		30%
Cash and cash equivalents	11%		16%
Inventory	11%		12%



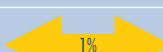
The number of municipalities whose financial statements were qualified in this area decreased from 117 (36%) in 2009-10 to 93 (31%) in 2010-11. Common reasons for the qualifications included the following:

- Sufficient appropriate evidence to substantiate the assets recorded was not available.
- Reconciliations of the supporting ledgers to the financial statements were not performed.
- Adequate information was not available to enable an assessment of the recoverability of receivables.

Liabilities Qualification area	2010-11	Movement from prior year	2009-10
Payables, accruals and borrowings	26%		27%
Taxes and VAT	16%		18%
Provisions and guarantees	13%		15%

The financial statements of 92 (31%) auditees were qualified [2009-10: 118 (36%)] in the area of liabilities. Common reasons for the qualifications included the following:

- Sufficient appropriate evidence to substantiate recorded liabilities was not available.
- Reconciliations of the supporting ledgers to the financial statements were not performed.
- VAT principles were applied incorrectly and there were material unexplained differences between the VAT transactions accounted for and the information furnished to the South African Revenue Service.

Other disclosure items Qualification area	2010-11	Movement from prior year	2009-10
Contingent liabilities and commitments	19%		18%
Cash flow statement	14%		14%
Other disclosures	13%		12%

The 84 (28%) auditees [2009-10: 104 (32%)] whose financial statements were qualified in this area constitute a minor decrease. Common reasons for the qualifications included the following:

- Cash flow statements were not presented in accordance with GRAP 2, *Cash flow statements*.
- Liabilities were not valued and recognised in accordance with GRAP 19, *Provisions, contingent liabilities and contingent assets* and IAS 19, *Employee benefits, especially with regard to rehabilitation of landfill sites, leave entitlement and post-retirement benefits*.



Revenue Qualification area	2010-11	Movement from prior year	2009-10
Revenue	25%		29%
Revenue - Transfer payments and grants	7%		8%

Seventy-eight (26%) auditees were qualified [2009-10: 110 (34%)] in the area of revenue. Common reasons for the qualifications included the following:

- Some auditees did not have adequate systems to ensure that all revenue was recorded. For example, electricity and water meter readings were not recorded for all applicable properties.
- Sufficient appropriate evidence to support recorded revenue was not available.

Expenditure Qualification area	2010-11	Movement from prior year	2009-10
Expenditure	21%		24%
Employee cost	13%		16%
Expenditure - Transfer payments and grants	6%		5%

The number of auditees qualified in the area of expenditure decreased from 98 (30%) in 2009-10 to 72 (24%) for the 2010-11 financial year. Common reasons for the qualifications included the following:

- Audit evidence could not be obtained regarding the occurrence and accuracy of overtime payments.
- Leave captured on the systems could not be substantiated by adequate supporting documentation.
- Suspense accounts were not reconciled and cleared.
- Integration differences between salary sub-systems and the general ledger were not followed up.

Unauthorised, irregular as well as fruitless and wasteful expenditure Qualification area	2010-11	Movement from prior year	2009-10
Irregular expenditure - SCM related	27%		12%
Unauthorised expenditure	11%		26%
Fruitless and wasteful expenditure	9%		15%

In the financial statements of 87 (29%) auditees [2009-10: 100 (30%)], the disclosed unauthorised, irregular, and fruitless and wasteful expenditure was misstated. The common reason for such misstatement is that auditees identify these types of expenditure during the audit after the financial statements have been submitted. The amounts identified are then not disclosed, either because the full extent of the misstatement cannot be determined or because auditees are unwilling to make the disclosure.

Annexure 1 to this report lists the audit outcomes of all auditees, indicating their financial statement qualification areas.

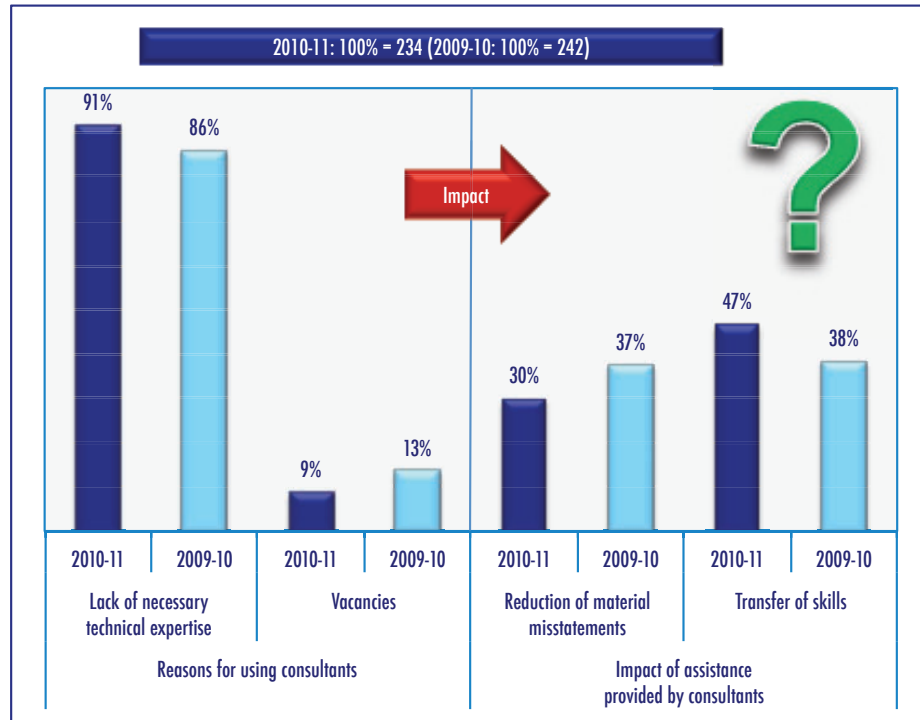
2.2.5 Financial statement-related assistance provided by consultants

As in previous financial years, auditees continued to engage consultants to assist them with accounting-related services and the preparation of year-end financial statements. Of the 343 auditees analysed, 234 (68 %) were assisted by consultants compared to 74% in 2009-10. Based on the available information, the cost to auditees of consultants/consultancies is estimated to have exceeded R295 million (2009-10: R237 million) for the 2010-11 financial year, i.e. an average in excess of R1,2 million per auditee. This excludes amounts spent by the National Treasury and provincial treasuries and the Department of Cooperative Governance and Traditional Affairs on consultants assigned to assist municipalities.

The following figure depicts the most common reasons why consultants were engaged and the impact of their assistance, as a percentage of the auditees that used consultants. Vacancies in financial staff posts where assistance was sought varied from zero to 15% in the various provinces. The reported extent of skills transfer from consultants to municipal staff could not be independently verified, and

therefore the reduction in reliance on consultants during future financial statement preparations could also not be forecast.

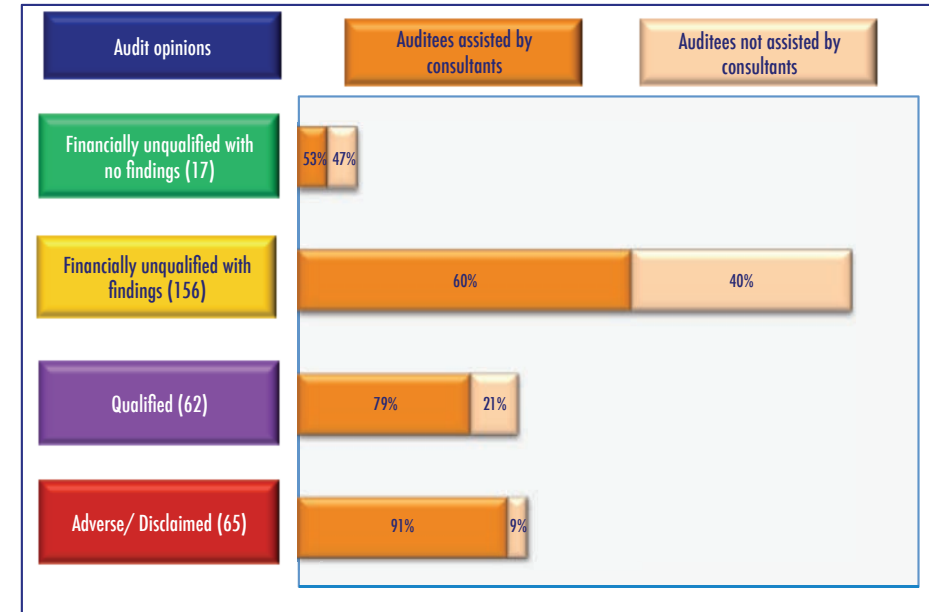
Figure 12: Analysis of assistance provided by consultants



The reduction in material misstatements relates to account balances or amounts and not to financial statements as a whole. Consultants were therefore able to correct parts of the financial statements that had been misstated in the previous financial year, but were unable to ensure that auditees progressed towards financially unqualified audit opinions.

Not all improvements in audit outcomes (or lack of improvement) can be directly attributed to the use of consultants, as the contracted scope of work varies from one auditee to the next. The audit outcomes of auditees where consultants were used are depicted in the following figure.

Figure 13: Audit outcomes of auditees where consultants were used



An analysis of the use of consultants and their impact on the current year's audit outcomes resulted in the following conclusions:

- No vacancies existed in the finance departments of 9% of the auditees that had enlisted the assistance of consultants. This indicates that although vacant posts are filled, the skills of the incumbents are not adequate to perform the duties for which they were employed.
- The skills level and experience of staff appointed in the finance department, especially with regard to the compilation of financial statements that comply with GRAP, are not adequate.
- Consultants are often appointed close to year-end and the data used by or provided to consultants to prepare the financial statements is often not reliable.
- Deficiencies in record keeping and the absence of processing and reconciliation controls will continue to limit the ability of consultants to assist with the preparation of financial statements that meet the standards of GRAP.



Given the above, there are concerns regarding the ability of auditees to obtain financially unqualified audit opinions in future audits if not assisted by consultants.

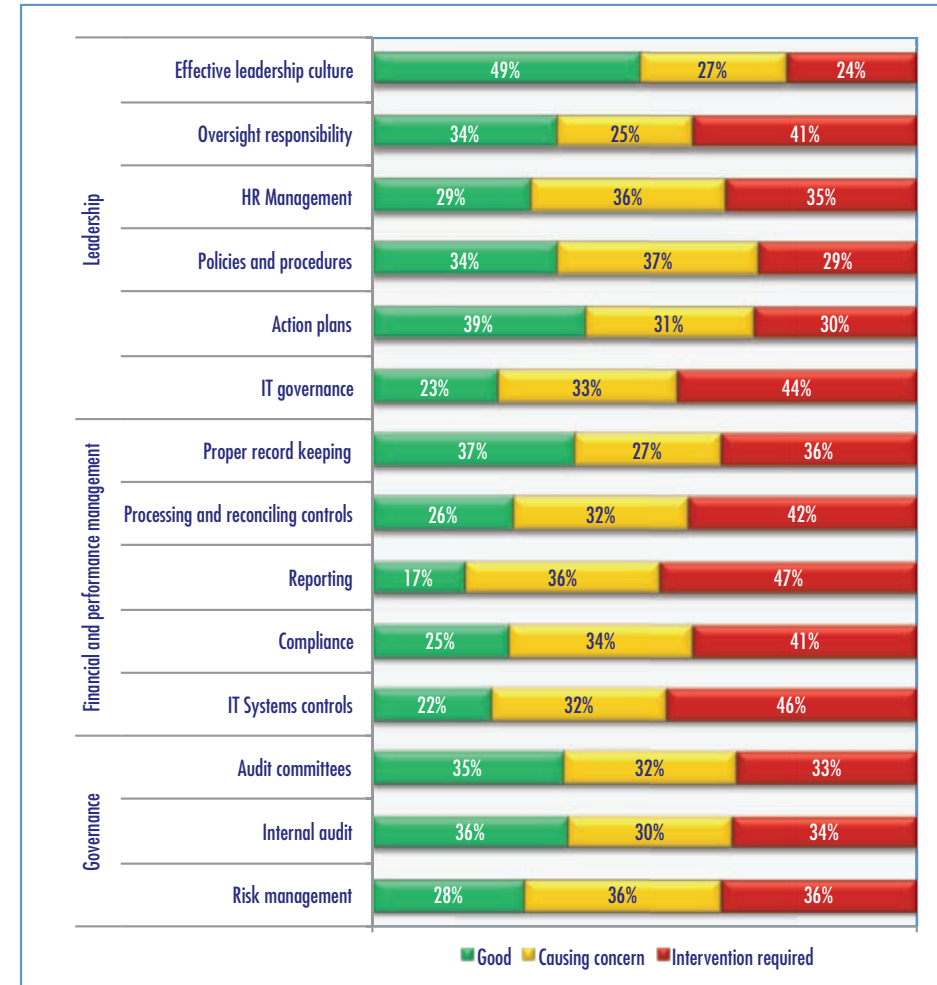
Auditees should have a strategy to ensure that skills are transferred to municipal staff. Contracts with consultants should include specific skills transfer clauses and not be limited to assistance in correcting financial statements.

2.2.6 Root causes and best practice recommendations

The ability of auditees to produce financial statements that are free from material misstatement is influenced by the existence of a sound system of internal control. The key drivers of these controls are classified under the fundamental principles of (i) leadership; (ii) financial and performance management and (iii) governance. More information on the specific drivers of internal control, together with recommendations, is provided in section 4 of this report.

The figure that follows indicates where deficiencies in the internal controls are prevalent. After that, broad areas requiring attention from municipal leadership and ways to address these deficiencies are outlined.

Figure 14: Assessment of key drivers of internal control over financial reporting



This assessment signifies that insufficient action has been taken to implement the fundamental principles of internal control. Identified root causes and good practices, together with the recommended way forward, are summarised as follows:

Aspect	Identified root causes and way forward
Information and processes relied on by leadership	<p>The leadership, which includes the councillors and mayors, had not demonstrated a sufficient understanding of their oversight functions and had not satisfied themselves that processes were implemented to ensure that reported information was credible and reliable.</p> <p><u>Way forward</u></p> <ul style="list-style-type: none"> Executive mayors and councils should insist on receiving monthly financial statements. They should ensure that proper accounting records are being kept, that all transactions are timeously processed throughout the financial year and that key reconciliations are periodically prepared and the accuracy of information is independently verified. Leadership should demonstrate willingness and determination to accept accountability for audit outcomes and should establish standards of work that are understood by all staff and are monitored, while deviations are timeously addressed.
Limitations of information systems used by auditees	<p>Many of the systems do not have the functionality to produce the information required to prepare GRAP-compliant financial statements.</p> <p><u>Way forward</u></p> <p>This limitation should be addressed through modifications made by vendors or auditees acquiring new/supplementary systems in order to provide the data in the required format and detail.</p>
Performance management and skills acquisition	<ul style="list-style-type: none"> There seems to be a lack of willingness and determination to address the deficiencies identified by the auditors. The impact of assistance provided by consultants, given the relatively small reduction in material misstatements in financial statements submitted for audit and the low rate of skills transfer, raises concerns regarding the sustainability of any improved audit outcomes achieved this year. <p><u>Way forward</u></p> <ul style="list-style-type: none"> The leadership should assess the essential skills required and ensure that competent personnel are employed to perform the required activities. A system of performance assessment that includes consequences due to non-performance should be developed. Policies and procedures should be implemented which reflect expectations and hold individuals accountable. This should include incentives and rewards for good performance. The over-reliance on consultants is not cost-effective in the long term and a deliberate strategy is required to ensure that skills are transferred to the municipal staff.
Commitment to obtain financially unqualified audit opinions	<p>Daily and monthly accounting and reconciling routines are absent at many auditees and it appears as if a qualified audit opinion on the financial statements has become acceptable to the leadership as being the norm.</p> <p><u>Way forward</u></p> <p>Leadership should satisfy themselves that qualifications raised in audit reports receive sufficient attention and that specific target dates set for their resolution are met.</p>

Aspect	Identified root causes and way forward
Monitoring by audit committees and internal audit	The internal control monitoring mechanisms of the audit committee and internal audit are not functioning optimally, as many control weaknesses are only uncovered during the audit of the financial statements.
	<p><u>Way forward</u></p> <ul style="list-style-type: none"> Ongoing evaluations and monitoring should be performed to ensure that controls are in place and functioning. Any deficiencies identified should be communicated to the relevant parties, while commitments to address these should be time bound and include specific responsibilities.

2.3 Findings arising from the audit of reporting against predetermined objectives

The Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) requires auditors of public sector entities to audit annually the reported information relating to the performance of the auditees against their PDOs.

This section of the general report presents findings arising from the audits as follows:

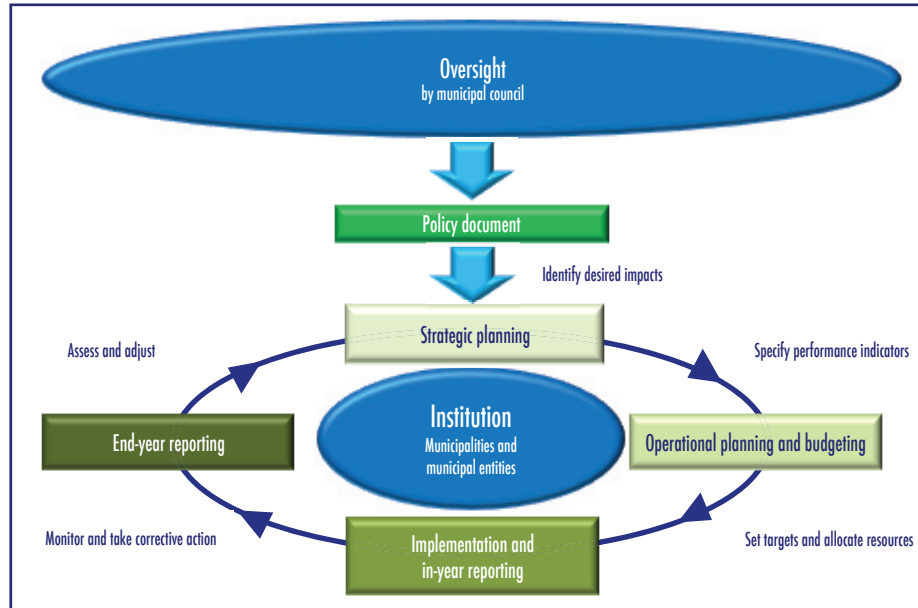
- The background to performance information and PDOs and the approach followed in the auditing thereof are included in sections 2.3.1 and 2.3.2 below.
- The outcomes of these audits are presented and analysed in sections 2.3.3 and 2.3.4.
- Section 2.3.5 assesses the drivers of internal control at auditees as they relate to reporting against PDOs and presents the root causes of the findings and the way forward.

2.3.1 Background to performance information and PDOs

Performance information is essential to inform the public and oversight bodies as to whether municipalities and their municipal entities are delivering services to communities. Performance should be compared against strategic plans and budgets to alert those charged with governance to areas where corrective action is required. Further, performance information facilitates effective accountability, enabling legislators, members of the public and other interested parties to track progress, identify the scope for improvement in service delivery and better understand issues in this regard. The planning, budgeting and reporting cycle for local government is depicted in the figure below.



Figure 15: The planning, budgeting and reporting cycle



Performance information indicates how well government institutions are performing against strategic objectives. In the case of local government, strategic objectives indicate what a municipality and its municipal entities intend to deliver in terms of services to fulfil their legislated mandate.

In terms of legislation, the strategy of a municipality and its municipal entities should be included in a five-year integrated development plan (IDP). The annual performance indicators and targets that a municipality and its municipal entities aim to achieve in pursuit of the strategic objectives in the IDP are included in the annual service delivery and budget improvement plan (SDBIP). Performance indicators and targets are used to track and measure performance in relation to the strategic objectives. Legislation further requires municipalities and their municipal entities to report against their PDOs (service delivery) and to submit such annual performance reports for auditing, together with the annual financial statements. Key elements of the legislative requirements are depicted below.

Figure 16: Legislative requirements relating to planning, budgeting assessment and performance management

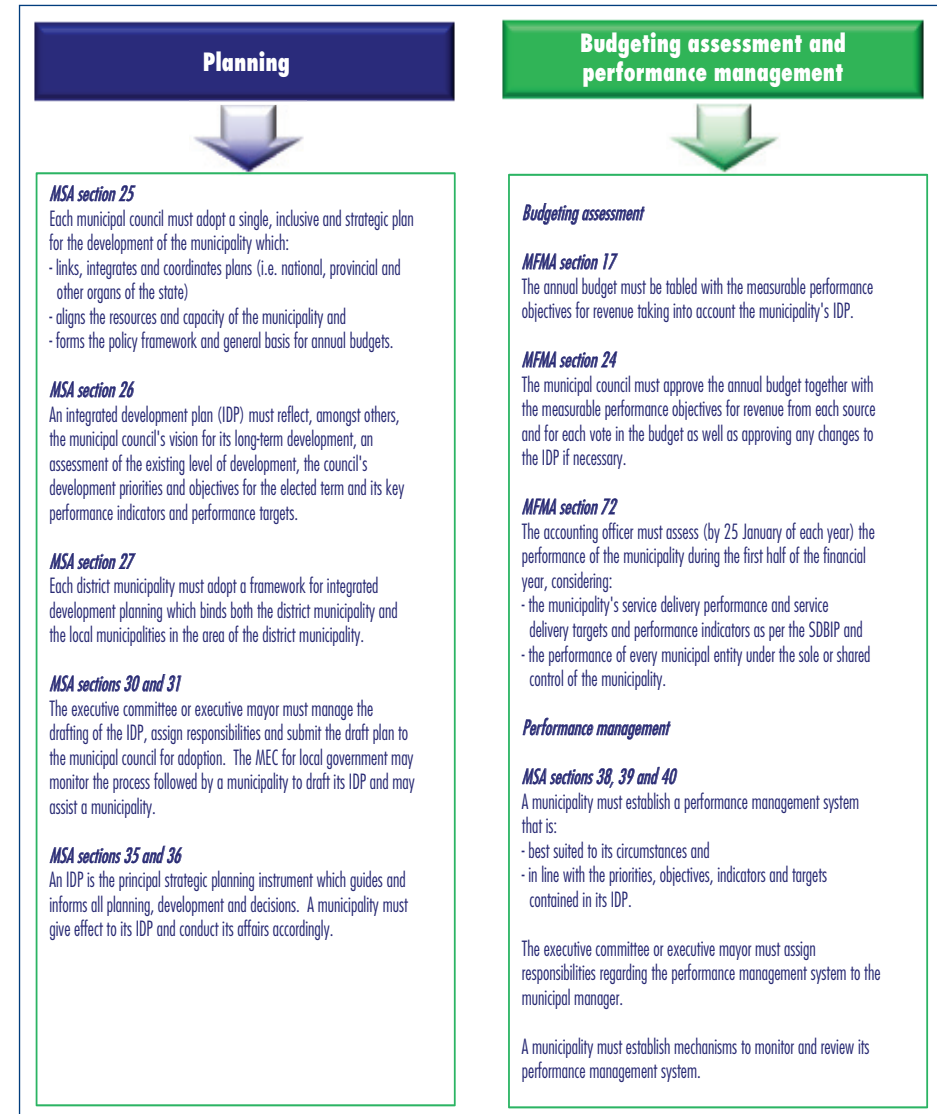
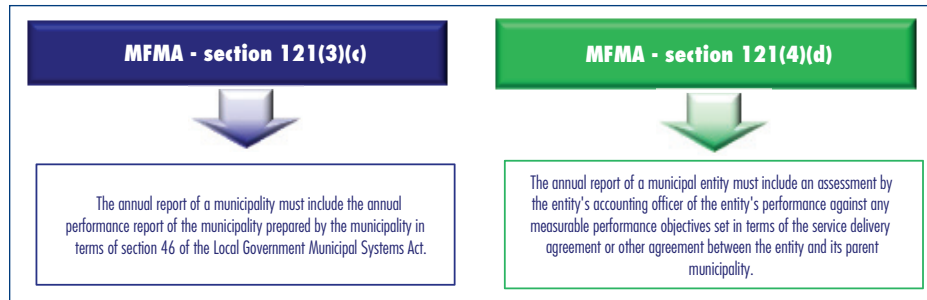


Figure 17: Legislative requirements relating to performance (service delivery) reporting



2.3.2 Overview of the AGSA's approach to the audit of predetermined objectives

The audit of PDOs is defined as an annual audit of reported actual performance against predetermined objectives. This is executed as an integral part of the annual regularity audit, confirming compliance with applicable laws and regulations as well as the usefulness and reliability of the reported performance information as published in the annual performance reports of municipalities and their municipal entities.

The AGSA has been gradually phasing in the audit of PDOs since the 2005-06 financial year, explaining to leaders within all spheres of government the importance of lending credibility to published service delivery information by auditing it. Since the 2009-10 financial year, a separate audit conclusion, based on the results of the audit of PDOs, has been included in the management report. However, these conclusions have not yet been elevated to the level of the audit report.

PDO findings are classified under the main audit areas of usefulness and reliability.

Usefulness	The audit focused on whether there was consistency of objectives, indicators and targets between planning and reporting documents, and whether indicators/ measures related logically and directly to an aspect of the institution's mandate and the realisation of strategic goals and objectives. Auditing further focused on whether indicators and targets were measurable (i.e. that targets were specific, measurable and time bound and indicators/measures were well defined and verifiable).
Reliability	Audit work focused on reliability, where source documentation relevant to reported performance was assessed to determine whether it adequately reflected the facts (i.e. whether it was valid, accurate and complete).

2.3.3 Summary and movements in the number of auditees with findings arising from the audit of PDOs

As depicted in the following figure, the provinces where the number of auditees with PDO findings had increased are Limpopo and the Northern Cape. All other provinces showed a reduction except for Gauteng, which had the same population of auditees with findings as for the 2009-10 financial year.

Movements in the number of auditees with findings on their reporting against PDOs for the financial year ended June 2011 are depicted in the figure below, followed by a provincial analysis.



Figure 18: Overall movements in number of auditees with findings on predetermined objectives [300 auditees reported on (2009-10: 328)]

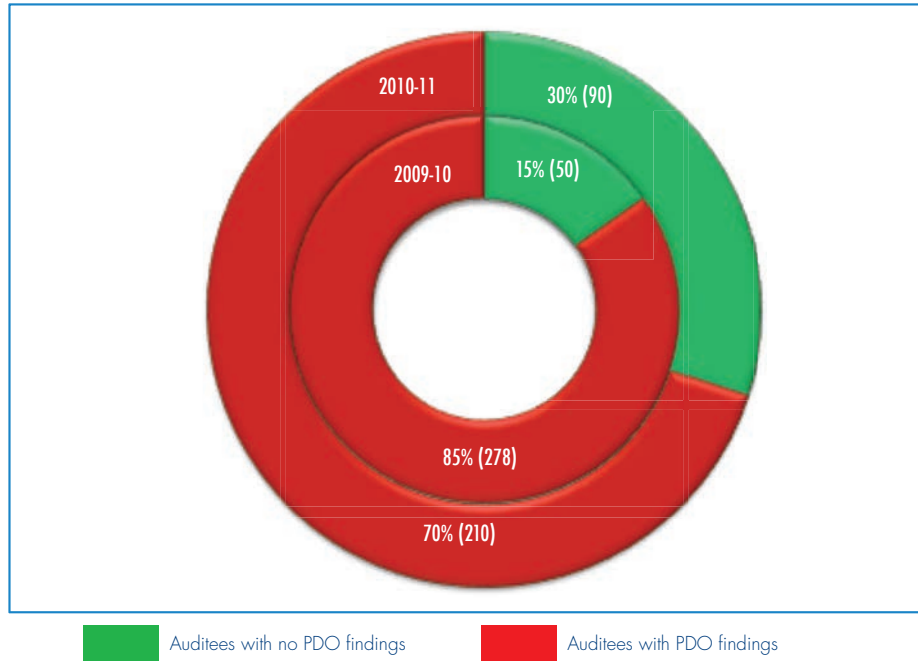


Table 8: Provincial trends of number of auditees with PDO findings

Movement from prior year	↑ 20%	↑ 15%	↔ 2%
2010-11	74%	85%	45%
	Eastern Cape	Free State	Gauteng
Movement from prior year	↑ 37%	↓ 12%	↑ 16%
2010-11	57%	90%	65%
	KwaZulu-Natal	Limpopo	Mpumalanga
Movement from prior year	↓ 6%	↑ 9%	↑ 14%
2010-11	90%	91%	74%
	Northern Cape	North West	Western Cape

Legend:
↑ Improved
↔ Less than 5% change
↓ Regressed

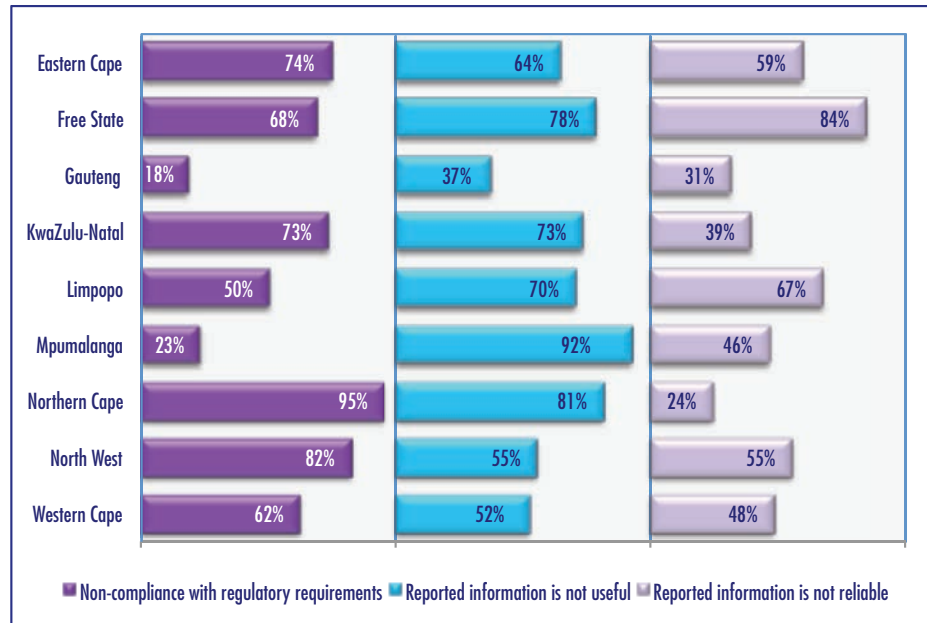
Progress, or the lack thereof, by auditees in addressing prior year findings on PDOs is depicted in the following figure.

Figure 19: Overall trends in findings on reporting on PDOs



A provincial analysis of the findings categories is presented in the following figure.

Figure 20: Provincial analysis of the number of auditees with findings on reporting against PDOs



2.3.4 Detailed analysis of findings relating to PDOs

Findings relating to auditees' reporting against PDOs are analysed below. The percentages reflect those auditees with findings arising from the audit of performance against PDOs, based on the total number of audits completed by 31 January 2012.

Details of specific findings are as follows:

Annual performance report not received in time for audit purposes

Auditees are required to submit their performance report for auditing by 31 August annually. Twenty-six (11%) municipalities and nine (16%) municipal entities did not submit their reports in time for audit.

Fifty-two per cent of auditees in the Northern Cape did not submit their performance information for auditing. The non-submission rate for all other provinces is below 10% except for the Free State (20%), KwaZulu-Natal (10%), Limpopo (13%) and Mpumalanga (15%).

Non-compliance with legislation

The legislative requirements as detailed in section 2.3.1 were not complied with by all auditees. The most prevalent finding was the lack of adoption and implementation of a performance management system at 37% of auditees. There were no mid-year budget and performance assessments at 30% of auditees and 20% of auditees did not report in their annual performance report on performance against predetermined objectives, indicators and targets. Thirty per cent of municipalities did not disclose in the annual performance report the measures taken to improve performance. Of great concern is that a performance audit committee was not in place at 27% of auditees and at 20% their performance audit committee did not function in the manner prescribed in legislation. Further to this, internal audit at 37% of auditees did not audit performance measures.

Usefulness of reported information

The usefulness of reported information is measured against the criteria of relevance and measurability. The most prevalent finding on consistency was that the reported information of 46% of auditees was not consistent with planned objectives, indicators and targets. In terms of measurability, planned performance targets were



not specific (32%), measurable (21%) and time bound (26%). At 33% of auditees it was also found that the planned indicators/measures were not well defined.

Reliability of reported information

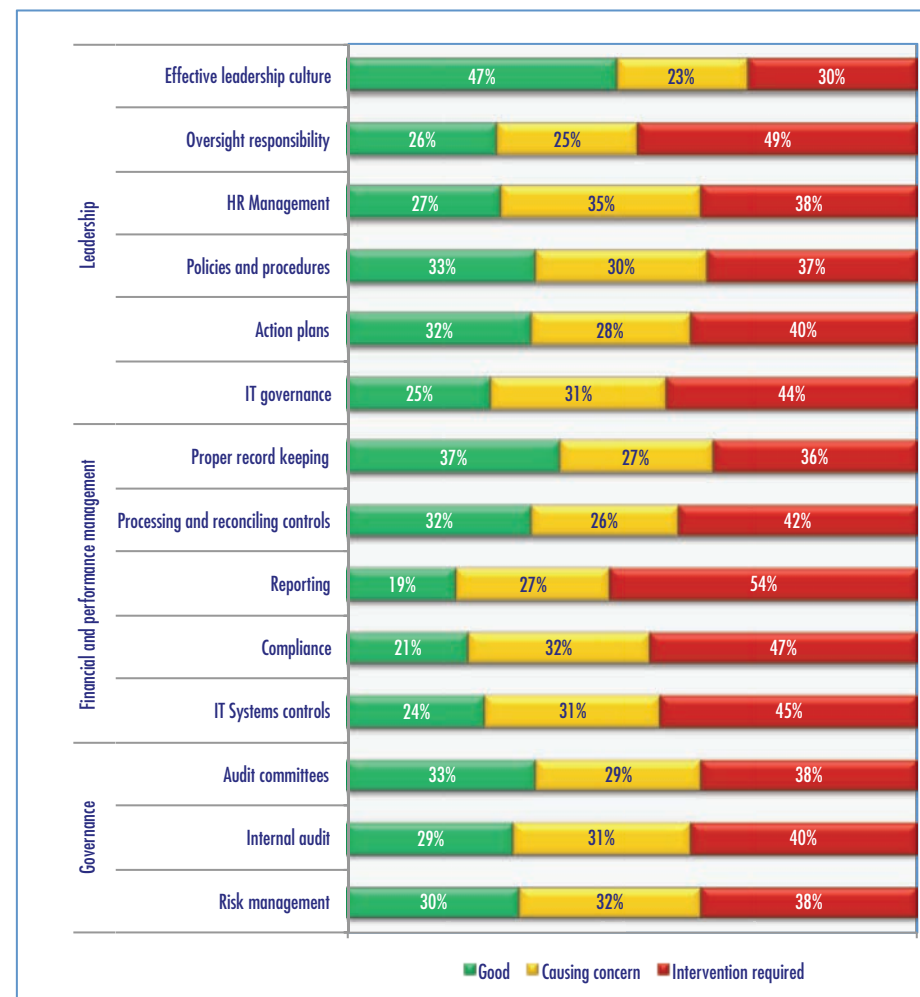
The reliability of the information in the annual performance report was tested to assess its validity, accuracy and completeness. The most prevalent findings were that the information was not complete (39%) and at 24% of auditees there was no supporting documentation.

2.3.5 Root causes and best practice recommendations

The ability of auditees to meet the legislated requirements and satisfy the prescribed criteria related to reporting on PDOs (service delivery) is influenced by the existence of a sound system of internal control. The key drivers of these controls are classified under the fundamental principles of (i) leadership; (ii) financial and performance management and (iii) governance. More information on the specific drivers of internal control, together with recommendations, is provided in section 4 of this report.

The figure below shows where there were deficiencies in the internal controls over performance information. After that broad areas requiring attention from municipal leadership and ways to address these deficiencies are outlined.

Figure 21: Assessment of drivers of internal control – reporting against PDOs



The best practices implemented by those municipalities that did not have findings included preparing regular performance reports that were subjected to credibility assessments by the audit committee and internal audit unit; implementing the

recommendations of these governance structures and holding officials accountable for the quality of their performance reports.

Reporting against PDOs remains one of the challenges in achieving clean audit opinions. A total of 210 (70%) auditees had findings on PDOs and as the AGSA will be expressing an audit opinion in the near future, auditees need to ensure that adequate performance reporting systems are in place and that staff have the necessary skills and training to report sufficiently against PDOs. Another important matter to attend to is the lack of effective record or document management systems that generate corroborating evidence for actual performance reported. The main weaknesses in reporting against PDOs relate to the usefulness and reliability of information.

This assessment reveals that insufficient action had been taken to implement the fundamental principles of internal control. Identified root causes and good practices, together with the way forward, are summarised as follows.

Aspect	Identified root causes and way forward
<p>Formal planning for service delivery and performance reporting</p>	<p>Councillors, mayors and municipal managers have not demonstrated a proper understanding of their responsibility relating to service delivery planning, measuring and reporting, while reporting on performance is still viewed only as a year-end reporting requirement that must be satisfied.</p> <p>Instances still occur where annual performance reports are completed merely for compliance purposes, while the council does not obtain the necessary assurance that these reports are credible. Mid-year budget and performance assessments are not performed, or the results of such assessments are not reported to relevant parties.</p> <p>Many auditees' organisational structures have not been aligned to meet the requirements of PDO reporting, and auditees are not staffed with appropriately skilled personnel, resulting in a lack of capacity for key activities that include the following:</p> <ul style="list-style-type: none"> • Preparation of planning documents which contain useful performance measures that can be measured. • Design and implementation of systems and processes to collect, summarise and collate information about actual performance. • Preparation of accurate performance reports and monitoring of reported performance. <p><u>Way forward:</u></p> <ul style="list-style-type: none"> • Organisational structures should be aligned to ensure adequate performance planning, management and reporting. • Adequate capacity should be established within IDP offices with the required budgetary allocation.



Aspect	Identified root causes and way forward
Systems and processes	<p>Many auditees lack manual or computerised systems and processes to ensure that actual reported performance is reconciled to supporting documentation and reviewed and approved by designated officials. Also absent are internal policies and procedures for determining objectives, indicators and targets and reporting against them.</p> <p><u>Way forward:</u></p> <ul style="list-style-type: none"> The requirements of performance management systems should be properly documented and communicated, including the roles and responsibilities of officials who collect, collate, compile, file, review and report PDO information. Performance management systems should be reviewed and monitored to ensure that the service delivery information is valid, accurate and complete and supported by credible documentation. Centralised document management systems should be implemented to ensure that reports and other evidence to substantiate reported performance are appropriately filed and stored. These should be easily retrievable to substantiate the reported performance and should be readily available for audit purposes.
Performance management and skills acquisition	<p>Officials are not adequately trained in respect of performance management practices, systems and reporting on PDOs to ensure a sound understanding of statutory requirements and relevant frameworks issued.</p> <p><u>Way forward</u></p> <ul style="list-style-type: none"> Prioritising the improvement of the skills and competence of those who occupy critical performance management positions. Ensuring that performance contracts are aligned to the IDP and implemented and that poor performance is dealt with. Determining training needs or skills shortages within the municipality and addressing these through training interventions and focused recruitment.

Aspect	Identified root causes and way forward
Monitoring by audit committees and internal audit	<p>Monitoring of the reported information by the leadership and governance structures was lacking. In many cases the relevant audit committees (or performance audit committee) and internal audit units did not review the performance reports on a quarterly basis to verify that the submitted reports were credible and supported by valid, accurate and complete source documentation. Performance of the auditees was not monitored in-year to ensure that corrective action could be taken within the year. This included the mid-year budget and performance assessment and review by internal audit and audit committees of performance management processes and reporting.</p> <p><u>Way forward</u></p> <ul style="list-style-type: none"> Internal audit units should conduct quarterly reviews of the reported performance information and confirm the existence of supporting documentation. Risks relating to PDO reporting should be included in risk management strategies and annual internal audit coverage plans. Audit committees should include experienced members with a full understanding of reporting against predetermined objectives.

2.4 Findings arising from the audit of compliance with laws and regulations

The PAA requires auditors of public sector entities to audit, on an annual basis, compliance with laws and regulations applicable to financial matters, financial management and other related matters.

- An overview of the audit approach for compliance with laws and regulations is provided in section 2.4.1.
- The level of identified material non-compliance and overall trends are analysed in section 2.4.2.
- Section 2.4.3 analyses the nature of transversal non-compliance findings.
- A summary of findings arising from auditing supply chain management (SCM), an AGSA-specific focus area, is presented in section 2.4.4.

An analysis of unauthorised, irregular as well as fruitless and wasteful expenditure incurred by auditees in contravention of legislation appears in section 2.4.5.

Section 2.4.6 provides an assessment of the drivers of internal control at auditees as they relate to compliance with laws and regulations. The root causes of non-compliance as well as the recommended way forward are also analysed in that section.

2.4.1 Overview of the AGSA's approach to the audit of compliance with laws and regulations

Laws and regulations set out the activities that the public sector must perform in serving the citizens and stipulate any limits or restrictions on such activities, the overall objectives to be achieved and how the due process rights of individual citizens are to be protected. Local government auditees are subject to legislation such as the Municipal Finance Management Act (MFMA) and the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), of which the objectives are proper financial and performance management, transparency, accountability, stewardship and good governance.

The procedures performed to obtain evidence that auditees had complied with applicable laws and regulations were limited to the following focus areas:

- Annual financial statements, performance report and annual report
- asset management
- audit committees
- budgets
- expenditure management
- internal audit
- revenue management
- strategic planning and performance management
- transfer of funds and conditional grants
- procurement and contract management
- human resource management and compensation.

Although compliance in most of the specified areas had been audited in previous financial years, the scope and extent of coverage increased for the year under review in accordance with the phased approach.

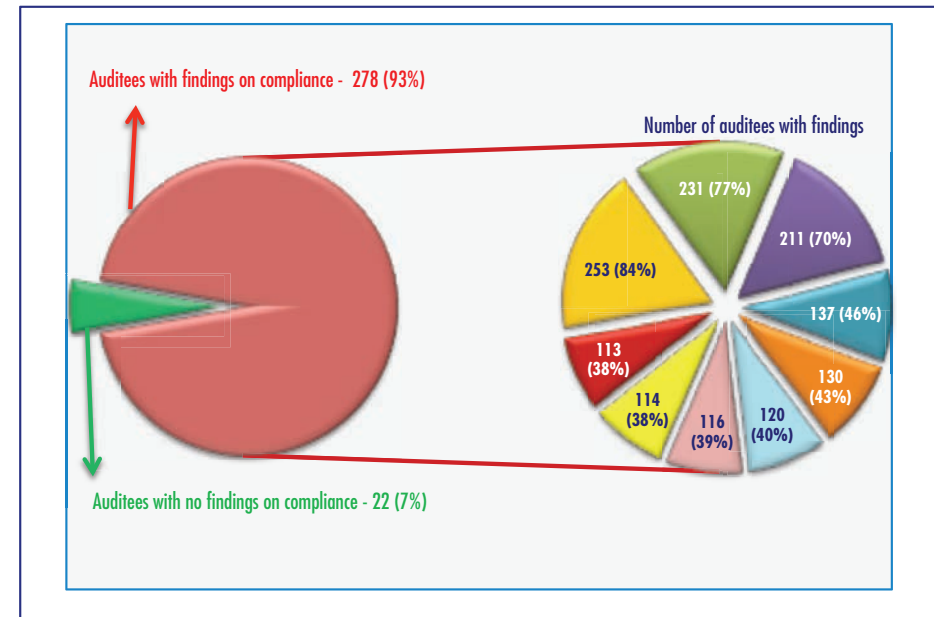
2.4.2 Overall trends in the level of material non-compliance reported

As depicted below, findings on material non-compliance with laws and regulations were raised in the audit reports of 278 auditees (93%) [2009-10: 303 auditees (92%)]. This represents an increase compared to the prior year.

The results of the 43 audits outstanding at 31 January 2012 are, however, not included in the analysis. These audits were outstanding as a result of late submission of financial statements, which is considered to be material non-compliance with the

MFMA. It is projected that the actual rate of material non-compliance is 94% (321 auditees).

Figure 22: Analysis of material non-compliance findings



Number of auditees with findings relating to:

- Unauthorised, irregular as well as fruitless and wasteful expenditure (253)
- Submitted financial statements required material adjustments (231)
- Procurement and contract management (211)
- Other expenditure management findings (137)
- Strategic planning and performance management (130)
- Audit committees (120)
- Other financial statement, performance report and annual report findings (116)
- Budgets (114)
- Other areas of non-compliance (113)



A provincial analysis of the prevalence and trends in non-compliance findings is presented in the following table. The majority of provinces showed no significant changes, with deterioration in Gauteng and the Western Cape.

Table 9: Provincial trends in the number of auditees with non-compliance findings

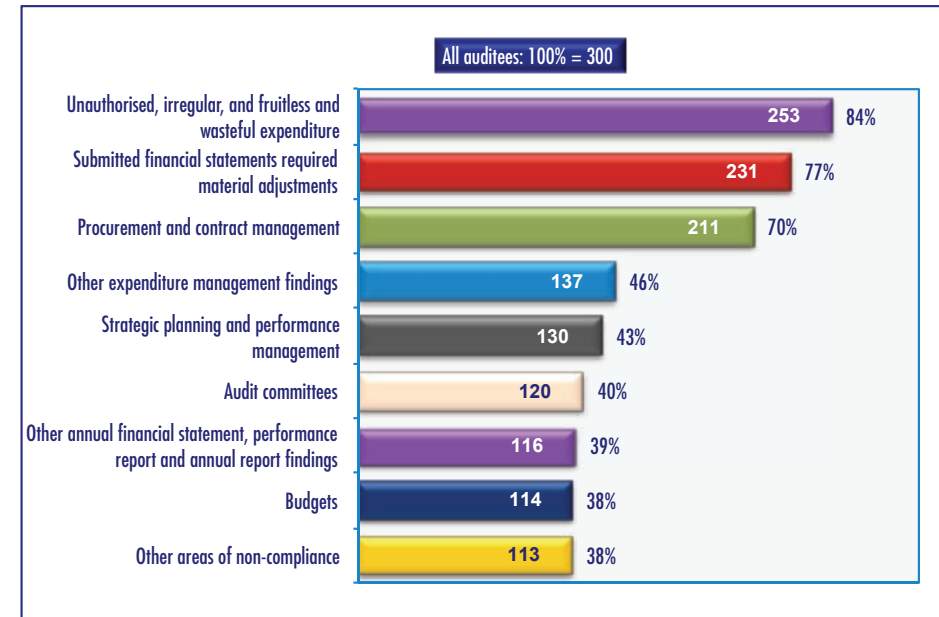
Movement from prior year	↔ 0%	↓ 3%	↓ 12%
2010-11	98%	96%	90%
	Eastern Cape	Free State	Gauteng
Movement from prior year	↔ 9%	↔ 4%	↔ 6%
2010-11	90%	93%	75%
	KwaZulu-Natal	Limpopo	Mpumalanga
Movement from prior year	↓ 3%	↓ 5%	↓ 11%
2010-11	100%	100%	93%
	Northern Cape	North West	Western Cape



2.4.3 Nature of transversal findings on non-compliance with laws and regulations

The following figure depicts the areas of material non-compliance, as reported in the audit reports, which were most prevalent at auditees overall for the year under review. As the focus areas and legislative requirements audited for the 2010-11 financial year differ from those of the previous year, no comparison is made with the prior year.

Figure 23: Transversal reported areas of material non-compliance



The table that follows analyses the auditees with significant non-compliance findings across the provinces.

Table 10: Transversal areas of material non-compliance per province

Province	Unauthorised, irregular as well as fruitless and wasteful expenditure	Submitted financial statements required material adjustments	Procurement and contract management	Other expenditure management findings	Strategic planning and performance management	Audit committees	Other annual financial statement, performance report and annual report findings	Budgets
Eastern Cape	94%	85%	72%	70%	57%	46%	56%	61%
Free State	89%	93%	81%	78%	63%	78%	52%	67%
Gauteng	69%	74%	48%	29%	14%	7%	7%	10%
KwaZulu-Natal	85%	71%	60%	19%	32%	26%	21%	15%
Limpopo	87%	83%	83%	67%	37%	57%	43%	47%
Mpumalanga	70%	65%	70%	60%	25%	30%	30%	35%
Northern Cape	95%	95%	90%	57%	95%	81%	71%	71%
North West	91%	100%	91%	64%	73%	45%	64%	55%
Western Cape	78%	44%	78%	7%	37%	30%	52%	26%
Total	84%	77%	70%	46%	43%	40%	39%	38%

Annexure 1 to this report lists all auditees where material non-compliance was reported in one or more of the AGSA's compliance focus areas. Transversal non-compliance findings relating to the AGSA's compliance focus areas are detailed below, except for the following:

- The findings on strategic planning and performance management and other PDO-related non-compliance are analysed in section 2.3 (PDO reporting).
- Procurement and contract management (SCM) findings are analysed in sections 2.4.4 and 3.

Expenditure management – including unauthorised, irregular and fruitless and wasteful expenditure

The most prevalent non-compliance finding was that accounting officers did not take reasonable steps to prevent unauthorised, irregular, and/or fruitless and wasteful expenditure at 253 auditees (84%). Section 2.4.5 provides more detail on the findings and the extent and nature of this expenditure.

Other non-compliance findings relating to expenditure management were identified at 137 (46%) auditees. The most significant of these findings at 118 (39%) auditees was the inability of auditees to pay their creditors within the prescribed 30 days after receipt of the invoice or statement. The late payment is a recurring finding that was also reported in the prior year at 109 (46%) auditees. There has been little improvement in this regard.

The primary reason for the late payment relates to cash flow constraints experienced by auditees, which cause them to prioritise those payments that are possible with the available funds. Many auditees do not have systems and processes in place to track the ageing of invoices to ensure that payments are made to suppliers within 30 days of receipt. The late payments put pressure on small and medium enterprises, in particular, and lead to service providers not wanting to do business with local government, which in turn could have a negative impact on service delivery. A further consequence is fruitless and wasteful expenditure as a result of interest and/or penalties levied on overdue accounts as detailed in section 2.4.5.

Annual financial statements, performance report and annual report – including submitted financial statements requiring material adjustments

The MFMA directs that annual financial statements must be prepared which fairly present the state of affairs of the auditee, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results and its financial position as at the end of the financial year and disclose the further information required in terms of the act.

It is accepted that financial statements are adjusted after submission to the auditors based on the results of the audits, most notably in the areas that require significant technical interpretation or estimation and in cases of unauthorised, irregular, or fruitless and wasteful expenditure. However, a history of material adjustments being made annually in other areas is indicative of non-compliance with the MFMA.



This non-compliance finding was reported at 231 (77%) auditees. Section 2.2.1 provides more detail on the cause and impact thereof.

Other non-compliance findings relating to annual financial statements, performance and annual reports were raised at 116 (39%) auditees. The most significant of these findings related to non-compliance with requirements for the annual performance report, which are detailed in section 2.3.

Audit committees

Findings on non-compliance with requirements of the MFMA and MSA with regard to audit committees were raised at 120 (40%) auditees. The most significant of these findings was a lack of performance by audit committees or ineffective functioning, as detailed in section 2.3.

Audit committees for financial and compliance matters were not in place at 30 (10%) auditees, while non-compliance with the prescribed audit committee requirements was identified at 33 (11%) auditees. Section 4.4 provides more detail on the cause and impact thereof.

Budgets

Findings were raised at 114 (38%) auditees. The most significant of these are depicted in the following table:

Table 11: Non-compliance with municipal budget and reporting regulations

Focus area	Summary of common findings	Number of auditees	Percentage of auditees reported on
Budgets	Expenditure not in accordance with approved budget	75	25%
	Monthly budget statements not submitted to prescribed parties	39	13%
	Quarterly reports on implementation of budget and financial state of affairs not submitted to council	39	13%

The municipal budget and reporting regulations became effective from the 2010-11 budget with the objective of securing sound and sustainable management of budgeting and reporting practices. In spite of the reforms introduced to improve the development of the budget and its in-year monitoring, 75 (25%) auditees were

not able to contain their expenditure within the approved budget. The finding on non-submission of monthly and quarterly reports also indicates that auditees overspend because they do not monitor expenditure against the approved budget. Furthermore, where such monitoring did occur, the information used was not credible and reliable.

Unauthorised expenditure stemmed from the overspending as detailed in section 2.4.5 and is creating further financial sustainability concerns for auditees as detailed in section 5.

2.4.4 Summary of findings arising from the audit of supply chain management

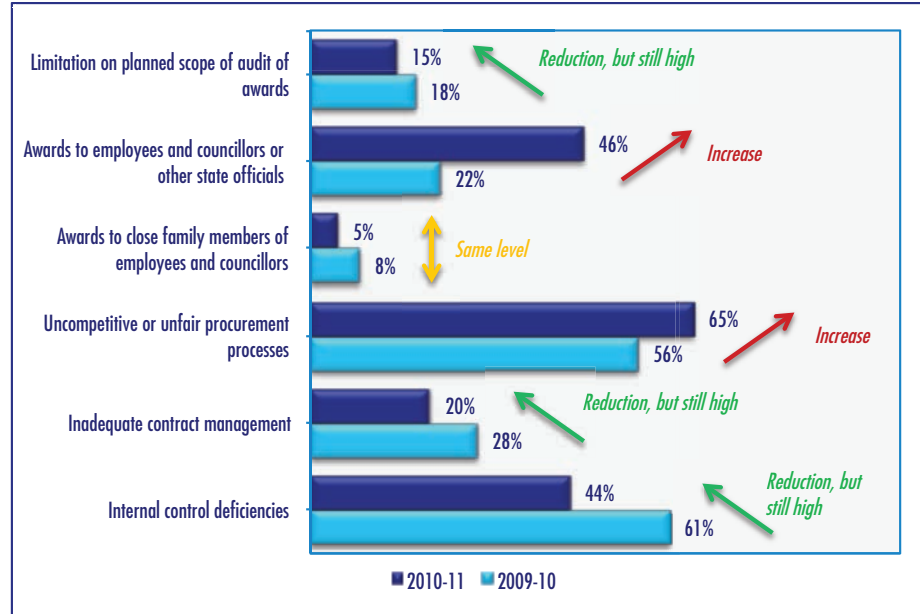
The audits included an assessment of procurement processes, contract management and the related controls in place. To ensure a fair, equitable, transparent, competitive and cost-effective SCM system, the processes and controls need to comply with legislation and minimise the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices.

Contracts awarded and price quotations accepted (referred to as “awards” in the remaining sections of this report) to the value of R28 billion were tested. Awards to the value of R3,3 billion that were selected for audit could, however, not be audited, as the required information or documentation was not made available by auditees.

Findings arising from the audit were reported in the management reports of 240 (80%) of the auditees, while the findings at 214 (71%) of these auditees were material enough to warrant reporting in the audit report.

Findings arising from the audit are summarised in the following figure. The percentages are based on the number of auditees reported on.

Figure 24: Summary of findings arising from SCM audit



The details of the most prevalent non-compliance findings that were material enough to be reported in the audit reports are depicted in the following table.

Table 12: Non-compliance findings arising from the audit of procurement and contract management

Focus area	Summary of common findings	Number of auditees	Percentage of auditees reported on
Procurement and contract management	Three written quotations not invited and/or deviations not justified	113	38%
	Awards made to providers who are in service of other state institutions	81	27%
	Competitive bids not invited and/or deviations not justified	75	25%

Section 3 of this report provides a more detailed analysis of SCM findings.

2.4.5 Unauthorised, irregular as well as fruitless and wasteful expenditure

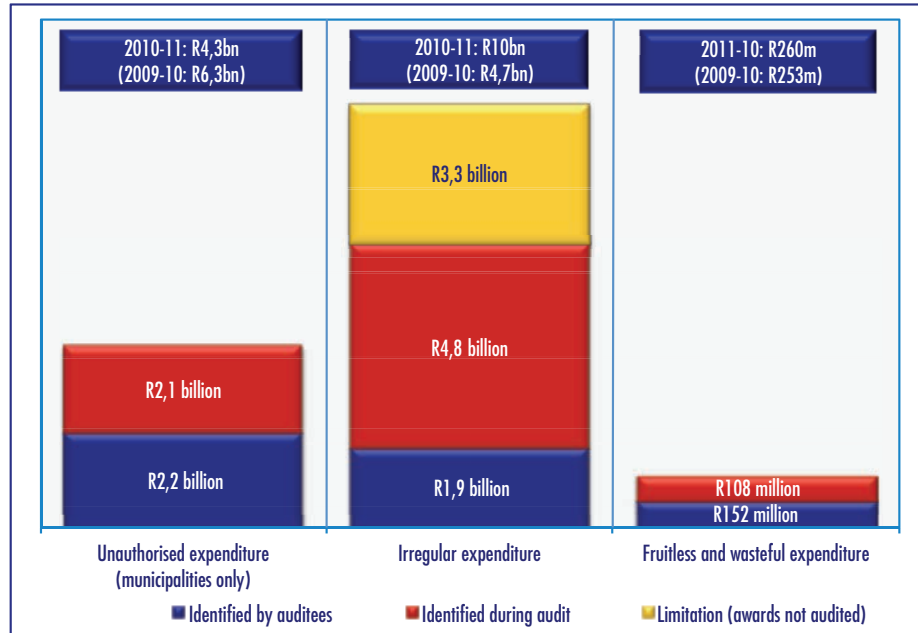
The MFMA requires accounting officers to take reasonable steps to ensure that unauthorised, irregular as well as fruitless and wasteful expenditure is prevented. Although there is an expectation that no such expenditure should be incurred, it is not always possible for an accounting officer to prevent its occurrence, even if all reasonable steps have been taken. In those exceptional circumstances where it does occur, the MFMA makes it compulsory for auditees to disclose such expenditure in their financial statements and a detailed accountability process is prescribed which could result in disciplinary processes and recovery of monies from liable officials.

Extent of unauthorised, irregular as well as fruitless and wasteful expenditure

The figure below depicts the extent of unauthorised, irregular as well as fruitless and wasteful expenditure incurred in the year under review, as well as the portion that was identified during the audit and had not been detected by the auditees.



Figure 25: Unauthorised, irregular as well as fruitless and wasteful expenditure



The extent of this expenditure and non-compliance by the accounting officers is indicative of an environment where incurring unauthorised and irregular expenditure has become the norm and not the exception. Reasonable steps are not taken to prevent such expenditure, while its occurrence is also not detected by auditees and is mostly identified by means of the AGSA's audit process.

A provincial analysis of the 234 auditees that had incurred R11 billion in unauthorised and irregular expenditure in total is presented in the table below.

Unauthorised, irregular or fruitless and wasteful expenditure was incurred by 86% of auditees. The audits further revealed that the accounting officers of 84% of auditees did not ensure that reasonable steps were taken to prevent this type of expenditure. This was reported in the audit reports as material non-compliance.

Table 13: Provincial analysis of unauthorised and irregular expenditure

Province	Unauthorised expenditure (municipalities only)						Irregular expenditure					
	Number of auditees	Percentage (of auditees reported on)	Movement in number of auditees from 2009-10	Amount (R'000)	Movement in amount from 2009-10	Identified during audit	Number of auditees	Percentage (of auditees reported on)	Movement in number of auditees from 2009-10	Amount (R'000)	Movement in amount from 2009-10	Identified during audit
Eastern Cape	30	68%	↓ -36%	559 963	↓ -10%	27%	45	83%	↓ -18%	1 399 099	↓ -64%	89%
Free State	17	77%	↓ -21%	1 299 788	↓ -88%	39%	24	89%	→ 4%	790 832	↓ -36%	74%
Gauteng	5	33%	↓ -25%	259 248	↑ 84%	59%	19	45%	↓ -27%	780 544	↓ -285%	99%
KwaZulu-Natal	21	34%	↓ -17%	514 075	↑ 19%	30%	53	78%	↓ -23%	2 147 481	↓ -111%	38%
Limpopo	16	59%	→ 0%	546 200	↓ -50%	96%	25	83%	↓ -56%	675 383	↓ -391%	87%
Mpumalanga	9	45%	↓ -29%	384 219	↑ 20%	83%	11	55%	↑ 8%	258 097	↑ 31%	97%
Northern Cape	18	86%	↑ 22%	307 414	↓ -20%	24%	19	90%	↑ 27%	353 704	↓ -8%	88%
North West	5	56%	↑ 58%	165 579	↑ 89%	96%	8	73%	↑ 53%	164 798	↑ 74%	84%
Western Cape	13	54%	↑ 24%	270 047	↑ 5%	7%	18	67%	↑ 25%	148 051	↑ 72%	84%
Total	134	55%	→ -1%	4 306 534	↑ 32%	48%	222	74%	→ -3%	6 717 989	↓ -44%	72%



Nature and overall trends in unauthorised expenditure (municipalities only)

The nature of the unauthorised expenditure incurred is analysed in the following table.

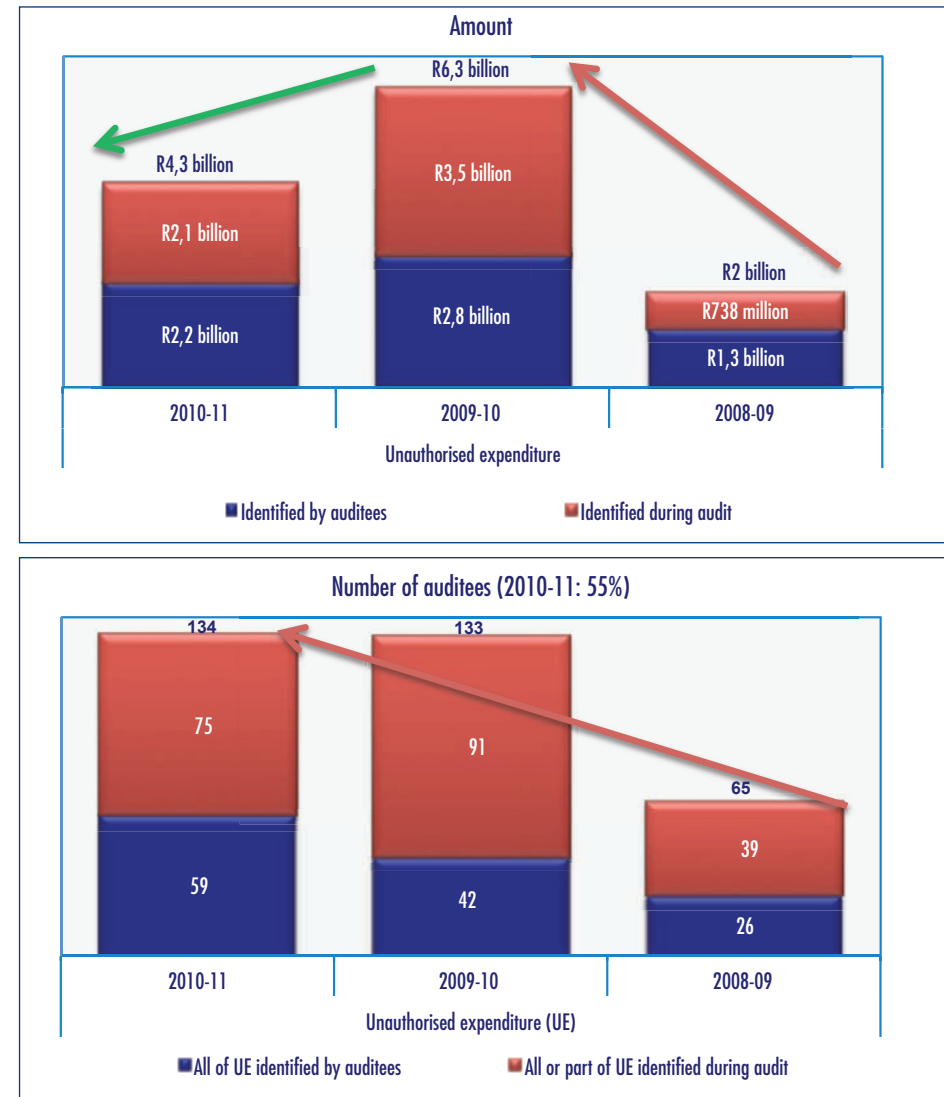
Table 14: Nature of and current year's movements in unauthorised expenditure

Nature	Number of auditees	Movement in number of auditees from 2009-10	Amount	Movement in amount from 2009-10
Overspending of budget/ main sections within budget	116	2%	R3,8 billion	37%
Spending not in accordance with purpose/ condition of an allocation or grant received	24	63%	R395 million	133%
Other non-compliance	3	63%	R139 million	101%

Note: 'Unchanged' denotes an increase/reduction of 5% or less in the level of findings compared to the previous financial year.

The figure below reflects the three-year trend in unauthorised expenditure.

Figure 26: Three-year trend in unauthorised expenditure



Despite a R2 billion decrease in the amount of unauthorised expenditure, this does not signify an improvement because the decrease was mostly caused by the following:

- Gauteng's unauthorised expenditure decreased by R1,7 billion as R1,5 billion of the 2009-10 unauthorised expenditure was an exception relating to the 2010 World Cup expenses.
- The North West's unauthorised expenditure decreased by R1,3 billion since fewer auditees were reported on because of outstanding financial statements.

The number of auditees that incurred unauthorised expenditure remained the same at 55% of auditees, which is a further indication that there had been little improvement overall.

R3,8 billion (88%) of the unauthorised expenditure was incurred due to overspending of the budget as a result of weak budgetary controls, which was also identified as a prevalent and material non-compliance finding as detailed in section 2.4.3. The overall amount for overspending had decreased, but again merely as a result of the Gauteng and North West anomalies. The biggest contributor to the overspending was the Free State at R1,3 billion. The highest incidence was in the Northern Cape (86%), Free State (77%) and Eastern Cape (59%).

Auditees tend to fare better in detecting unauthorised expenditure as is evident from the financial statements and budget reporting. It is thus unusual that 48% of unauthorised expenditure was identified by the auditors. Unauthorised expenditure invariably means that money for other programmes was diverted to fund it, which affects service delivery in accordance with the performance objectives set for the year. It also creates further financial sustainability concerns for auditees as detailed in section 5.

Nature of irregular expenditure and overall trends

The nature of irregular expenditure incurred is analysed in the following table.

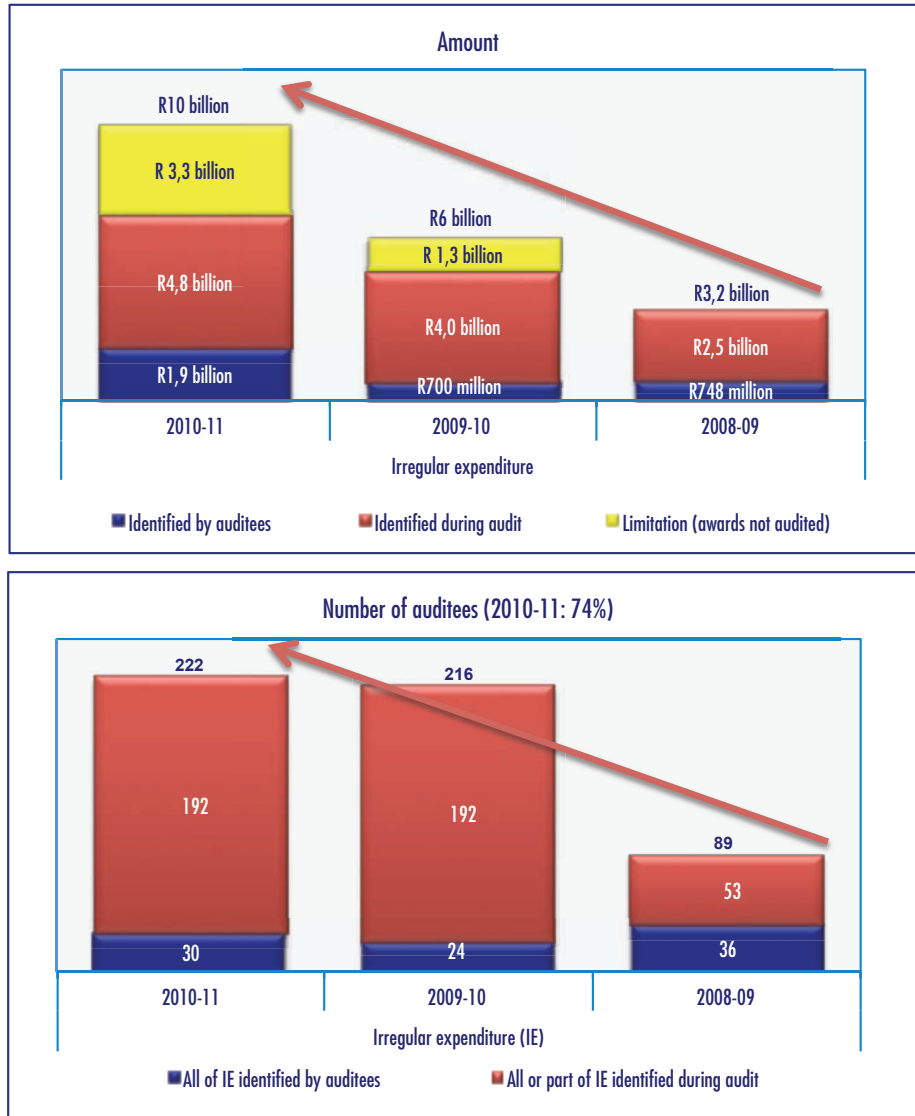
Table 15: Nature of irregular expenditure and current year's movements

Nature	Number of auditees	Movement in number of auditees from 2009-10	Amount	Movement in amount from 2009-10
Supply chain management-related	215	9% ↓	R6,6 billion	55% ↓
Compensation of employees-related	26	4% ↔	R34 million	84% ↓
Other non-compliance	26	16% ↑	R98 million	61% ↑

The figure that follows reflects the three-year trend in irregular expenditure.



Figure 27: Three-year trend in irregular expenditure



The three-year analysis includes limitation amounts for the past two years in which SCM was audited as a specific focus area. These amounts represent the value of awards to suppliers that could not be audited as no documentation could be presented for audit (also refer to sections 2.4.4 and 3 for more information). It demonstrates that the actual irregular expenditure could be significantly higher than the amounts identified by auditees and the audit process.

The increase and prevalence of irregular expenditure continued unabated, with the highest contributing factor being non-compliance with SCM legislation. For SCM-related irregular expenditure both the number of auditees and the amount had increased compared to the previous year, despite the AGSA's specific focus on this area and the commitments made and action plans drawn up to address it after the prior year's outcomes.

The biggest contributors to the irregular expenditure were KwaZulu-Natal (R2,1 billion) and the Eastern Cape (R1,4 billion). In terms of prevalence within the province, the Northern Cape is the highest (90% of auditees) followed by the Free State (89%) and Limpopo (83%), with only Gauteng incurring irregular expenditure at fewer than half of its auditees.

Irregular expenditure does not necessarily mean that money had been wasted or that fraud had been perpetrated – the impact is only determined after investigations by the council. It is, however, a measure of an auditees' ability to comply with laws and regulations relating to expenditure and SCM. Its prevalence, high values and continued increases demonstrate the inability of local government to comply with the laws and regulations that protect public money against fraud, waste and uneconomical procurement.

Nature of fruitless and wasteful expenditure and overall trends

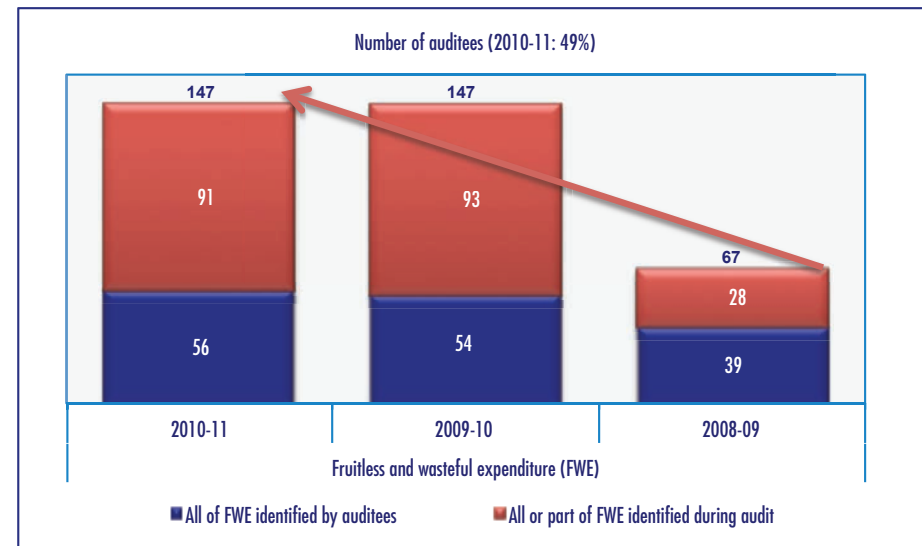
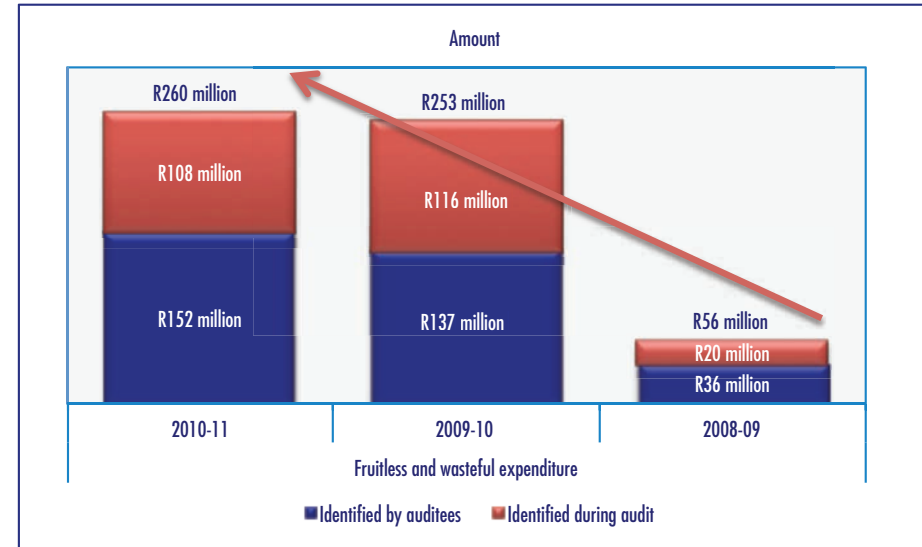
The nature of the fruitless and wasteful expenditure incurred is analysed in the following table.

Table 16: Analysis of fruitless and wasteful expenditure

Fruitless and wasteful expenditure - type	Number of auditees	Percentage (of auditees reported on)	Amount
Payments for goods and services not received or not required	14	5%	R21 million
Payments to defaulting contractors	5	2%	R9 million
Interest and penalties on the late payment of suppliers' invoices and taxes	106	35%	R156 million
Compensation-related	11	4%	R27 million
Other	51	17%	R47 million
Total	187	62%	R260 million

The figure below reflects the three-year trend in fruitless and wasteful expenditure.

Figure 28: Three-year trend in fruitless and wasteful expenditure





Fruitless and wasteful expenditure continued to increase and was incurred at half of the auditees and across all provinces, with the highest contributor being the Free State at R115 million.

The late payment of creditors, which was also raised as a material and prevalent non-compliance finding as detailed in section 2.4.3, caused the most fruitless and wasteful expenditure.

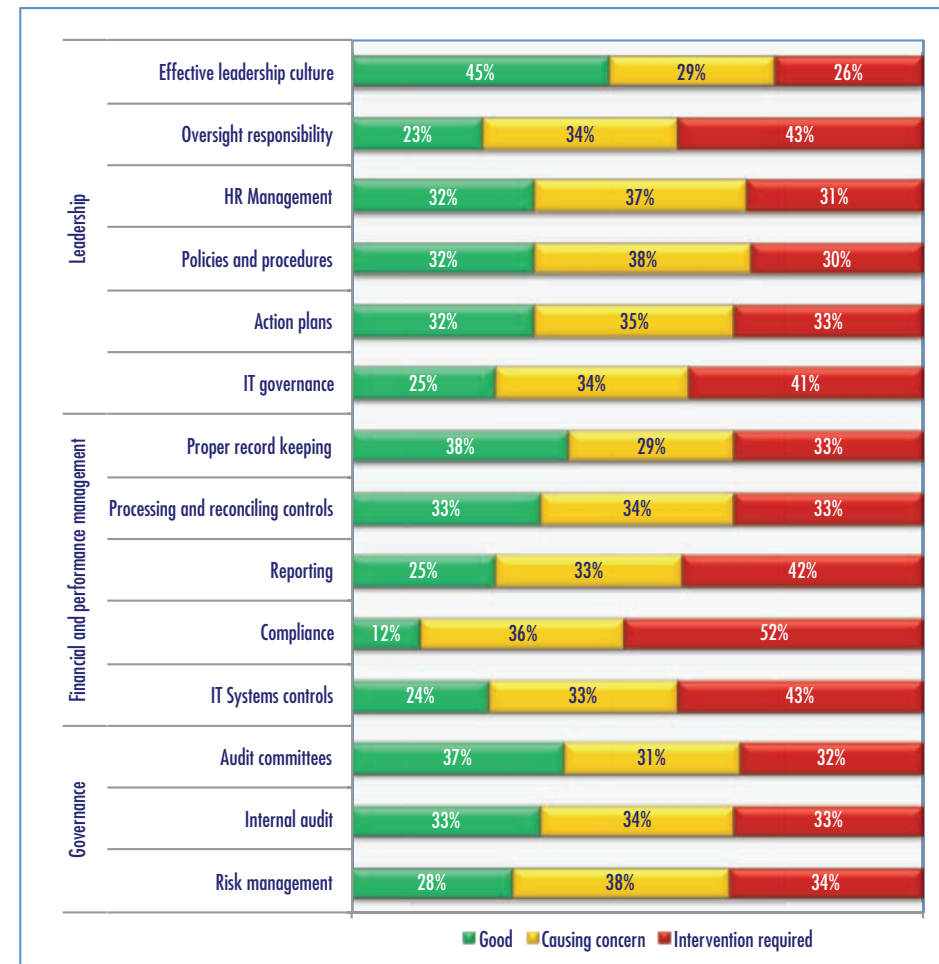
Although the amounts are significantly less than unauthorised and irregular expenditure, it does mean that payments of R260 million had been made in vain and without the public having received any value. In most cases this stemmed from weak internal controls and insufficient care given to protecting public money.

2.4.6 Root causes of non-compliance and best practice recommendations

The ability of auditees to enforce adherence to legislation and discharge their statutory responsibilities is influenced by the existence of a sound system of internal control. The key drivers of these controls are classified under the fundamental principles of (i) leadership; (ii) financial and performance management and (iii) governance. More information on the specific drivers of internal control, together with recommendations, is provided in section 4 of this report.

The following figure indicates deficiencies in the internal controls over compliance with laws and regulations. After that broad areas requiring attention from municipal leadership and ways to address these deficiencies are outlined.

Figure 29: Assessment of drivers of internal control over compliance with laws and regulations



The cornerstone of local government reform initiatives since 1994 has been the legislation introduced to define, enable, enforce and monitor sound and sustainable financial and performance management. Legislation such as the MFMA (2004) and MSA (2000) introduced transparency, accountability, stewardship and good governance which, in turn, safeguard citizens against abuse of public money and lack of service delivery. The legislation and the principles embedded therein are also geared towards achieving the defined national outcome of a responsive, accountable, effective and efficient local government system.

It is within this context that the continued high levels of non-compliance with legislation and the lack of improvement on the prior year are of grave concern. It also does not bode well for the implementation of the long-awaited legislation that will provide for improved competencies of key personnel, disciplinary processes and human resource management as detailed in section 4.2.

In spite of the commitments made at all levels of government and action plans compiled by the auditees, there was little impact on the outcomes. It is also disappointing that auditees often express the view that the legislation is difficult to understand and onerous to implement. The lack of improvement in areas such as SCM, which received much attention from the AGSA, both in the provinces and at national level, however, points to a disregard for laws and regulations.

Not all political leaders took these matters seriously and accepted their accountability in this regard. There are also limited consequences for the failure of accounting officers and municipal officials to comply, even though there are clear remedies in legislation to deal with transgressions.

In addition to these overall root causes, the assessment of drivers of internal control signifies that insufficient action has been taken to implement the fundamental principles of internal control in this area. Identified root causes and good practices, together with the way forward, are summarised as follows.

Aspect	Identified root causes and way forward
Leadership to set the tone	<p>Insufficient attention is given by leadership to ensuring that auditees operate within the boundaries and rules set by legislation. Accounting officers, mayors and councillors, provincial treasuries, Departments of Local Government and the premiers should set the tone for officials to the effect that legislation does not represent red tape or bureaucracy, but reflects, through Parliament, the will of the citizens as to how public funds should be administered and services delivered.</p> <p><u>Way forward</u></p> <ul style="list-style-type: none"> • The control environment, which the leadership creates by setting the correct tone for actions and behaviour that demonstrate integrity and ethical values to support the functioning of an effective system of internal control, is paramount. • Leadership should set an example for officials by complying with legislation that is applicable to them, without compromise. • In their dealings with municipal officials, the importance of legislation and a zero tolerance approach to non-compliance should be stressed and clearly demonstrated in the uncompromising manner in which transgressions are dealt with. • Municipal officials should know that all non-compliance has consequences.
Systems and processes	<p>The systems and processes are not aligned to the requirements of legislation and officials are unaware of the requirements and any changes in this regard.</p> <p><u>Way forward</u></p> <ul style="list-style-type: none"> • Policies and procedures should be aligned to legislation. • Officials should be trained on a continuous basis, not only on compliance with the policies and procedures, but also with regard to the intention and desired outcome of legislation and the practical implementation thereof. • Proper record keeping, especially in the area of SCM, will enable compliance, but will also demonstrate transparency and accountability on the part of auditees and not raise concerns about possible fraud or irregularities where documentation is missing. • Compliance checklists are required as an implementation tool for policies and procedures. These will enable officials, supervisors and monitoring units (e.g. internal audit) to check whether all legislative requirements are met in the daily transactional and management processes as well as in the SCM process.



Aspect	Identified root causes and way forward
Oversight and monitoring	<p data-bbox="390 332 1141 393">Insufficient attention is given to the monitoring of compliance at administrative, oversight and provincial level.</p> <p data-bbox="390 401 495 426"><u>Way forward</u></p> <ul data-bbox="390 447 1141 723" style="list-style-type: none"> <li data-bbox="390 447 1141 541">• Regular reports to municipal management and council on compliance with key legislation, specifically in the area of SCM, will promote awareness of legislative requirements and ensure that management deals with compliance in a regular and structured manner. <li data-bbox="390 546 1141 640">• Council and specifically MPACs should intensify their focus on compliance matters and ensure that members have sufficient knowledge of legislation to interact meaningfully on matters of compliance. <li data-bbox="390 645 1141 723">• Provincial treasuries should improve their monitoring and support activities to enable auditees to fully implement legislative requirements and instructions from the time they become effective.
Effective governance measures	<p data-bbox="390 738 1141 799">Leadership does not receive sufficient assurance and support from internal audit and audit committees.</p> <p data-bbox="390 807 495 832"><u>Way forward</u></p> <ul data-bbox="390 854 1141 1262" style="list-style-type: none"> <li data-bbox="390 854 1141 1014">• The legislation with which most local government must comply is extensive and the leadership will need to direct their attention to those areas of highest risk. In this regard, the risk identification and management process should be of great value to the leadership and should not be relegated to an annual exercise that does not comprehensively address all compliance objectives. <li data-bbox="390 1019 1141 1202">• Internal audit is required to play a significant role in monitoring compliance with laws and regulations. Although audits show that the internal audit function covers this in their audits, such audits are not effective in identifying weaknesses, or the audit findings and recommendations are not appropriately addressed. Internal audit can also greatly improve internal controls in the SCM processes by proactively auditing the regularity of contract award processes and providing some assurance to management on this matter. <li data-bbox="390 1207 1141 1262">• Audit committees should direct internal audit focus appropriately and monitor implementation of recommendations made by both internal and external auditors.





SECTION 3: FINDINGS ARISING FROM THE AUDIT OF SUPPLY CHAIN MANAGEMENT

This section of the general report presents the findings arising from the audit of supply chain management (SCM) as follows:

- A summary of the audit performed and its outcome is provided under section 3.1.
- Section 3.2 highlights limitations placed on the planned scope of the audit and the impact thereof.
- Sections 3.3 and 3.4 provide information on contracts and quotations awarded (hereafter referred to as “awards”) to state officials or their close family members.
- Uncompetitive or unfair procurement processes identified are analysed in section 3.5.
- The audits also identified inadequate contract management and SCM controls. Details are provided under sections 3.6 and 3.7.
- An overall conclusion is provided in section 3.8 which links to the root causes and way forward regarding compliance with laws and regulations presented in section 2.4.

3.1 The audit of supply chain management

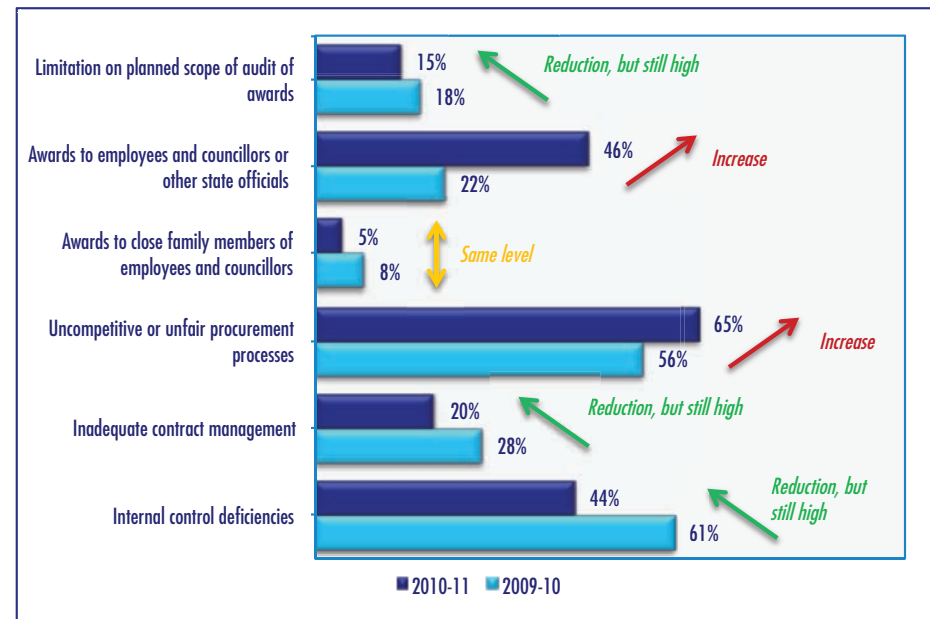
The audits included an assessment of procurement processes, contract management and the related controls in place. To ensure a fair, equitable, transparent, competitive and cost-effective SCM system, the processes and controls need to comply with legislation and must minimise the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices.

As is evident from the analysis of irregular expenditure (section 2.4), R6,7 billion (98%) of the irregular expenditure incurred by auditees was the result of contravention of SCM legislation. Of this irregular expenditure, 72% was identified during the audit process.

Findings arising from the audit were reported in the management reports of 240 (80%) of the auditees, while at 214 (71%) of these auditees the findings were material enough to warrant reporting thereof in the audit report.

The following figure presents a summary of SCM findings, with a comparison to the audit results of the previous year. The percentages are based on the number of auditees reported on.

Figure 30: Summary of findings on supply chain management



Details of the most prevalent findings are provided in the paragraphs that follow.

3.2 Limitations on planned scope of audit of awards

Sufficient appropriate audit evidence on compliance with the requirements of the SCM legislation could not be provided by 44 (15%) auditees for some of the awards selected for testing. No alternative audit procedures could be performed to obtain reasonable assurance that the expenditure incurred in respect of these awards was not irregular. The reason for the limitations was inadequate record keeping and document management.

The following table depicts those provinces with auditees where limitations were experienced.

Table 17: Provincial analysis of limitations experienced (only applicable provinces)

Province	Number of auditees	Number of awards	Value of awards
Eastern Cape	14	338	R 598 million
Free State	7	986	R1 939 million
Limpopo	3	43	R 270 million
Mpumalanga	4	78	R 27 million
Northern Cape	8	160	R 83 million
North West	5	119	R 355 million
Western Cape	3	27	R 1 million
Total	44	1751	R3 274 million

The general reason for the limitations was inadequate record keeping and document management. In Mpumalanga documentation was destroyed due to water and fire damage and seized for forensic investigations.

Due to these limitations, the findings reported in the remainder of this section might not reflect the full extent of irregularities and SCM weaknesses at the auditees.

3.3 Awards to employees and councillors or other state officials

Supply chain management regulation 44 prohibits awards to persons or entities owned/managed by them if they are in the service of the auditee (i.e. employees and councillors) or if they are in the service of any other state institution. Expenditure incurred in this regard is also considered irregular.

The audit included the identification of such prohibited awards. Further testing was performed to determine whether the legislated requirements with regard to declaration of interest were adhered to.

The following table depicts the audit findings raised at auditees where prohibited awards were identified, with an indication of the positions of the persons involved.

The percentages are based on the number of auditees reported on. If prohibited awards were also identified in the previous year, the name of the province is highlighted in red.

Table 18: Provincial analysis of prohibited awards to officials in the service of the auditee

Province	Awards made to employees and councillors					Awards made to officials of other state institutions	Provider did not submit declaration of interest	Provider did not declare interest	
	Extent and positions of persons involved			Official did not declare interest	Official was involved in making the award				
	%	Amount	Positions	%	%				%
Eastern Cape	15%	R6,2 million	Councillors, senior managers and other employees	15%		50%	R54,6 million	30%	20%
Free State	15%	R6,7 million	Councillors and employees	11%		11%	R7,3 million	7%	11%
Gauteng	12%	R66,5 million	Councillors, senior managers and other employees	14%	2%	26%	R67,3 million	2%	26%
KwaZulu-Natal	15%	R40,3 million	Councillors and employees	13%	1%	54%	R185,8 million	53%	1%
Limpopo	17%	R0,6 million	Councillors, senior managers, SCM officials and other employees	13%		47%	R12,7 million		30%
Mpumalanga	40%	R11,0 million	Councillors, municipal manager, SCM officials and other employees	35%	5%	75%	R15,2 million	65%	
Northern Cape	14%	R0,4 million	Employees	5%		19%	R4,4 million	5%	10%
North West	27%	R10,8 million	Councillors and employees	9%		45%	R9,2 million		64%
Western Cape	15%	R1,8 million	Councillors and employees	19%		48%	R86,0 million	26%	22%
Total	17%	R144 million		15%	1%	43%	R443 million	25%	17%

The increase in prohibited awards from 22% to 46% is not unexpected. In the prior year the audit of this matter was limited to metros and other high-capacity municipalities (40% of the auditees) – the increase in scope resulted in an increase in findings.

The awards made to employees and councillors are of great concern as these could be prevented and detected by implementing basic controls, including declarations of interest by the parties. The lack of such controls could be indicative



of a lack of regard for this prohibition at the affected auditees. Although there was little evidence in the provinces that the persons were involved in making the award, the possibility of undue influence cannot be discounted, especially if the persons were in positions of influence, which could create opportunities for irregularities, e.g. councillors, senior and municipal managers and SCM officials.

Auditees do not have access to information on persons employed in other state institutions, which means they can only rely on the declarations provided by the suppliers. These declarations also identify employees and councillors with an interest. At most of the auditees where prohibited awards were identified, the auditees did not ensure that the declaration was submitted, or the supplier did not declare the interest. The lapse in internal controls with regard to requesting declarations of interest was also identified as one of the most prevalent findings on the procurement processes (section 3.5) and the most common control weakness (section 3.7). The impact of non-adherence to this requirement is demonstrated by the high number of prohibited awards identified. Failure by suppliers to declare their interest constitutes a corrupt and fraudulent act and should be investigated and dealt with in accordance with legislation.

Limited action has been taken in response to similar findings in the prior year, which means an opportunity was missed to show that these irregular actions by persons in the service of the auditees or its suppliers are not tolerated and have consequences.

3.4 Awards to close family members of employees and councillors

Awards to persons or entities owned/managed by persons who are close family members of persons in the service of the state, whether at the auditee or at any other state institution, are not prohibited. However, such awards of more than R2 000 must be disclosed in the financial statements of the auditee for the sake of transparency and as required by SCM regulation 45. A close family member is defined as a spouse, child or parent of a person in the service of the state.

The audit included the identification of awards to close family members. Further testing was performed to determine whether the financial statement disclosure was made and whether the legislated requirements with regard to declarations of interest were adhered to.

The following table depicts the audit findings raised at auditees where awards to close family members of officials of the auditee were identified, with an indication of the positions of the officials involved. The percentage is based on the number of auditees reported on. Where such awards were also identified in the previous year, the name of the province is highlighted in red.

Table 19: Provincial analysis of awards to close family members (only applicable provinces)

Province	Awards made to close family members of persons in service of the auditee			No disclosure in financial statements	Official did not declare interest	Provider did not submit declaration of interest	Provider did not declare interest
	%	Amount	Positions	%	%	%	%
Eastern Cape	7%	R33,8 million	Senior manager and other employees	7%	7%		7%
Free State	4%	R3,9 million	Employees		4%		4%
Mpumalanga	10%	R3,5 million	Municipal manager, SCM officials and other employees	5%	5%		5%
Northern Cape	5%	R0,9 million	Senior manager				
North West	18%	R181,5 million	Employees				
Western Cape	11%	R3,5 million	Employees		7%	4%	
Total	4%	R227 million		2%	3%	1%	2%

Although awards to close family members are not prohibited, the non-disclosure in the financial statements and failure by the officials or the suppliers to declare their interest are indicators that the relationships are being concealed. The possibility of undue influence cannot be discounted and all instances require investigation.

3.5 Uncompetitive or unfair procurement processes

The principles of contracting for goods and services in a manner that is fair, equitable, transparent, competitive and cost-effective come from our Constitution. Legislation, most notably the MFMA and SCM regulations, prescribes the processes and rules to be followed by auditees in order to apply the constitutional principles consistently and correctly and safeguard the process against abuse. The preferential procurement framework further gives effect to the constitutional principle of affording preference to the previously disadvantaged in the allocation of work by the public sector.

Our audits also focus on whether procurement processes followed were fair and competitive in that they provided all suppliers equal opportunity to compete for public sector contracts and that the process does not favour some suppliers above others.

It is important that the prescribed processes be followed to ensure that the selected supplier meets the requirements and has the capacity and ability to deliver the goods and services, and that those goods and services are procured at competitive and economical prices.

The procurement processes of 786 contracts (R1,7 billion) and 6 587 quotations (R26,4 billion) were tested. The five most prevalent findings on non-compliance with SCM legislation that resulted in uncompetitive or unfair procurement processes are summarised in the following table – similar findings were identified in all the provinces in the prior year. The percentage is based on the number of auditees reported on.

Table 20: Provincial analysis of findings on uncompetitive or unfair procurement processes

Province	Three price quotations not obtained/ deviations not approved or justified		Competitive bids not invited/ deviations not approved or justified		Preference points system not applied or not correctly applied		Tax clearance not obtained from SARS		No declaration of interest submitted by provider		Other findings	
	%	R'000	%	R'000	%	R'000	%	R'000	%	R'000	%	R'000
Eastern Cape	52%	75 326	24%	65 322	22%	145 761	15%	40 958			59%	1 281 208
Free State	78%	45 454	56%	98 466	26%	44 078	30%	47 356	26%	147 404	56%	1 380 627
Gauteng	21%	2 913	26%	127 673	7%	50 272			7%	75 057	19%	96 019
KwaZulu-Natal	21%	15 250	16%	314 705	16%	50 302	13%	40 631			9%	1 697 719
Limpopo	57%	78 824	7%	20 489							47%	300 832
Mpumalanga	25%	4 518					10%	10 195	15%	83 863	55%	420 521
Northern Cape	52%	16 002							33%	27 981	71%	111 360
North West	55%	6 796	36%	26 352	27%	31 915	27%	14 350			91%	48 067
Western Cape	37%	8 842	11%	5 543					26%	56 771	52%	116 841
Total	40%	253 925	20%	658 550	12%	322 328	10%	153 490	9%	391 076	42%	5 453 194

Further details of non-compliance with the legislation are as follows:



Table 21: Summarised findings on non-compliance with legislation

Finding	Key findings
Three price quotations not obtained/ deviations not approved or justified	A price quotation process is prescribed for procurement of goods and services valued at between R10 000 and R200 000. Three price quotations were not in all instances obtained from prospective providers and the deviations were not approved by a properly delegated official or committee as required.
Competitive bids not invited/ deviations not approved or justified	A competitive bidding process should be followed for the procurement of goods and services above R200 000. Competitive bids were not always invited and the deviations were not approved by a properly delegated official.
Preference points system not applied or not correctly applied	The preference point system was not applied in all procurement of goods and services above R30 000, as required by Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000).
Tax clearance not obtained from SARS	Awards were made to suppliers without proof from the South African Revenue Service (SARS) that their tax matters were in order.
No declaration of interest submitted by provider	As part of the bidding and procurement process, providers are required to declare any connections they have with persons in service of the auditee or other state institutions. The declarations were not always submitted by the providers, with the result that the auditees did not have sufficient information to identify conflicts of interest and prohibited awards.
Other findings	Other findings include the following: <ul style="list-style-type: none"> Quotations not obtained from listed prospective suppliers/ suppliers that met listing requirements. Bids advertised for a shorter period – no approval of deviation. Bids not adjudicated by a properly constituted adjudication committee. Prospective supplier list not administered in accordance with requirements. Other required information and declarations not submitted Bids not evaluated by a properly constituted evaluation committee. No prospective supplier list for inviting price quotations.

3.6 Inadequate contract management

Shortcomings in the manner in which contracts are managed result in delays, wastage and fruitless expenditure, which in turn impact directly on service delivery to communities served by municipalities.

The five most prevalent findings on inadequate contract management are summarised in the following table – similar findings were identified in all the provinces in the prior year. The percentage is based on the number of auditees reported on.

Table 22: Provincial analysis of findings on contract management

Province	No written contract/ contract not signed by delegated official		Inadequate contract performance measures and monitoring		Contracts amended or extended - reasons not tabled in council		Contracts extended or renewed to circumvent competitive bidding processes		Performance of contracts not monitored on a monthly basis		Other findings	
	%	R'000	%	R'000	%	R'000	%	R'000	%	R'000	%	R'000
Eastern Cape	15%	111 174	15%	223 430							6%	281 376
Free State			7%	25 620	7%	401 854	7%	49 939	11%	43 687	11%	53 712
Gauteng	5%	11 860			2%	23 036	2%	6 446			2%	38 837
KwaZulu-Natal	4%	358 049			4%	715 354	3%	3 484			9%	292 958
Limpopo	7%	107 762	13%	157 292			7%	3 979			20%	108 048
Mpumalanga			5%	1 547					10%	5 062		
Northern Cape	5%	33 635	14%	65 513			5%	2 215			19%	97 981
North West	9%	163 287	18%	11 057	9%	13 395			36%	161 942	9%	220
Western Cape	4%	49 722	4%	4 055	4%	1 379			4%	406		
Total	6%	835 489	7%	488 514	3%	1 155 018	3%	66 063	3%	211 097	8%	873 132

Further details of these findings are as follows:

Table 23: Summarised findings on contract management

Finding	Key findings
No written contract/ contract not signed by delegated official	Goods and services were received and payments were made to suppliers without a written, signed contract being in place.
Inadequate contract performance measures and monitoring	Measures applied in monitoring the performance of contractors were not sufficient to ensure that contractors delivered in accordance with the contract.
Contracts amended or extended - reasons not tabled in council	In order to enable accountability and oversight the MFMA prescribes that reasons for amendment or extension of contracts should be tabled in council. Instances were identified where the council was not informed.
Contracts extended or renewed to circumvent competitive bidding processes	It is normal business practice to extend or renew contracts where circumstances warrant it. However, at some auditees it was done to the extent that competitive bidding processes were being circumvented, resulting in a procurement practice that was unfair, uncompetitive or not transparent.
Performance of contracts not monitored on a monthly basis	The performance of the contractor in terms of the contract or agreement was not monitored on a monthly basis as required by the MFMA.
Other findings	<ul style="list-style-type: none"> Contracts were not prepared in accordance with general conditions of contract (prescribed by National Treasury). Contracts do not stipulate provisions for termination in the case of non-compliance.

3.7 Inadequate SCM controls

Findings on the most prevalent identified deficiencies in fundamental SCM controls are summarised in the following table – similar findings were identified in all the provinces in the prior year. The percentage is based on the number of auditees reported on.

Table 24: Provincial analysis of findings on SCM controls

Province	Inadequate controls to ensure interest is declared	Risk assessment did not address SCM	SCM officials not adequately trained	Declaration of interest not recorded in register	No controls to monitor performance contractors	Other controls
Eastern Cape	20%	19%	19%	17%		74%
Free State	22%			30%	19%	48%
Gauteng	2%		2%			14%
KwaZulu-Natal	4%					13%
Limpopo			13%			63%
Mpumalanga		5%		15%		30%
Northern Cape	33%	29%		24%	33%	90%
North West	55%				36%	45%
Western Cape	4%					19%
Total	12%	6%	5%	8%	5%	41%

Further details of the findings are as follows:



Table 25: Summarised findings on SCM controls

Finding	Key findings
Inadequate controls to ensure interest is declared	The controls at some auditees were inadequate to ensure that: <ul style="list-style-type: none"> officials declared whether they or their close family members, partners and associates had interests in suppliers to the auditee suppliers declared any connections to persons in service of the auditee or other state institutions.
Risk assessment did not address SCM	SCM is generally an area of considerable risk at most of the municipalities. However, the risk was not recognised in the risk assessments performed by some municipalities.
SCM officials not adequately trained	Some officials involved in the implementation of the SCM policy were not adequately trained to perform their duties effectively.
Declaration of interest not recorded in register	The controls were inadequate to ensure that officials declared whether they or their close family members, partners and associates had interests in suppliers or in a contract to be awarded. Proper reviews were not performed to ensure completeness of declarations.
No controls to monitor performance contractors	Measures applied in monitoring the performance of contractors were not sufficient to ensure that contractors delivered in accordance with the contract, as the municipality did not have a system in place to record all the payments and monitor the budget of all the contracts they had entered into.
Other controls	<ul style="list-style-type: none"> Register of bids received on time was not published on website. Accounting officer did not submit quarterly reports to mayor/board on SCM policy implementation. SCM policy/procedures were in conflict with applicable legislation/did not include all requirements. SCM policies/procedures/fraud prevention plan did not provide measures to prevent abuse of SCM system. No processes to report any breach of or failure to comply with SCM system. Fraud prevention plan – no measures for preventing and detecting fraud in procurement. SCM officials were not aware of SCM policies/did not understand roles and responsibilities. Inadequate controls for vendor acceptance and maintenance. SCM policy implementation not reviewed on annual basis. Performance of SCM unit was not regularly analysed. Audit committee review of compliance with laws and regulations did not include SCM.

3.8 Overall conclusion on SCM matters

The level of service delivery to citizens and the degree to which government's socio-economic objectives are promoted are directly and significantly helped or frustrated by the degree to which the procurement systems in local government comply with the SCM legislation that endeavours to ensure a fair, equitable, transparent, competitive and cost-effective SCM system.

Continued non-adherence to SCM legislation defers restoration of the public's confidence in the ability of state officials to systematically take care of their interests – and deprives citizens of much-needed services.

It is encouraging to note that administrative, political, national and provincial leaders recently again undertook to take the lead in addressing non-compliance with SCM legislation to ensure a strong ethical culture within local government. However, the lack of improvement in SCM despite similar commitments made in the prior year is of concern and points to a lack of focus by leadership in the past year or an unwillingness to address this matter.

The root causes and way forward for SCM are similar to those of compliance with laws and regulations, as detailed in section 2.4.6. If the control weaknesses listed in section 3.7 are addressed, it will also immediately have a positive impact. Overarching, however, is the principle that non-compliance should have consequences and that accountability must be enforced at all levels. The political and administrative leadership should make a conscious decision to take action against transgressors.

Only when the leadership has set a tone of decisively dealing with SCM malpractices, will the citizenry have confidence in procurement by local government.

