

Golden Gate, north-eastern Free State

100

**GENERAL REPORT**  
on audit outcomes of **FREE STATE**  
**LOCAL GOVERNMENT**

**2009-10**



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*



**100** YEARS  
1911-2011



# **General report**

## **on the audit outcomes of Free State local government 2009-10**

**PR133/2011**

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## **Our reputation promise/mission**

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



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## SECTION 1: FOREWORD

It is a great pleasure to present to the provincial legislature and municipal councils the 2009-10 general report which analyses the results of the audit outcomes of the Free State Local Government for the financial year ended 30 June 2010. The purpose of this general report is to provide an overview of the audit outcomes of local government as well as to guide those charged with governance and oversight, including the executive, councils and legislatures, to work towards achieving financially unqualified audit opinions with no findings on non-compliance with laws and regulations and no findings on the reporting on predetermined objectives.

The 2009-10 audit outcomes include 20 municipalities and five municipal entities whose audits were finalised by 31 January 2011. Of the six audit reports not included, four audits were in progress and two auditees had not yet submitted their annual financial statements for audit purposes.

The audit outcomes of municipalities and municipal entities for the current year showed a steady reduction in audit qualifications. Of the 20 municipalities analysed in this report, six municipalities showed improved audit outcomes since 2008-09, 13 remained unchanged and one regressed. Of the audit outcomes of the five municipal entities, two improved and three remained unchanged.

Notwithstanding the concerted effort made by the provincial leadership, CoGTA and the Provincial Treasury to assist the municipalities and commitments that were received from the mayors during the door-to-door visits that were conducted in the province, most of the mayors did not perform their oversight role as emphasised and agreed upon. As such very little impact is visible due to such lack of commitment at municipal level by most mayors and accounting officers, as well as capacity challenges experienced by municipalities.

Capital assets remained the main reason for qualifications in municipalities and municipal entities. Other areas that require improvement and leadership attention relate to key controls in financial management, service delivery and compliance with laws and regulations. This will assist in eliminating the material errors in financial statements that get corrected during the audit, despite the extensive use of consultants, as well as excessive unauthorised and irregular expenditure in most municipalities.

Clean audits will only be achieved if the political and legislative oversight plays an active supervisory role in monitoring the impact of interventions in the province. The future interactions of the AGSA with the political and legislative oversight will focus on the results and impact of these monitoring interventions.

In conclusion, I wish to thank the audit teams from my office and the audit firms that assisted with the audit of the Free State Local Government for their diligent efforts towards fulfilling our constitutional mandate and the manner in which they continue to strengthen cooperation with the leadership of the provincial portfolio.

Together, we will continue to make every effort to collaborate in order to accelerate the implementation of actions and contribute towards strengthening our country's democracy.

*Auditor-General*

**Auditor-General**

**Free State**

**May 2011**



## SECTION 2: EXECUTIVE SUMMARY

The purpose of this general report is to provide an overview of the audit outcomes of the municipalities and municipal entities of the Free State for the 2009-10 financial year. An overview of these audit outcomes was presented to the political leadership, the provincial legislature and the leadership of the municipalities during March 2011 to facilitate dialogue on the understanding of the key underlying issues and possible solutions in this regard.

The summary which follows contains key issues and conclusions reached on the main sections in this report, while further details are contained in the body of the report.

### 2.1 Overview of audit outcomes

The Free State Local Government comprises 25 municipalities and six municipal entities. The 2009-10 audit outcomes of 20 municipalities and five municipal entities whose audits were finalised by 31 January 2011 are analysed in this report. The 2009-10 audit outcomes are reflected in table 1, below.

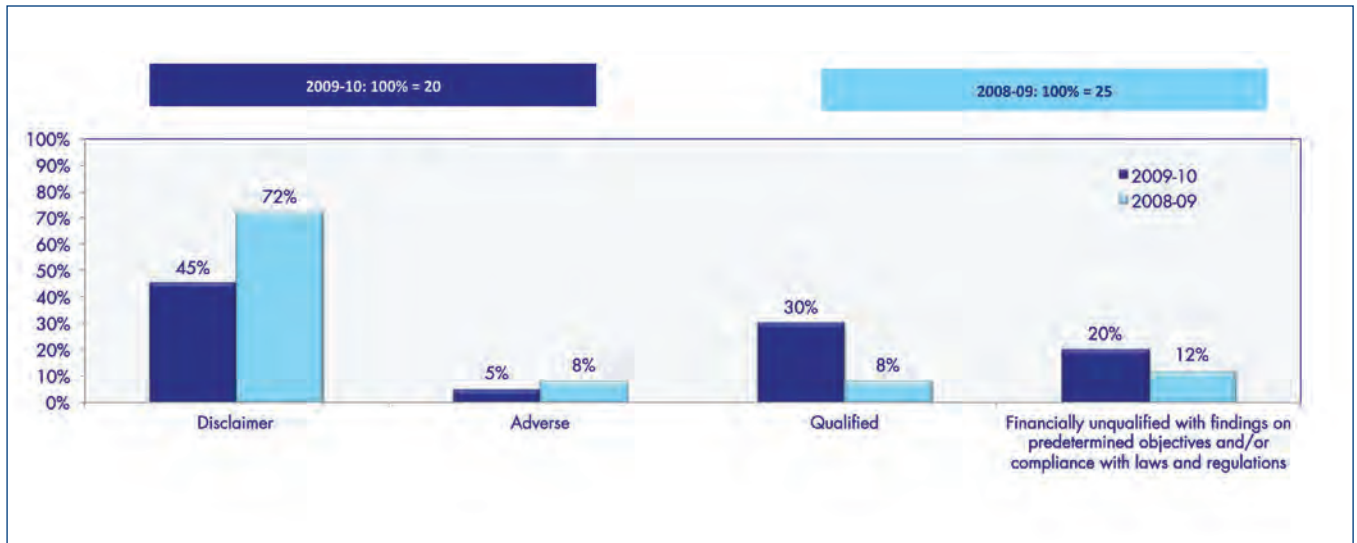
**Table 1: Summary of audit outcomes**

Audit outcomes	Municipalities		Municipal entities	
	2009-2010	2008-2009	2009-2010	2008-2009
Disclaimer	9	18	3	4
Adverse	1	2	0	0
Qualified	6	2	1	1
Financially unqualified with findings on predetermined objectives and/or compliance with laws and regulations	4	3	1	0
Financially unqualified with no findings on predetermined objectives and/or compliance with laws and regulations	0	0	0	0
<b>Total number of audits reported on</b>	<b>20</b>	<b>25</b>	<b>5</b>	<b>5</b>
<b>Number of audit reports not issued by 31 January 2011</b>	<b>5</b>	<b>0</b>	<b>1</b>	<b>1</b>
<b>Total number of audits</b>	<b>25</b>	<b>25</b>	<b>6</b>	<b>6</b>
Findings arising from the AGSA's other legal reporting responsibilities				
Predetermined objectives	20	23	5	3
Compliance with laws and regulations	20	25	5	5

Figures 1 and 2 graphically depict the outcomes of the audits of financial statements, while figures 3 and 4 present an analysis of findings arising from the audit of predetermined objectives and compliance with laws and regulations for municipalities and municipal entities, respectively.

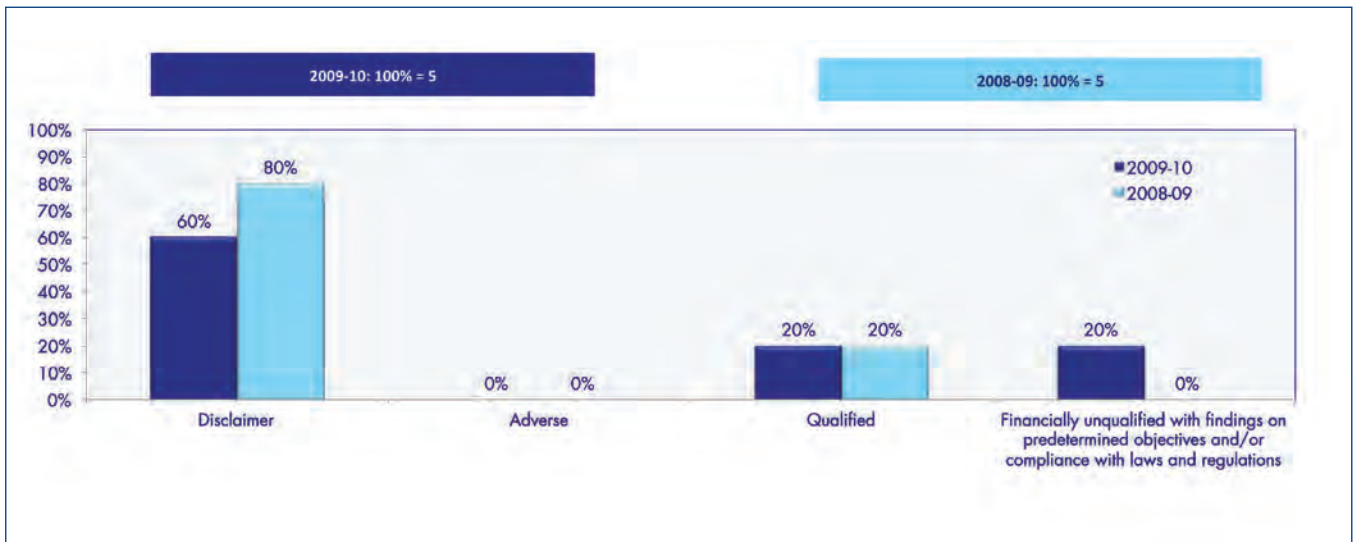


**Figure 1: Analysis of audit outcomes – Municipalities (based on consolidated financial statements where applicable)**



The audit reports of four municipal entities were consolidated with their parent municipalities. Sixteen municipalities do not have municipal entities and stand-alone audit reports were issued.

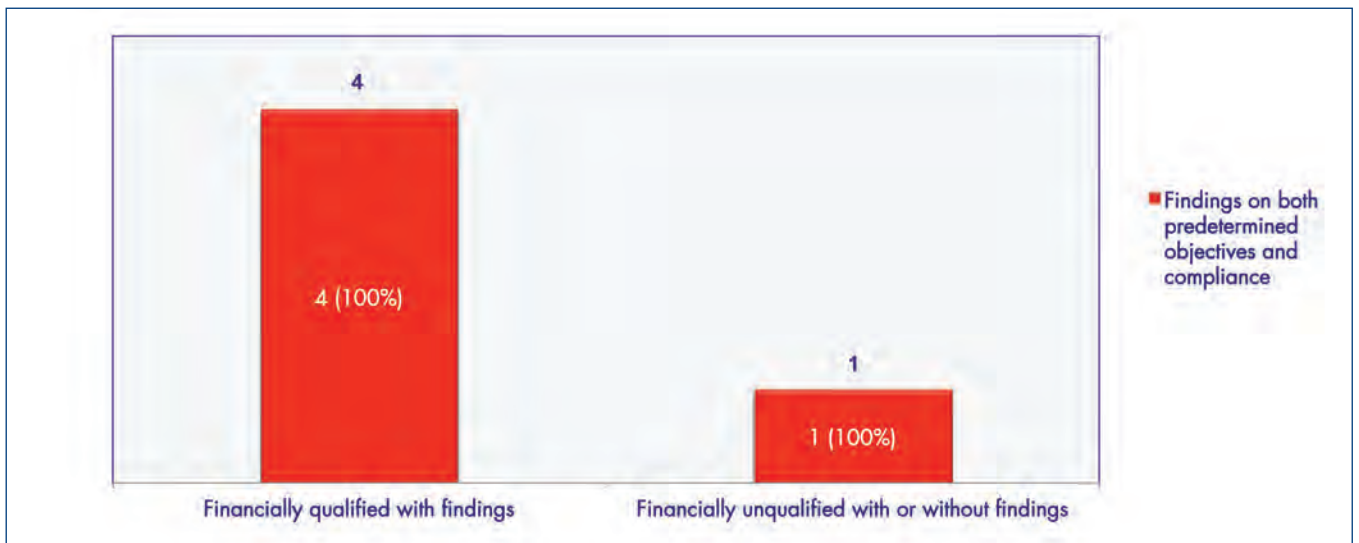
**Figure 2: Analysis of audit outcomes – Municipal entities**



**Figure 3: Analysis of municipalities with/without findings on predetermined objectives and/or compliance with laws and regulations**



**Figure 4: Analysis of municipal entities with/without findings on predetermined objectives and/or compliance with laws and regulations**



The 2008-09 audit outcomes reflected in figures 1 – 4 include those of two municipalities and two municipal entities that had not been completed at the date of 2008-09 general report.

**Highlights of the audit outcomes for the year under review**

**Municipalities**

The province displays a tendency to have improvements as well as regressions every year, and for 2009-10 of the 20 municipalities reported on, six (20%) improved, 11 (55%) remained unchanged (but were qualified), two (10%) remained unchanged at financially unqualified with findings on predetermined objectives or compliance with laws and regulations and one (5%) regressed, as mentioned below.



### *Improvements*

- **Disclaimer to financially unqualified**  
Thabo Mofutsanyana District Municipality improved from disclaimer to financially unqualified (with findings) owing to consultants analysing all audit queries and implementing corrective actions. Where irregular expenditure was detected, it was disclosed in the financial statements.
- **Qualified to financially unqualified**  
Motheo District Municipality improved from qualified to financially unqualified (with findings) owing to focused oversight, supervision and monitoring by the leadership of the municipality to address and correct all material items since 2008-09.
- **Disclaimer to qualified**  
Dihlabeng, Mantsopa and Nketoana Local and Xhariep District Municipalities improved from a disclaimer to a qualification. The improvements are mainly attributed to leadership taking active steps to correct prior year challenges, the submission of documentation and the involvement of consultants (no consultants appointed at Mantsopa Local Municipality).

### *Unchanged*

- **Disclaimer of opinions, including adverse**  
Ten municipalities, namely Kopanong, Letsemeng (2009-10: Adverse), Mafube, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Mohokare (2008-09: Adverse), Ngwathe and Phumelela Local Municipalities again registered disclaimer of audit opinions. The matters that prevent the municipalities from registering improved audit outcomes are non-compliance with laws and regulations, inadequate governance arrangements and deficient risk management practices.
- **Qualified**  
One municipality, namely Setsoto Local Municipality, remained qualified mainly due to the ineffective system of managing documentation.
- **Unqualified with findings**  
Two municipalities, namely Fezile Dabi and Lejweleputswa District Municipalities, remained financially unqualified (with findings).

### *Regression*

Financially unqualified (with findings) to qualification

Only one municipality, namely Tswelopele Local Municipality, regressed because of GRAP implementation challenges.

## **Municipal entities**

Of the five municipal entities reported in 2009-10, two (40%) improved and three (60%) remained unchanged (but were qualified).



*Improvements*

- Disclaimer to qualified  
Metsimaholo Mayoral Trust improved as only interest and bank charges were incurred during the current year, which could be verified 100%. The Mayoral Trust no longer made bursary payments as initially intended.
- Qualified to unqualified (with findings)  
Increased oversight by the leadership as well as annual financial statements being compiled by consultants resulted in the improved audit outcome at Lejweleputswa Development Agency.

*Unchanged*

- Disclaimer  
Three municipal entities (Centlec, Fezile Dabi Trust and Maluti-A-Phofung Water) again received a disclaimer owing to inadequate record keeping of supporting documentation and ineffective control and record keeping over assets.

The audits of five municipalities and one municipal entity (2008-09: one) had not been finalised by 31 January 2011.

**Table 2: Audits not finalised by 31 January 2011**

Auditees not reported on	Annual financial statements received date	Reason not finalised	Expected date/actual of finalisation
<b>Municipalities</b>			
Masilonyana	31-Aug-10	Quality issues with private audit firm who conducted the audit on behalf of the AGSA	31-May-11
Moqhaka	17-Feb-11	Late submission of annual financial statements	17-May-11
Naledi	7-Oct-10	Late submission of annual financial statements. Team had to withdraw from audit owing to unrest at the municipality. The December/January holiday and the availability of staff impacted on the finalisation of the audit report.	31-Mar-11
Nala	Outstanding	Annual financial statements outstanding	Three months from receipt of annual financial statements
Tokologo	4-Nov-10	Late submission of annual financial statements	12-Apr-11
<b>Municipal entity</b>			
Krynaauwvlust Farming Trust	Outstanding	Annual financial statements for 2008-09 and 2009-10 outstanding	Three months from receipt of annual financial statements

Since 31 January 2011 and up to the date of this report two further audits were finalised. Their audit outcomes were as follows:



**Table 3: Outcomes of audits finalised after 31 January 2011**

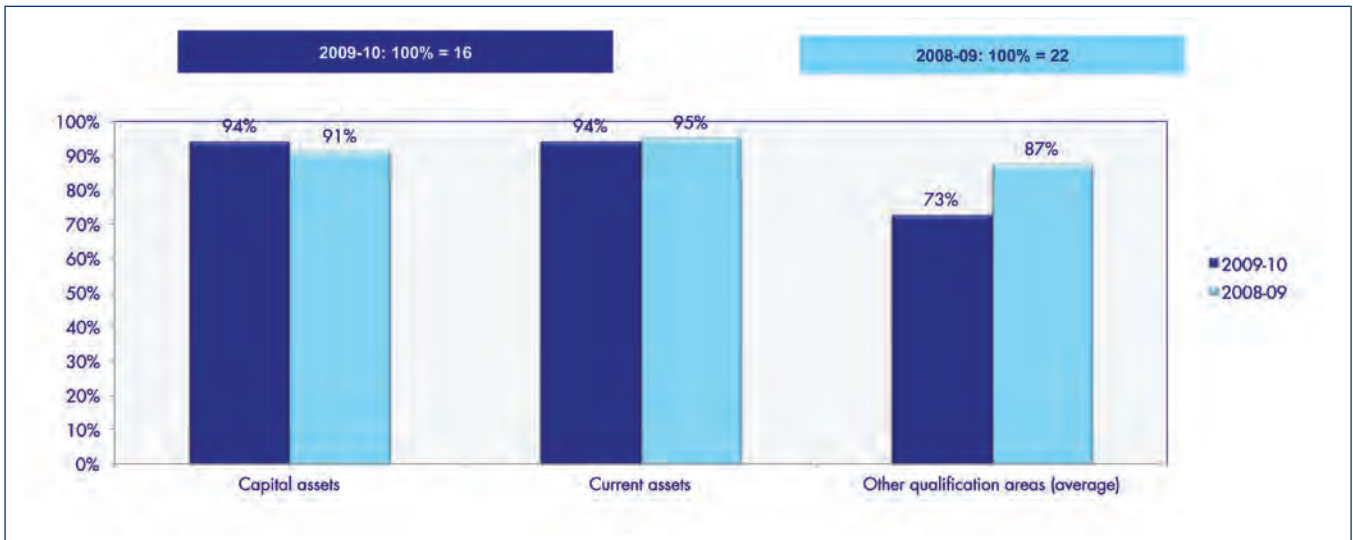
Auditee	2009-10 Audit opinion	2008-09 Audit opinion
Naledi Local Municipality	Disclaimer	Adverse
Tokologo Local Municipality	Disclaimer	Disclaimer

## 2.2 Findings on financial management

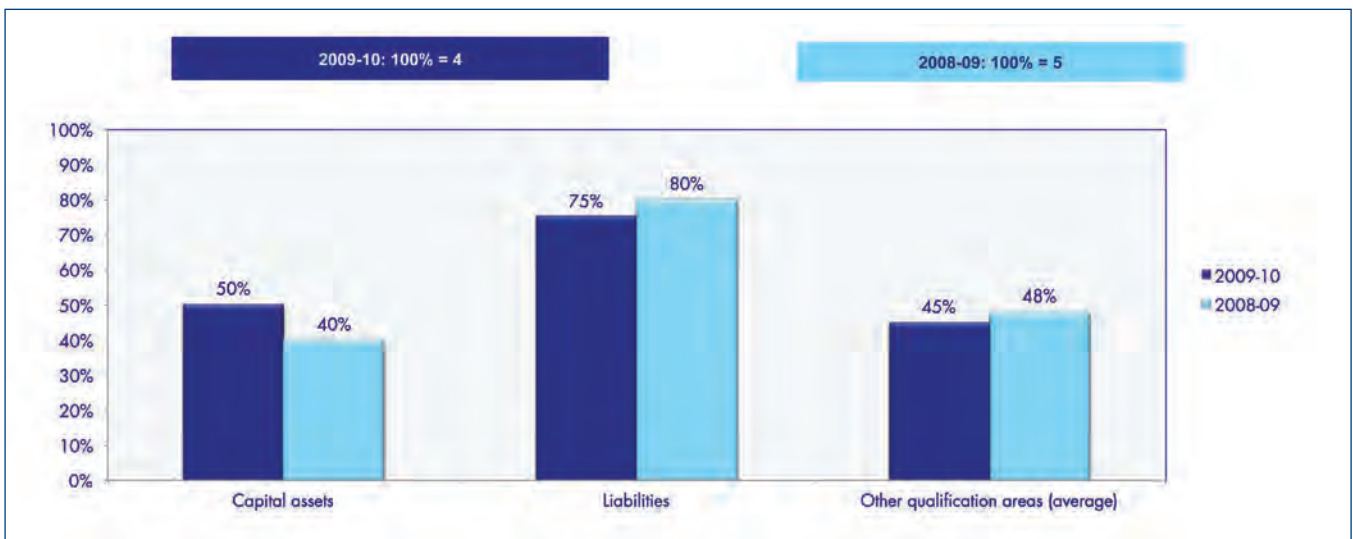
### 2.2.1 Transversal material issues that form the basis for the qualified/adverse/disclaimer of opinion on the financial statements

The figure below depicts the most common areas in financial statements attracting qualification findings.

**Figure 5: Transversal qualifications – municipalities**



**Figure 6: Transversal qualifications – municipal entities**



The financial statement qualification areas for the 16 municipalities and four municipal entities that obtained financially qualified audit opinions are reflected in table 5 below. There were numerous repeat findings, which is indicative that not all the previous year's qualifications were fully resolved or could be addressed within a one-year cycle.

**Table 4: Financial statement qualification areas**

Auditee	Audit opinion 2009-10	Movement in addressing 2008-09 qualification areas							Audit opinion 2008-09
		Capital assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I and F&W	
Dihlabeng	Qualified	Repeat	Repeat	Repeat	Repeat	Repeat	Addressed	Addressed	Disclaimer
Kopanong	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Letsemeng	Adverse	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Mafube	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Maluti - A - Phofung	Disclaimer	Repeat	Repeat	Repeat	Addressed	Repeat	Repeat	Repeat	Disclaimer
Mangaung	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Mantsopa	Qualified	Repeat	Repeat	Addressed	Repeat	Addressed	Addressed		Disclaimer
Matjhabeng	Disclaimer	Repeat	Repeat	Repeat	Repeat	New	Repeat	New	Disclaimer
Metsimaholo	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Addressed	Repeat	Disclaimer
Mohokare	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Adverse
Ngwathe	Disclaimer	Repeat	Repeat	Repeat	Repeat	New	Repeat	Repeat	Disclaimer
Nketoana	Qualified	Repeat	Repeat	Addressed	New	Repeat	Addressed	Repeat	Disclaimer
Phumelela	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Setsoto	Qualified	Repeat	Repeat	Repeat	Repeat		New	New	Qualified
Tswelopele	Qualified	New	New		New				Financially unqualified with findings
Xhariep District	Qualified	Addressed	Addressed	Addressed	Addressed	Addressed	Addressed	Repeat	Disclaimer
Centlec (Pty) Ltd	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Fezile Dabi DM Trust	Disclaimer						Repeat		Disclaimer
Maluti-A-Phofung Water	Disclaimer	Repeat	Repeat	Repeat	Addressed	Repeat	Repeat	Addressed	Disclaimer
Metsimaholo Mayoral Trust	Qualified			Repeat					Disclaimer

#### Corrective action taken to address previous qualification areas

Improvements in audit outcomes can be attributed to corrective action taken by management that included the following:

- Improvement in record keeping of expenditure that includes upgrading of filing system.
- Steps taken by management to acquire the necessary skills and the appointment of consultants to ensure that other disclosures are properly made in the financial statements.
- Management's commitment and involvement of consultants to address prior year issues.



*Action taken to address previous qualification areas not adequate to address prior year qualification findings*

The root causes of the most common financial statement qualification areas per balance sheet and income statement areas are as follows:

- Capital assets qualifications occurred in 15 (94%) municipalities and two (50%) municipal entities. This resulted from assets not being appropriately accounted for as required by the accounting standards. The complexity of measuring property, plant and equipment in terms of the relevant accounting standards required a high degree of expertise that was not always available. The recognition of assets, determining the useful lives of those assets, the impairment and depreciation and existence of assets could not be confirmed. Asset registers and asset management systems were not adequate to provide sufficient details regarding capital assets, specifically relating to infrastructure. A lack of commitment, achievable action plans and the leadership monitoring of milestones to ensure improvements contributed to the repeated qualification.
- Current assets comprised 15 (94%) municipalities and two (50%) municipal entities which showed, with one exception, no improvement compared to the previous year. This can be attributed to a lack of performing daily and monthly reconciliations, not improving the archive and filing systems and a lack of knowledge to ensure accounting is done properly as prescribed by the accounting standards.
- Liabilities comprised 11 (69%) municipalities and three (75%) municipal entities due to a lack of performing the required reconciliations, inadequate retention of documentation and a lack of supervision to ensure that the basic controls are observed.
- Other disclosure items comprised 14 (88%) municipalities and one (25%) municipal entity. The matters resulting from the qualifications were not corrected timeously due to a lack of knowledge of the relevant accounting standards by the preparers of the financial statements in the finance section.
- Revenue comprised 11 (69%) municipalities and two (50%) municipal entities. Management did not implement the necessary controls and reconciliations timeously to ensure accurate, reliable billings and correct accounting in terms of the accounting framework.
- Expenditure comprised nine (56%) municipalities and three (75%) municipal entities. The status is due to a lack of performing daily and monthly reconciliations, no document retention and a lack of supervision. The matter is worsened by the fact that no consequences are implemented for poor performance in the province.
- Unauthorised, irregular, and fruitless and wasteful expenditure comprised 13 (86%) municipalities and one (25%) municipal entity. The lack of control mechanisms to prevent and detect any payment where due processes were not followed resulted in a continuation of these findings. Again the lack of action taken against officials involved in, and responsible for, improperly procuring goods and services has resulted in repeated findings in these areas.

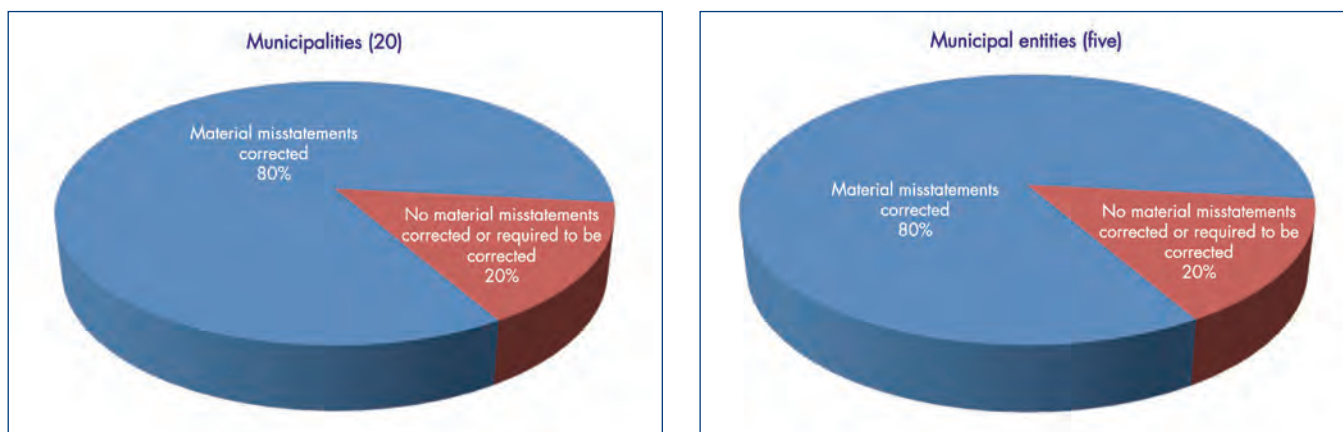
### 2.2.2 Material misstatements in financial statements submitted for audit purposes

Section 122 of the MFMA directs that municipalities and municipal entities should submit for audit purposes annual financial statements that fairly present the state of affairs and their financial position as at the end of the financial year. Such financial statements are therefore required to be free from material misstatements (i.e. material errors or omissions.)

A larger number of the financial statements submitted for auditing were of a poor quality in that they had to be materially adjusted during the audit process. Municipalities had significant deficiencies in the design and implementation of internal control in respect of financial reporting, which resulted in material corrections to the financial statements during the audit in the case of 16 municipalities (80%) and four municipal entities (80%).

The figure below indicates the extent of material misstatements present in the financial statements submitted for audit purposes and subsequently corrected by management as a result of audit findings. Where material misstatements were not corrected, the financial statements were qualified.

**Figure 7: Material misstatements in financial statements submitted for audit purposes**



Of the 16 municipalities and four municipal entities with material misstatements in financial statements submitted for audit purposes, three municipalities and two municipal entities did not make any adjustments to the financial statements. This resulted in qualified audit opinions for those entities.

Notwithstanding material misstatements being corrected in the financial statements by 13 (52%) municipalities and two (40%) municipal entities, their audit outcomes remained qualified because other misstatements were identified during the audit that could not be quantified and corrected by the auditees.

Similarly, three auditees (12%) (2008-09: one (3%)) corrected material misstatements in the financial statements and managed to obtain a financially unqualified (with findings) audit outcome. These were Motheo District Municipality, Thabo Mofutsanyana District Municipality and Lejweleputswa Development Agency.

### 2.2.3 Assistance provided by consultants to municipalities and municipal entities in the preparation of financial statements

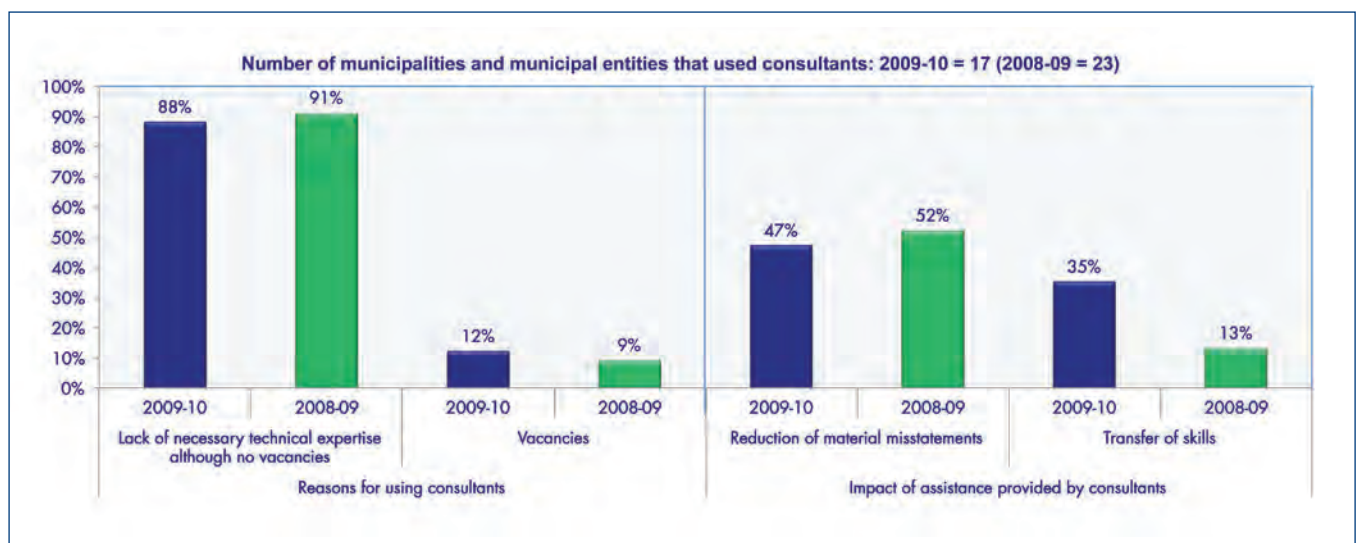
As in the past financial years, municipalities and municipal entities continue to engage the services of consultants to assist with accounting-related services and the preparation of financial statements for audit purposes. It should furthermore be noted that the impact of consultants is dependent on the accuracy, reliability and completeness of the underlying information that supports the financial statements, which the municipality provides to the consultants. In this regard, it is evident that the consultants become involved at a very late stage and compile the financial statements on inaccurate and incomplete trial balances. This confirms the incidents of errors and mistakes in the financial statements.

Of the 20 municipalities analysed, 17 (85%) used consultants to assist with accounting-related services and the compilation of financial statements, while three of the five (60%) municipal entities engaged the services of consultants for the same reason. Only five (28%) of these municipalities and one (33%) municipal entity achieved an improved audit outcome.

The cost of providing these services amounted to R29 314 062 (municipalities: R25 936 211; municipal entities: R3 377 851). CoGTA appointed and paid for the consultants at Thabo Mofutsanyana District Municipality and expenses in this regard are not included in the total above due to CoGTA not being able to split the amounts paid to the service provider for Operation Clean Audit in respect of additional services provided to each municipality. It was also not possible to determine the amount paid to consultants appointed at Mafube and Ngwathe for assistance with accounting-related services due to the inadequate setup of the general ledger accounts, inappropriate recording of expenditure incurred, as well as the non-submission of service level agreements, contracts and other appropriate audit evidence.

Depicted below are the reasons why auditees engaged the services of consultants to prepare financial statements and the AGSA's assessment of the impact of such assistance on the quality of the financial statements submitted for audit purposes.

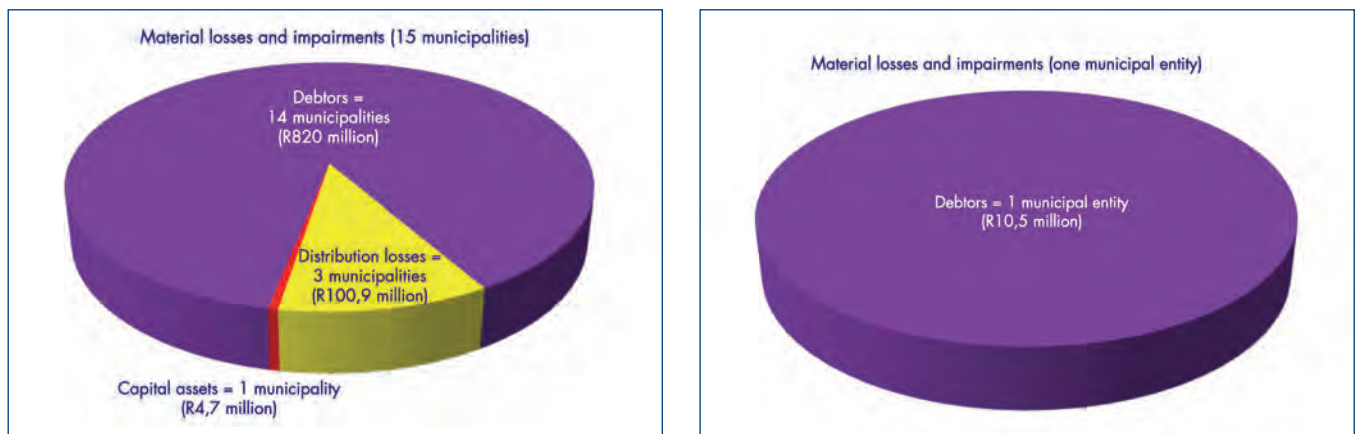
**Figure 8: Assistance provided by consultants – Municipalities**



Provincial leadership, CoGTA and the Provincial Treasury expressed their concern about the high number of municipalities dependent on the services of consultants without being able to earmark identified officials for skills transfer. CoGTA and the Provincial Treasury continue with their efforts to provide training to staff at municipalities in an effort to build capacity. Furthermore, CoGTA and the Provincial Treasury appointed consultants at certain municipalities to assist with turnaround plans and advisory services.

## 2.2.4 Material losses, material impairments of assets and underspending of the vote / conditional grant

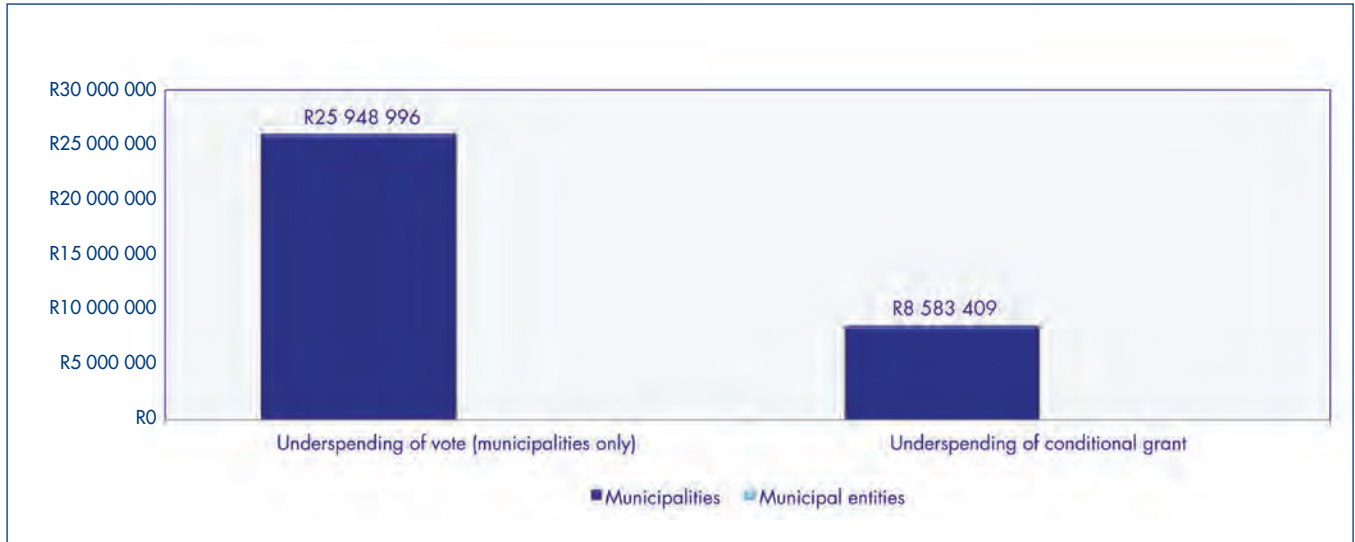
**Figure 9: Material losses and impairment of assets**



Total material losses and impairments of R935,9 million were incurred at the following 15 municipalities and one municipal entity: Dihlabeng, Kopanong, Letsemeng, Mafube, Mangaung, Mantsopa, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana, Phumelela, Setsoto, and Tswelopele Local Municipalities, Xharie District Municipality and Centlec (Pty) Ltd.

Losses incurred by municipalities relate to units of water and electricity lost during the distribution process, i.e. illegal connections, faulty meters as well as leakages due to deteriorating infrastructure assets (R100,9 million). The major cause for the impairment of assets at municipalities is the impairment of amounts owing to the municipality due to the poor payment history (municipalities – R819,8 million, municipal entities R10,5 million). One municipality incurred a loss of R4 734 059 on the disposal of assets due to the overstatement of assets as a result of the incorrect application of the provisional accounting for assets.

*The details of municipalities and municipal entities with findings are listed in annexure 3.*

**Figure 10: Material underspending of the vote/conditional grants**

Motheo District Municipality underspent on their vote due to their planned de-establishment. As a result of this, the council placed a moratorium on the filling of various vacant senior positions. This resulted in shortcomings with internal control measures at the municipality. Also, certain general expenses and integrated development plan (IDP) funding were not incurred or distributed to local municipalities as budgeted for.

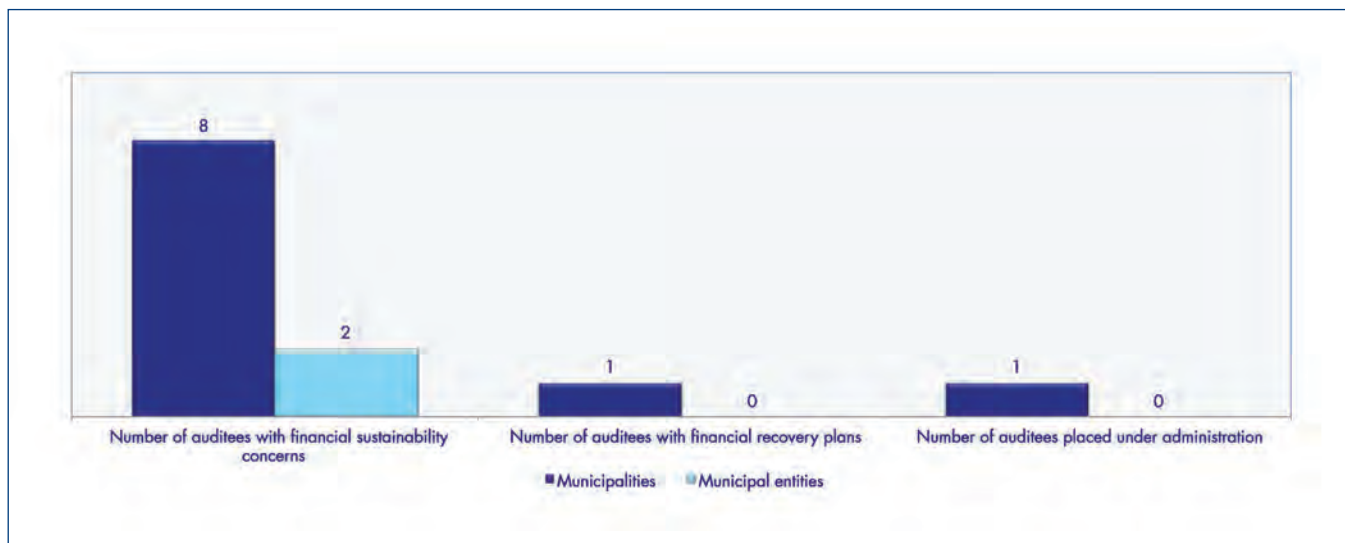
The lack of capacity at Mohokare Local Municipality resulted in ineffective planning to procure services. This caused a delay in the procurement process and an underspending of R8 583 409 on the conditional grant. As a result, Mohokare Local Municipality service delivery did not take place as per the IDP and the financial administration was also ineffective for the period under review.

None of the municipal entities underspent on votes or grants. At Mohokare Local Municipality, instances were identified where the infrastructure and drought relief grants were utilised for operating expenditure.

### 2.2.5 Funding of operations/financial sustainability/going concern

A number of municipalities in the province face serious financial sustainability challenges as depicted below:

**Figure 11: Municipalities and municipal entities with funding concerns**



The broad causes of financial sustainability concerns are depicted below:

**Figure 12: Analysis of funding or going concern issues**



Only Phumelela Local Municipality had a financial recovery plan in place to address their going concern and financial sustainability concerns. CoGTA and the Provincial Treasury support the municipality with the implementation of the turnaround plan.



Concerns regarding the funding of operations have been identified at seven municipalities and two municipal entities. Concerns arise from the following:

- Kopanong, Letsemeng, Mafube, Mohokare, Ngwathe, Phumelela and Setsoto Local Municipalities had financial sustainability issues as a result of not collecting amounts owed by consumers. This is as a result of prevalent unemployment in these areas as well as the lack of controls by the municipalities in following up outstanding debts.
- At Motheo District Municipality material uncertainty existed regarding the possible de-establishment of the district municipality owing to the establishment of a metropolitan municipality in the Mangaung area.
- Going concern issues were raised at Maluti-A-Phofung Water (Pty) Ltd due to the high net deficit and the inability to pay creditors.
- The Metsimaholo Mayoral Trust is dormant and the council of Metsimaholo Local Municipality passed a resolution to dissolve the trust. The responsibilities of the trust will be taken over by the municipality.

## Way forward

For municipalities and municipal entities to address the financial matters referred to above a concerted effort will have to be made to:

- coordinate efforts by CoGTA and the Provincial Treasury to ensure that interventions are not duplicated, that interventions are implemented, monitored and that corrective action is taken where needed
- implement oversight mechanism by the Provincial Treasury and CoGTA to evaluate the costs of consultants and devise a concerted approach in ensuring that benefit is realised
- implement oversight mechanisms by the political leadership as well as legislative oversight. The aim of the supervision will be to monitor the implementation of interventions and actions and to ensure that the required impact is achieved
- improve the quality of financial information by implementing daily and monthly reconciliations and to ensure that the basic control disciplines are adhered to and adequately supervised
- improve reliable billing by implementing daily and monthly reconciliations of meter readings to ensure that all revenue due to the municipality is collected
- monitor electricity and water distribution losses on a monthly basis and prioritise repairs and maintenance to maximise profits
- implement financial recovery plans with a view to promoting own financial sustainability
- review the need for maintaining the existence of the municipal entities, such as trusts and their impact on service delivery.

## 2.3 Findings on reporting on predetermined objectives





Findings arising from the audit of predetermined objectives of municipalities were raised at all 20 audits completed in the current year compared to 23 of 25 audits completed during the previous year. At municipal entities findings were raised at all five audits completed, compared to three of the five audits completed during 2008-09. The findings relate to the matters indicated below.

The percentages reflect those municipalities and municipal entities that had findings on the audit of performance information against predetermined objectives calculated as a percentage of the total number of



entities who submitted their reports on predetermined objectives for review. The findings relate to the matters indicated below.

**Figure 13: Analysis of findings on reporting on predetermined objectives**

	<b>Late/non-submission: 2009-10: 24% 2008-09: 42%</b>
	<b>Non-compliance: 2009-10: 92% 2008-09: 96%</b> Compliance with the MFMA, MSA and municipal planning and performance management regulations pertaining to the planning, management, monitoring, review and reporting of performance Inadequate presentation of reported information, reported information not submitted in time for audit purposes and non-existence and non-functioning of a performance audit committee.
	<b>Not useful: 2009-10: 72% 2008-09: 46%</b> Consistency, relevance and measurability of planned and reported performance information. Information is not consistent with targets and indicators as set in the strategic/corporate/annual performance plans and targets which are not specific, measurable and time bound.
	<b>Not reliable: 2009-10: 56% 2008-09: 42%</b> Reported information not accurate, complete and consistent in relation to the source data, evidence or documentation. Lack of sufficient appropriate audit evidence in relation to reported performance information and source information not adequately supporting the accuracy and completeness of the reported facts.

Only audits where performance information was received and reviewed are included in the analysis for usefulness and reliability of information. Lejweleputswa District Municipality, Motheo District Municipality and Lejweleputswa Development Agency submitted their performance information after the deadline of 31 August 2011. This information was audited and included in the results above.

Kopanong Local Municipality, Setsoto Local Municipality and Metsimaholo Mayoral Trust submitted their performance information too late and as a result it was not audited. *The details of municipalities and municipal entities with findings are listed in annexure 1.*

#### *Non-compliance with regulatory requirements relating to performance management*

Non-compliance findings include objectives, indicators and targets not being predetermined and performance information not being reported against them. In some instances, material differences between actual and planned performance were not explained. Findings on non-compliance related mainly to the following:

- Lack of adoption and implementation of a performance management system (12 municipalities and two municipal entities)
- Inadequate content of integrated development plans (11 municipalities)
- Inadequate content of strategic/corporate/annual performance plans (two municipal entities)

These findings can be attributed to a lack of both an adequate performance management system and an understanding of the performance management process. This resulted in the performance management system being viewed as a paper exercise for compliance purposes and not being utilised to ensure accurate reporting on service delivery to the community.

### *Usefulness of information on performance against predetermined objectives*

Findings include objectives not being measurable against indicators and targets and the absence of clear and logical links between the objectives, outcomes, outputs, indicators and performance targets.

Significant findings in this category specifically related to the following:

- Reported information not consistent with planned objectives, indicators and targets (10 municipalities )
- Planned performance targets not specific or measurable (six municipalities and one municipal entity)
- Lack of reporting on all predetermined objectives in annual performance report (one municipal entity)

These findings can be attributed to the fact that performance management and reporting on predetermined objectives do not receive the same level of attention and commitment as financial reporting. Furthermore, objectives, indicators and targets are not reviewed to ensure that they are realistic, achievable, measurable and funded. Proper systems were also not implemented and maintained to ensure the accurate recording, monitoring and reporting of actual performance.

### *Reported information on performance against predetermined objectives not reliable*

Findings on reliability include instances where the actual reported performance could not be verified.

Findings in this category mainly relate to the following:

Supporting information for reported indicators is not complete and is also not accurate (seven municipalities).

These findings can be attributed to a lack of understanding of what information and supporting documentation will be required to substantiate the information presented in the annual report. It is also indicative of a lack of adequate quality control measures to ensure that only accurate information will be presented in the annual report.

Action to be taken by leadership includes:

- developing the performance management system
- allocating responsibility for collating performance information
- providing training for the staff responsible for performance information
- establishing proper record-keeping management system for performance information
- establishing monitoring mechanisms for performance reporting.

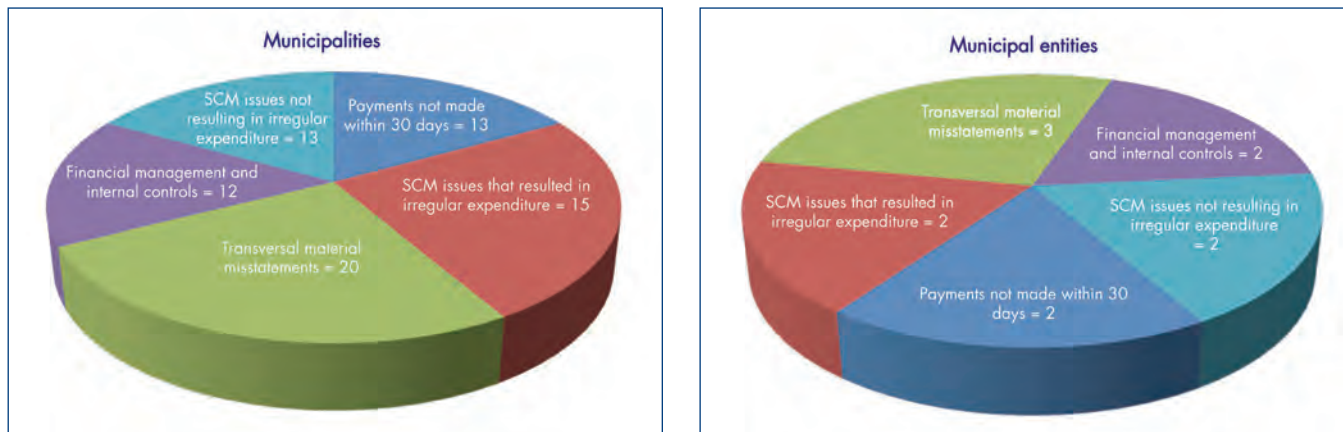
## **2.4 Findings on compliance with laws and regulations**

### **2.4.1 Transversal findings on compliance with laws and regulations**

In total, 20 municipalities (2008-09: 25) and five entities (2008-09: five) had findings on compliance with laws and regulations. The figures below depict the most prevalent findings.



**Figure 14: Analysis of the most prevalent findings on compliance with laws and regulations, including transversal misstatements and supply chain management**



Transversally, the most common findings are the material misstatements in the submitted financial statements (refer to section 2.2.2 above) and non-compliance with legislation on supply chain management (refer to section 2.4.3 below).

The reported lapses in compliance with laws and regulations were directly linked to inadequate risk assessment by the leadership of municipalities and their failure to address the significant deficiencies in the design and implementation of internal control.

Municipalities did not comply with laws and regulations relating to:

- 13 municipalities and two municipal entities that did not pay their expenditure within the required 30 days from the receipt of an invoice, or such a period as prescribed for certain categories of expenditure
- 12 municipal managers and two chief executive officers who did not adhere to his/her legislative responsibilities of managing the financial administration of the municipality by not taking reasonable steps to ensure that the municipality had and maintained effective, efficient and transparent systems of financial management and internal controls. Daily, weekly and monthly reconciliations and controls should be implemented to ensure that financial transactions are accurately recorded and substantiated.

*The details of municipalities and municipal entities with findings are listed in annexure 2.*

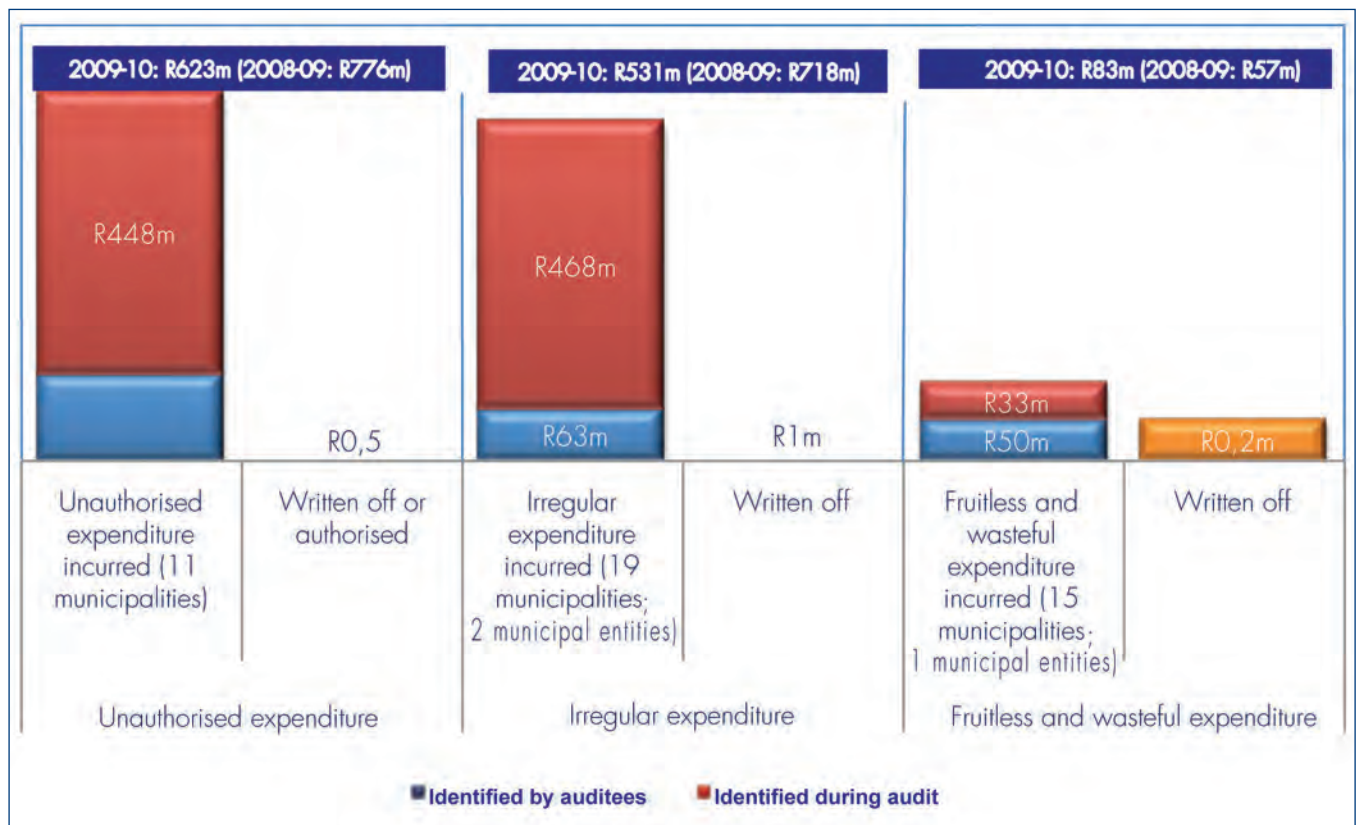
#### **2.4.2 Unauthorised/irregular/fruitless and wasteful expenditure incurred during the year**

Unauthorised, irregular, and fruitless and wasteful expenditure represents expenditure that was not incurred in accordance with the MFMA principles of sound and sustainable management of financial affairs of municipalities and municipal entities.

The figure below depicts the following:

- The amounts of the unauthorised, irregular, and fruitless and wasteful expenditure that was incurred during the year include the expenditure that was disclosed in the financial statements as well as that not disclosed (which resulted in qualifications).
- The number of auditees where it was incurred.
- The proportion of the expenditure that was identified during the audit and not by the systems of the auditee.
- The expenditure determined by the council to be irrecoverable and that was written off by them or authorised (in the case of unauthorised expenditure) during the year.

**Figure 15: Unauthorised, irregular and fruitless and wasteful expenditure reported by auditees and additional amounts identified during audits**

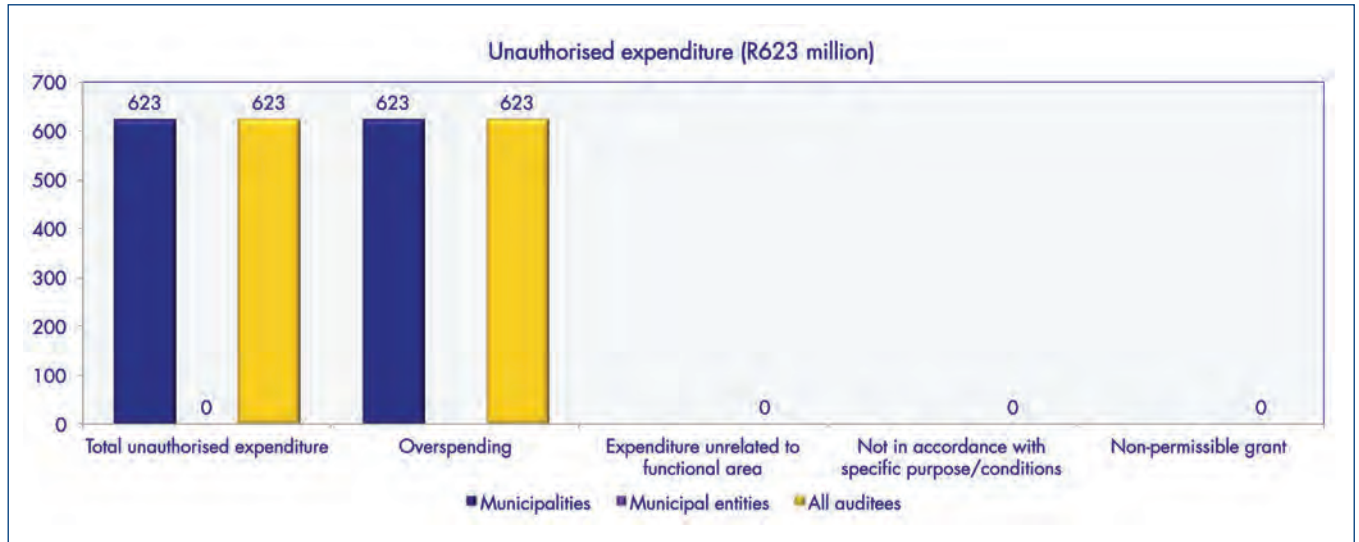


Unauthorised expenditure – R622,7 million (2008-09: R775,6 million)

Unauthorised expenditure of R622,7 million was incurred by 11 municipalities (2008-09: 19) and no municipal entities. This represents a decrease in the number of municipalities incurring unauthorised expenditure to the value of 42% during the 2008-09 financial year. The decrease in the number of municipalities that incurred unauthorised expenditure is as a result of strict budgetary controls which were evident in three municipalities. In other municipalities, no unauthorised expenditure was reported due to material underspending of the budget as a result of staff shortages and impending de-establishment of a district municipality, which resulted in not filling vacant positions and not approving new projects.

Unauthorised expenditure relates to overspending on various votes as a result of inadequate monitoring of the implementation of budgets by the leadership of the municipalities. The actual amounts are depicted below.

**Figure 16: Unauthorised expenditure – Municipalities and municipal entities**

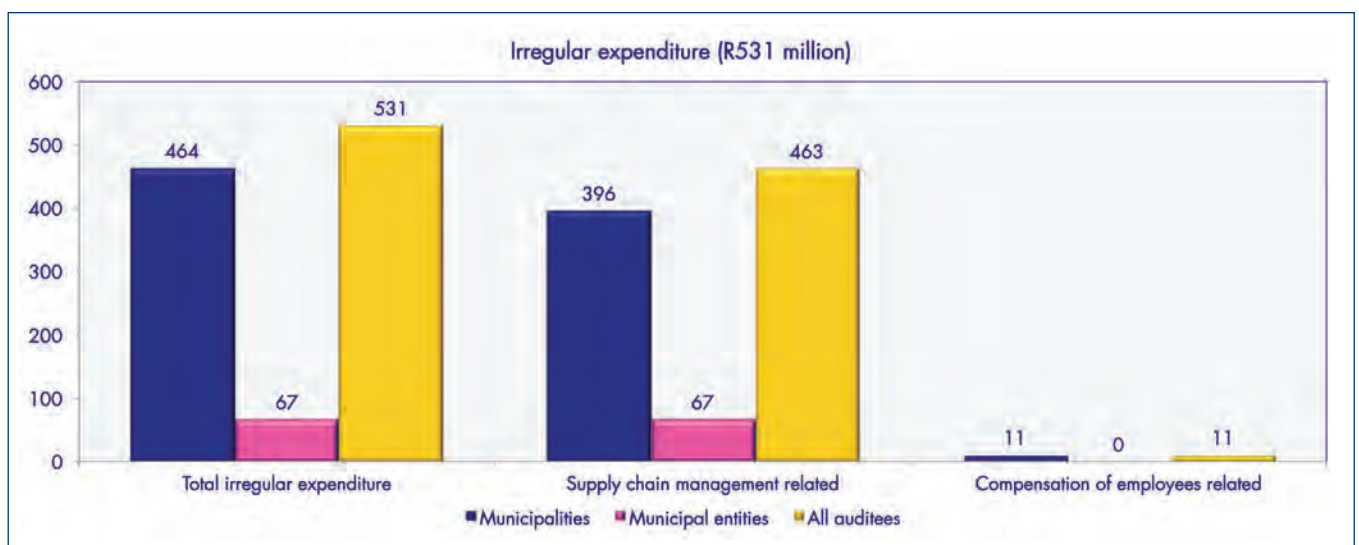


The details of municipalities and municipal entities with findings are listed in annexure 3.

*Irregular expenditure – R531 million (2008-09: R717,9 million)*

Irregular expenditure due to the contravention of, or non-adherence to, requirements of supply chain management, compensation of employees' requirements and other requirements was incurred by 19 (2008-09: 23) municipalities and two (2008-09: three) municipal entities. The actual amounts are depicted below.

**Figure 17: Irregular expenditure**



Of the total amount of irregular expenditure incurred by the municipalities, R400,3 million (86%) was not disclosed in the financial statements submitted for audit purposes, but identified by the external auditors during



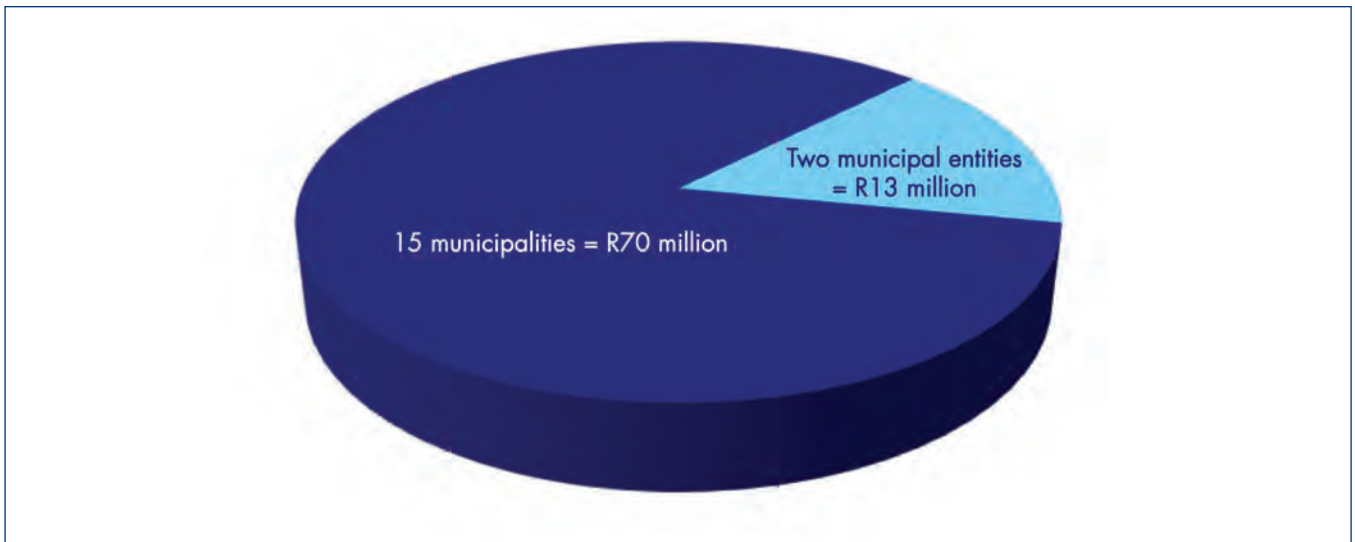
the audit. Irregular expenditure was not disclosed by the municipalities due to insufficient record keeping and a lack of internal control and monitoring measures. In respect of the municipal entities an amount of R67,4 million (100%) was also identified by the external auditors during the audit. An amount of only R669 982 was written off or authorised during the year. Municipalities still need to go through a process to determine responsibility and to take corrective measures before the expenditure can be condoned.

*The details of municipalities and municipal entities with findings are listed in annexure 3.*

*Fruitless and wasteful expenditure – R82,9 million (2008-09: R56,9 million)*

Fifteen municipalities and two municipal entities incurred fruitless and wasteful expenditure amounting to R70,1 million (2008-09: 17 (R56,8 million)) and R12,8 million (2008-09: two (R192 048)), respectively.

**Figure 18: Fruitless and wasteful expenditure incurred by municipalities and municipal entities**



Fruitless and wasteful expenditure was incurred due to the following:

- Penalties and interest charged on late payments
- The payment of settlement costs
- Legal costs being paid
- VAT not claimed on valid tax invoices
- Allowances paid in excess of SARS rates
- Payments made without any evidence that goods/services were rendered
- Payments made towards unfulfilled contracted services
- Double payments being made
- Charges paid on termination of contract

*The details of municipalities and municipal entities with findings are listed in annexure 3.*

### 2.4.3 Findings on non-compliance with legislation on supply chain management

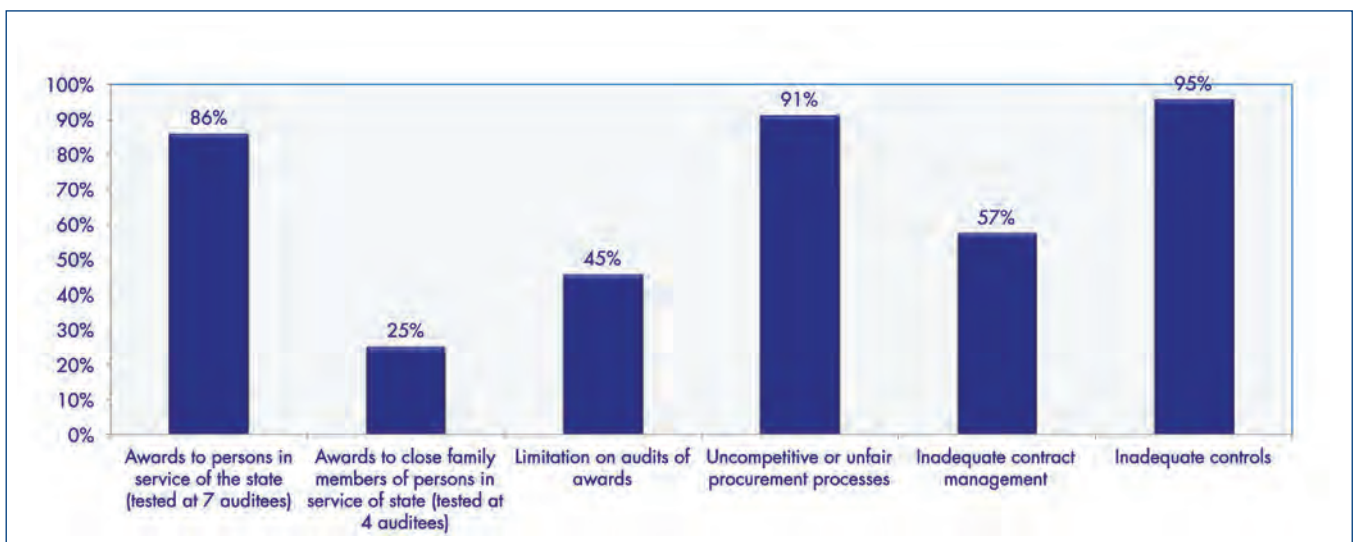
The audits conducted at municipalities and municipal entities for the year included an assessment of procurement processes, contract management and the controls in place to ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system that complies with legislation and minimises the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices.

As is evident from the analysis of irregular expenditure, R464 billion (87%) of the irregular expenditure incurred was as a result of the contravention of the SCM policy and legislation, and 95% of this irregular expenditure was not detected by the implemented controls but by the audit process. In most instances, irregular expenditure was incurred as a result of deliberate disregard of the Municipal SCM Regulations, incorrect interpretation of the Municipal SCM Regulations and inadequate processes and procedures to identify such expenditure.

The irregular expenditure incurred in the province was driven by competitive bids not invited (a finding at 67% of auditees); at least three written price quotations not being obtained for procurement between R30 000 and R200 000 (a finding at 64% of auditees); and deviations from procurement processes not justifiable (a finding at 25% of auditees). While there were SCM policies in place at the majority of the auditees, it was the lack of enforcement by management and not monitoring compliance with the SCM policy by leadership that resulted in significant irregular expenditure. This is not surprising when basic controls such as proper record keeping, risk assessment and internal monitoring were lacking and resulting in inefficient contract management, unfair contract amendments, extensions and renewals not in compliance with the regulations.

Findings arising from the audits of supply chain management were raised at 19 (95%) municipalities and two (40%) municipal entities. At nine municipalities and one municipal entity audit procedures could not be performed as the required information or documentation was not provided by management. Where audit testing could be performed, the findings relate to the matters indicated below.

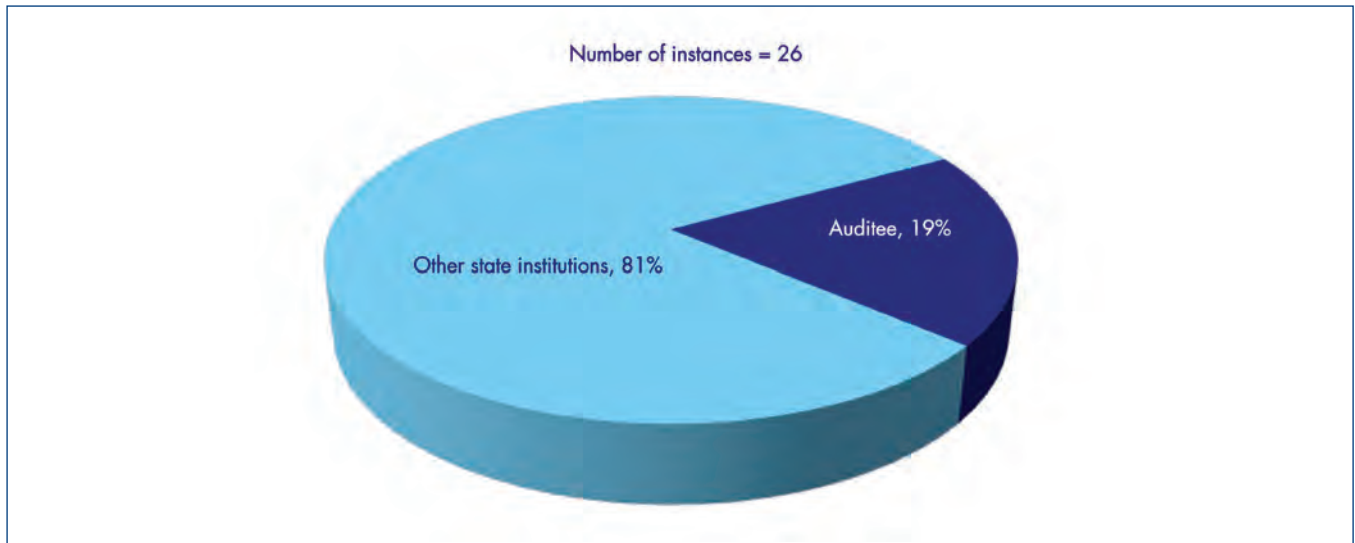
**Figure 19: Summary of findings on supply chain management**



The details of municipalities and municipal entities with findings on supply chain management are listed in annexure 6.

Contracts and quotations to the value of R13 360 532 million were awarded to persons in the service of the state. The majority of persons in the service of the state that received awards from the auditee were in the service of other state institutions as indicated below.

**Figure 20: Analysis of persons in service of the state receiving awards from the auditee**



The testing of awards to persons and their close family members in the service of the municipality and other state institutions was limited to the five high-capacity municipalities and two low-capacity municipalities. The awards to persons and their close family in the service of the municipality (5 out of 26 awards) related to a councillor and other officials.

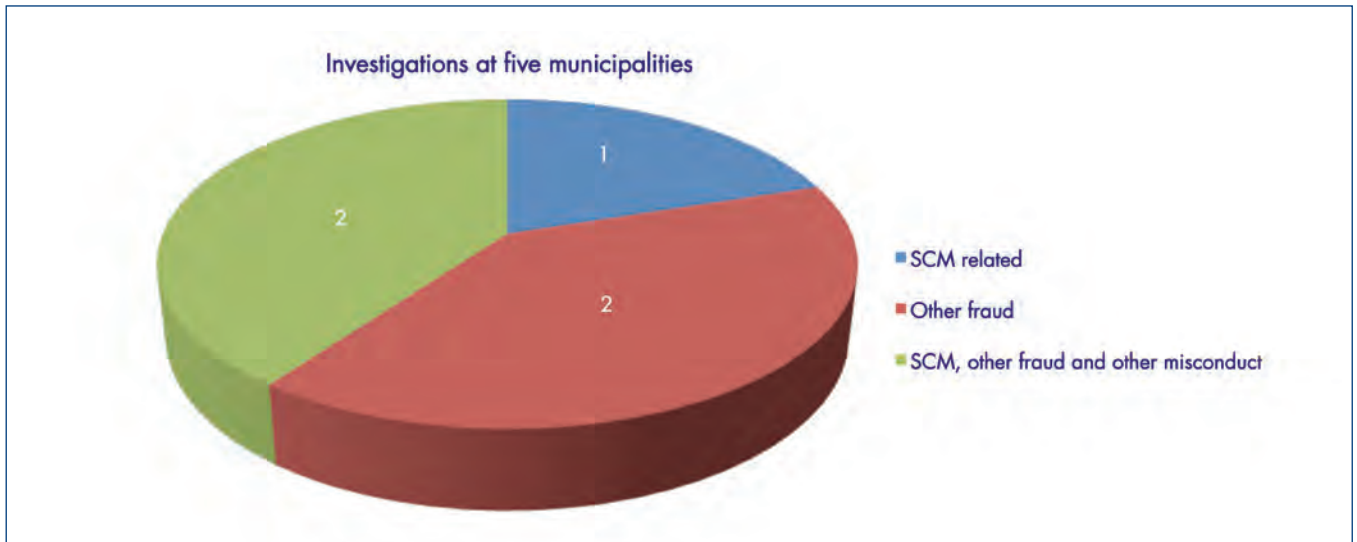
The detailed findings on SCM matters are presented in section 5 of this report.

#### **2.4.4 Investigations and performance audits**

##### **Investigations**

The table below depicts the reasons for investigations finalised or in progress. These were not necessarily performed by the AGSA, but were assessed as being material for purposes of inclusion in the auditor's report.

**Figure 21: Analysis of the reasons for investigations conducted at municipalities**



The investigations analysed above were all requested by the individual municipalities (Mangaung, Matjhabeng, Maluti-A-Phofung, Dhlabeng and Mohokare Local Municipalities) and external service providers were appointed to conduct various investigations on supply chain management, other fraud and other misconduct related matters. These investigations were all still ongoing at the date of finalisation of the audits.

### Performance audits

Details of performance audits during the period under review are as follows:

**Table 5: Tabling dates for performance audit reports**

Detail of performance audits	Date tabled
Mangaung Local Municipality	Not tabled yet.
Audit objectives: Infrastructure projects	
To determine:	
<ul style="list-style-type: none"> <li>if infrastructure projects, sanitation, water and roads, are planned and designed to ensure effective service delivery.</li> <li>whether the most appropriate contractors and consultants were appointed for planning and construction of projects.</li> <li>whether the project management of the projects ensured that it was completed on time, within budget and at the required level of quality.</li> <li>whether completed projects were utilised immediately after completion to deliver services to the community.</li> </ul>	

#### 2.4.5 Oversight reports and tabling of annual reports

The MFMA prescribes the processes of tabling annual reports in the council and legislature and the subsequent publishing of the annual report in order to ensure oversight and transparency. The figures below depict the level of compliance with these requirements. The figure below reflects whether the 2008-09 annual reports were dealt with as required after tabling in the council. Also depicted is whether the 2009-10 annual reports were tabled timeously and made public as required by legislation.

**Figure 22: Oversight reports and tabling 2008-09 annual reports**

Sixteen municipalities tabled their annual reports in the council within seven months after the financial year. The remaining four municipalities did not table their annual reports within the legislative deadline, which include the following:

- Lejweleputswa District Municipality could not submit an annual report due to Lejweleputswa Development Agency which submitted their annual financial statements late. The consolidated report was issued on 31 January 2011.
- Leadership at Mafube Local Municipality does not take ownership and disregards compliance with laws and regulations.
- Management at Ngwathe Local Municipality was appointed in an acting capacity and did not take full responsibility for ensuring compliance with laws and regulations.
- Metsimaholo Local Municipality submitted their annual report to the council, who referred it back to the finance section for corrections.

Of the 16 annual reports tabled within seven months after the financial year, only five were made public. Non-compliance with legislation relates to the non-submission of the annual reports to the council and the evaluation of oversight reports to enable the council to initiate corrective action where needed.

*The timelines for the 2008-09 and 2009-10 annual reports are listed in annexure 7.*

#### **2.4.6 Way forward on compliance-related findings**

The executive leadership realised that the success of clean administration and sustainable improvement in local government is dependent on the adequate involvement of executive mayors and mayors together with the municipal councillors. In addressing the findings of non-compliance that are prevalent in all the municipalities and the municipal entities, the executive leadership, including the political leadership, committed to address these findings by implementing the following:

- The political and legislative oversight will monitor and supervise the adherence to compliance with laws and regulations on an ongoing basis and will meet at least quarterly.

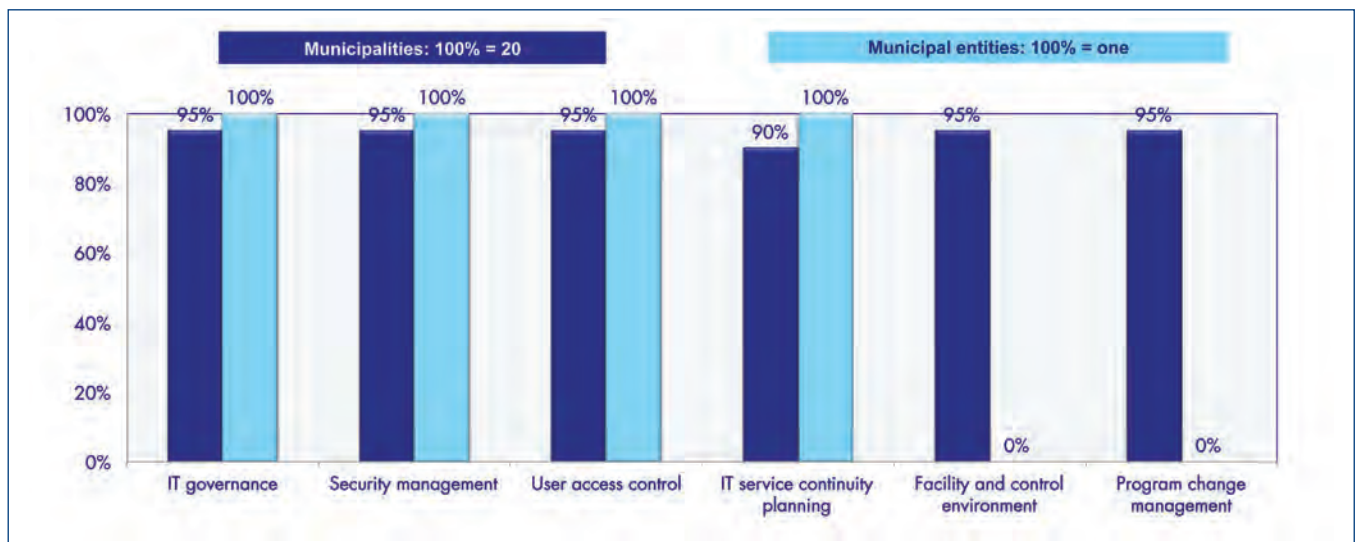
- An orientation workshop will be presented to incoming councillors after the local government elections scheduled for May 2011 with special emphasis on the importance of the correct leadership tone.
- A team of highly competent people will be appointed in the province to provide support to municipalities; this includes a chief director to oversee municipalities within the Provincial Treasury. This will be complemented by a joint team to be established between CoGTA and the Provincial Treasury to support municipalities and to monitor the implementation of action plans by municipalities.
- Controls and checklists will be implemented to ensure that non-compliance is prevented before it is incurred.

## 2.5 Findings on information technology systems

Audits of the information technology (IT) systems were performed at 20 municipalities and one municipal entity during the year under review. Seven different application systems were found to be in use for financial accounting purposes at the 20 municipalities and one municipal entity where the audits were performed. The different systems also increase the support and guidance that must be provided by the national and provincial treasuries regarding GRAP implementation. This is in contrast with central and provincial government which use transversal systems that provide for more cost-effective and efficient management of the systems.

The following figure indicates the prevalence of common focus area findings in municipalities and municipal entities:

**Figure 23: Audit findings raised on common IT focus areas**



The key matters to address in order to improve the state of IT at municipalities and municipal entities are the following:

- The lack of an IT governance process to ensure that IT functions are operational and capacitated.
- Inadequate business continuity and disaster recovery plans and centres to ensure the availability of financial information in instances of data loss.

- The high dependency on service providers due to a lack of skills and support to implement and manage system security functions (18 of the 21 IT manager positions not filled).
- Lack of central coordination, guidance and specialist support to local government to enable cost-effective and efficient management of IT.

In addressing the deficiencies identified in the IT environment, the Provincial Treasury and CoGTA introduced CaseWare at 13 municipalities and are in the process of rolling this out to the other municipalities in the province.

It is recommended that the following actions be taken by the coordinating ministries (DPSA, CoGTA and NT) and provincial oversight:

- The DPSA, in consultation with Government Information Technology Officers (GITO) Council, should extend the currently established IT governance framework to also incorporate local government. Furthermore, consideration should be given to extending the mandate of the State Information Technology Agency (SITA) to also provide specialised technical support to local government.
- Provincial oversight should establish a governance process that will promote knowledge sharing and shared IT technical support per district/province.
- The National Treasury (NT) should provide prescripts regarding financial systems to minimise excessive/duplicate systems and maintenance costs and explore: (i) providing local government with the possibility of applying the integrated financial management system (IFMS) currently under development; and (ii) alternatively, evaluate the possibility of developing a transversal system specifically for local government.
- The Department of Cooperative Governance and Traditional Affairs (CoGTA) should monitor and influence improvements in matters of system deficiencies and duplication at municipalities in collaboration with NT and the Department of Public Service and Administration (DPSA)

The minister of Public Service Administration has indicated his determination to make "service delivery through IT" a key focus of the DPSA. The minister has specifically committed to arranging an urgent meeting with key role players, including SITA, GITO Council, NT, CoGTA, PALAMA and SALGA with, inter alia, the following objectives:

- Approving an IT governance framework that has already been drafted for application by national, provincial and local spheres of government
- Reviewing the "IT strategy" of the Republic of South Africa
- Improving information security across the government
- Reviewing the mandatory and non-mandatory functions of SITA to assess the need for any amendments to the SITA Act, in order for SITA to provide critical specialised support to all spheres of government

The AGSA will participate in the planned meeting in order to ensure that audit concerns are addressed.

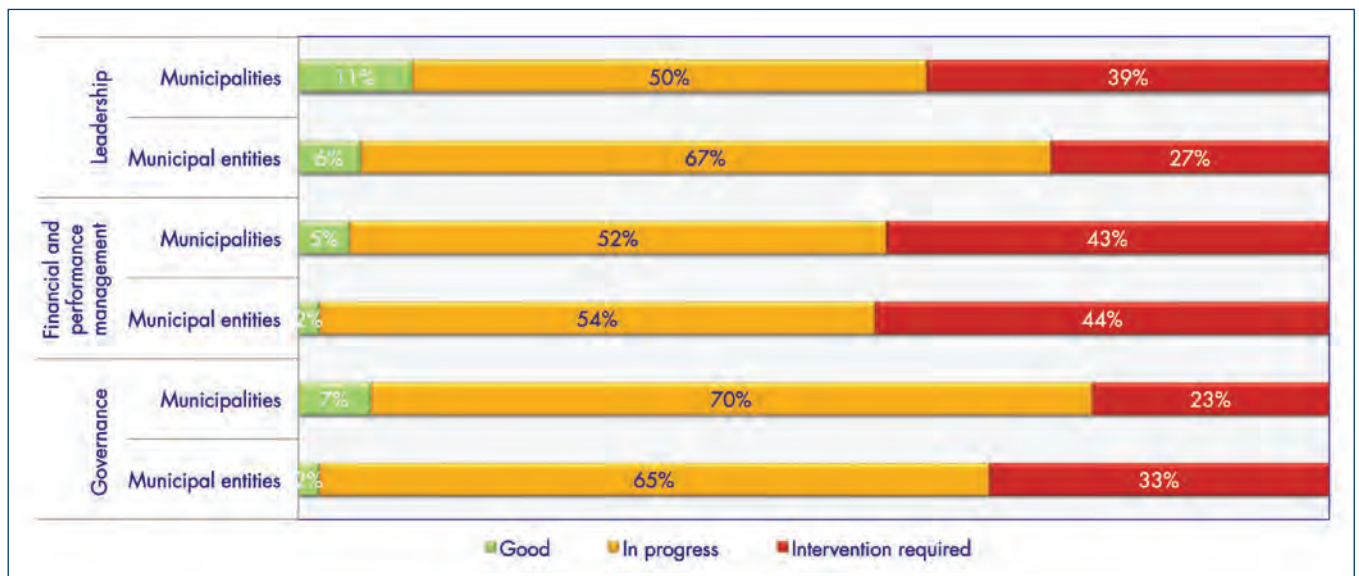
## 2.6 Drivers of audit outcomes

It is evident from the analysis of the audit outcomes presented in the preceding paragraphs that there is much to attend to in order to achieve clean administration and improve audit outcomes.

Municipalities and municipal entities that achieved improvements or maintained positive audit outcomes can attribute these improvements to some level of implementation of effective monitoring of the three fundamentals of internal control (leadership, financial and performance management and governance).

These controls are three dimensional and deficiencies in any or all of these are directly linked to the audit opinions on the financial statements, the findings on reporting on predetermined objectives, and the findings on compliance with applicable laws and regulations.

**Figure 24: Analysis of drivers of improved audit outcomes**



The analysis of audit outcomes as detailed in figures 1 and 2 is an indication that mayors are not effectively overseeing the financial and performance information and compliance with laws and regulations of municipalities and municipal entities.

The following are some of the reasons why the mayors did not honour the commitment they made to oversee the implementation of adequate oversight at the municipalities:

- Mayors, municipal managers and CFOs are not clear on their respective roles and responsibilities.
- Political instability and inadequate oversight by the leadership result in the administration at the municipalities not being actively monitored.
- Leadership did not set the right tone to ensure that the performance of staff is aligned to the desired audit outcomes. No action is taken against municipal managers and CFOs where the municipalities continue to receive disclaimers. No culture of consequences is evident at municipalities.
- Deployment to municipalities occurs without considering the adequacy of the skills for the relevant positions.

- Mayors fail to follow through on the commitments made.
- The initiatives and requirements of CoGTA, the National Treasury and the provincial treasury are not coordinated by the municipalities. Municipalities do not appreciate the interventions and there is limited buy-in to the solutions.

This is exacerbated by the issues relating to the lack of an effective governance framework for information technology which supports the business and other IT-related matters as depicted in figure 23 above.

*The detail on the drivers of audit outcomes is listed in annexure 5.*

These are key areas which, when addressed, demonstrate effective leadership relating to ethical business practices and good governance that enhances and protects the interests of the auditee.

Figure 17 depicts the irregular expenditure incurred by municipalities and municipal entities mainly as a result of the non-compliance with supply chain management policies and procedures. These matters, together with the incidence of material misstatements which had to be corrected as detailed in figure 7, the qualifications on the financial statements and the findings on reporting on predetermined objectives, indicate that basic disciplines such as proper record keeping, regular processing of transactions and reconciliations, preparation of monthly reporting and controls over compliance with fiduciary responsibilities, are not in place. Figure 8 depicts the extent of assistance provided by consultants due to the lack of the necessary technical expertise at municipalities and municipal entities. As consultants were appointed very late and their signed service level agreements did not stipulate their involvement in the transferring of skills, skills were in general not transferred.

These are the areas that should receive attention from the chief financial officers insofar as financial matters are concerned, and from the strategic/monitoring and evaluation unit with regard to performance matters. The mayor and municipal managers should hold the officials accountable and monitor the achievement of these controls on a regular basis.

Governance practices require attention and need to be strengthened. The internal audit functions should be adequately resourced to ensure that they operate effectively by identifying internal control deficiencies in a timely manner and by recommending and monitoring corrective action.

In addition, while audit committees have in general been appointed and have meetings, they are not effective in ensuring that internal and external audit findings are corrected and that the effectiveness of the control environment is assessed due to inadequate functioning of internal audit sections, and members of these committees do not fulfil their responsibilities.

Mayors have agreed that the actions highlighted require attention and have committed to taking ownership of the matters to be addressed by providing proper oversight and fulfilling their legislative responsibilities.

## 2.7 Action to address matters reported

**Table 6: Analysis of commitments made by key role players**

Key role players	Commitments
Joint coordinating effort by CoGTA (Operation Clean Audit) and the provincial treasury	Consultants have been appointed to assist municipalities, where interventions were approved, with the drafting of financial recovery plans, providing guidance towards Operation Clean Audit 2014 and conducting transaction verification exercises
	CoGTA and the provincial treasury developed and commenced with the implementation of the following four transversal projects aimed at supporting municipalities in terms of the Local Government Turnaround Strategy (LGTAS) in an effort to improve on audit outcomes: <ul style="list-style-type: none"> <li>• Municipal GRAP compliance support project</li> <li>• Municipal policies and business process project</li> <li>• Information technology support project</li> <li>• Implementation of CaseWare at 13 municipalities</li> </ul>
	CoGTA commissioned an investigation on possible maladministration and fraud at Matjhabeng Local Municipality. The investigation has been finalised and the report submitted to CoGTA.
	CoGTA has appointed consultants to deliver advisory services in respect of Operation Clean Audit with the Xhariep District Municipality and its local municipalities as pilot.
	CoGTA and the provincial treasury combined efforts to align IDPs and budgets.
	The provincial treasury and CoGTA supported municipalities with the implementation of the key controls, compiling and implementation of policies, clearing asset related and other problems.
	Financial assistance was provided to two municipalities through section 139 interventions, financing of a dedicated six months CFO support programme at one municipality and the finance of CFO packages for three years at four municipalities.
SALGA	Discussed audit outcomes with all municipalities
	Busy with the development of a method of work for MPACs.
Provincial political leadership (Premier, MEC Local Government and MEC Finance)	Political heads have taken responsibility for oversight functions.
	Consultants were appointed to support all municipalities in the Xhariep District as well as Masilonyana, Nala and Thabo Mofutsanyana.
	Premier and various MECs adopted municipalities to monitor progress.
	MECs are involved in the appointment of qualified and competent CFOs at four municipalities and further vacancies are earmarked to be filled with qualified staff.
Oversight (Public Accounts Committee)	Municipalities were and will be placed under administration, where necessary.
	The public accounts committee has invited all municipalities on a regular basis to record progress and to make recommendations for improvements.



**Table 7: Assessment of commitments from key role players to address audit outcomes since the audit**

Role players	Assessment of monitoring capacity and effectiveness								
	Supply chain management	Predetermined objectives	Financial management	Turnaround plans	IT controls	Human resource management	Use of consultants	Municipalities under administration	Governance structures
Joint coordinating effort (Provincial CoGTA and the provincial treasury: Operation Clean Audit)	In progress	Intervention required	In progress	In progress	In progress	In progress	In progress	Good progress	Intervention required
SALGA	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required
Provincial leadership (Premier, MEC Local Government and MEC Finance)	Intervention required	Intervention required	In progress	In progress	Intervention required	In progress	In progress	Good progress	Intervention required
Provincial oversight (Public Accounts Committee)	In progress	Intervention required	In progress	In progress	Intervention required	Intervention required	In progress	Intervention required	In progress

**Intervention required**
 **In progress**
 **Good progress**

Municipalities made firm commitments to improve the implementation of key controls, which were agreed upon during the AGSA door-to-door visits, in order to improve on their audit outcomes. The commitments made by the mayors and municipal managers during the door-to-door visits are as follows:

- Confirmation of daily disciplines of reconciling cash receipts, deposits and payments, and proper document management
- Monitoring that all monthly reconciliations are performed
- Confirmation of monthly asset counts and asset reconciliations with the mayor, including progress on record keeping of infrastructure assets
- Monthly feedback to the mayor on revenue and expenditure linked to the performance targets
- Monthly feedback to the mayor on the monitoring of compliance with laws and regulations with special attention to compliance with the conditions of conditional grants

The provincial leadership, legislative committees, the provincial treasury and CoGTA rolled out extensive initiatives to municipalities and municipal entities. However, the monitoring thereof, the followthrough on commitments and the cooperation received from municipalities and municipal entities remain a challenge in reaching the desired results.

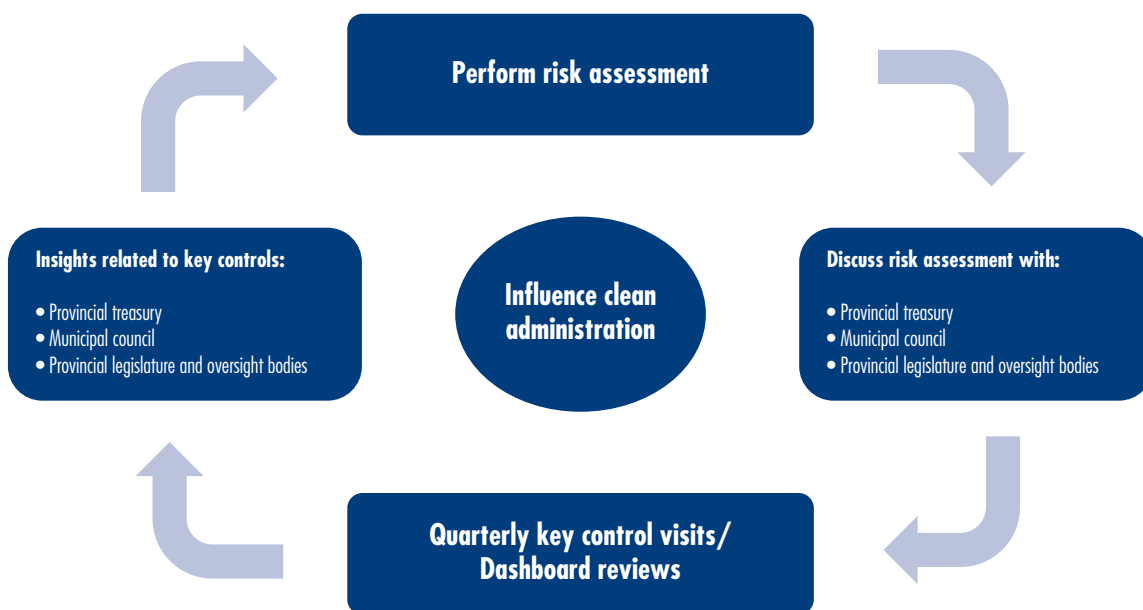
During the Auditor-General's roadshow on 3 March 2011 to present the 2009-10 MFMA audit outcomes, the executive leadership of the province, together with the AGSA, CoGTA and the provincial treasury committed to the coordination and monitoring of follow-up action plans, as summarised below:

- An orientation workshop will be presented to incoming councillors after the local government elections scheduled for May 2011 with special emphasis on the importance of the correct leadership tone.
- Both political and legislative oversight agreed to implement monitoring interventions.

- A team of highly competent people will be appointed in the province to provide support to municipalities. This includes a chief director level to oversee municipalities from within the provincial treasury. This will be complemented by a team to be established between CoGTA and the provincial treasury to support municipalities and to monitor the implementation of action plans by municipalities.
- The premier committed to ensure that a hands-on approach is followed by all leaders on all levels and he also committed to ensure that the right leadership tone is set in the province.
- Training on role clarification for mayors, municipal managers and chief financial officers will be presented.
- The premier will possibly redeploy mayors of municipalities with good outcomes to problem municipalities.
- The MEC: Provincial Treasury envisages possible financial support to struggling municipalities during the next budget cycle.
- Engagements are envisaged at national level to clarify the role of SALGA.

## 2.8 Initiatives by the AGSA to encourage clean administration

**Figure 25: Key elements of the AGSA initiatives to influence audit outcomes**



In order to guide and encourage the achievement of unqualified audit opinions with no reported findings on predetermined objectives and compliance with laws and regulations, the AGSA leadership embarked on an intensified programme to enhance its visibility in order to improve the effectiveness of the audit process and engage with all role players that could influence clean administration.

The following interaction with stakeholders took place:

- Internal control shortcomings and the monitoring of key controls were communicated to the accounting officers during quarterly visits and audit steering committee meetings.
- Commitments regarding the correction of key controls and the monitoring of action plans to correct key controls are obtained from accounting officers on a quarterly basis.

- Audit findings, root causes, recommendations and audit outcomes are discussed at audit steering committees during the course of the audit process.
- SCOPA is briefed yearly on the audit outcomes at municipalities and municipal entities and all hearings are attended.
- Audit committee meetings are attended to discuss strategic plans, audit outcomes, risk evaluation and internal and external audit findings.
- Regular meetings are held with the premier, the Speaker, MECs of the Treasury and CoGTA and the PCF to present the audit outcomes and status of the implementation of key controls.
- Presentations on the auditing of reporting on predetermined objectives to CFO forums and HOD forums.
- Quarterly feedback to the PCF on implementation of key controls.
- Technical committee meetings with the provincial treasury to discuss transversal matters and ultimately getting the solutions.

The AGSA will continue with the stakeholder interactions with those charged with governance to conduct quarterly assessments of key controls and focused feedback discussions to share the assessment results with a view to enhancing and strengthening leadership involvement in the operations of the municipalities. These interactions included identifying key controls per entity, influencing the implementation of these key controls and performing quarterly assessments of management's implemented actions to address the audit recommendations and to serve as the way forward in resolving poor audit outcomes.

After the local government elections the Free State office of the AGSA will provide guidance on the key control initiative to all councillors during an orientation workshop. The purpose of this guidance is to ensure that the leadership understands the necessity for a sound control environment. The quarterly assessment of the status of key controls at each municipality by the AGSA will continue with the results shared with the leadership, i.e. at least the mayors and MMs.

The AGSA's future interactions with the political oversight as well as the legislative oversight will focus primarily on the following:

- Follow-up on the implementation of supervisory and monitoring actions
- Early identification of risks in order to improve audit outcomes
- The status of key controls in the province will be discussed. If the basic principles of accounting are not observed the sustainability and improvement of audit outcomes will not be realised.

The AGSA will continue to interact and explain the objectives of reporting on predetermined objectives, what the process entails and what measures need to be implemented going forward at all available forums.

## **2.9 Matters that require attention to prevent a negative impact on audit outcomes in the coming year**

### *Predetermined objectives*

The majority of municipalities and municipal entities whose audits were finalised by 31 January 2011 had findings on predetermined objectives. Actions should be taken to address the significant deficiencies relating to the audit of predetermined objectives. Should actions not be taken and regularly monitored and reviewed



for completeness and implementation, the audit outcomes of the municipalities might be modified once the decision is made to elevate the conclusion on predetermined objectives to the auditor's report.

#### *Compliance with GRAP standards*

The current status of municipalities applying the transitional provisions allowed in terms of *GRAP 17: Property, plant and equipment*, remains for a period of up to three years, after which they would have to fully comply with the requirements of measurement of assets in terms of GRAP 17. This could pose a challenge for those municipalities that have taken advantage of these transitional provisions and are doing little to address the requirements for a fully compliant GRAP 17 asset system.

#### *Risks related to computerised information systems and the mitigation thereof*

Along with the benefits, the use of computerised information systems by municipalities and municipal entities comes with a number of monetary and financial reporting risks. Ineffective information system controls may contribute to financial management weaknesses, inaccurate financial and performance information, poor performance of the entity, and fruitless and wasteful expenditure, and may even contribute to non-compliance with applicable laws and regulations. Furthermore, weak information system controls make the systems vulnerable to be used to perpetrate fraud. The leadership of municipalities and municipal entities should assess the risks associated with computerised information systems and the mitigation thereof, and prioritise it appropriately, as well as review the adequacy of governance arrangements required to oversee information system issues.

## SECTION 3: OVERVIEW OF AUDIT OUTCOMES FOR 2009-10

This section of the analysis provides an overview of the following aspects related to the 60 municipalities and seven municipal entities whose audits were finalised at 31 January 2011:

Section 3.1 Summary of audit outcomes includes:

- Summary of audit outcomes
- Status of completion of the audits
- Movements in audit outcomes

Section 3.2 Findings on financial management includes:

- Financial statement areas attracting qualifications
- Material misstatements in financial statements submitted for audit purposes
- Financial statement-related assistance provided to municipalities by consultants
- Material losses, impairment of assets and material underspending of the vote/conditional grant
- Auditees with funding of operations, financial sustainability and going concerns issues

Section 3.3 Findings on reporting on predetermined objectives.

Section 3.4 Findings on compliance with laws and regulations:

- Transversal findings on compliance with laws and regulations
- Unauthorised, irregular, and fruitless and wasteful expenditure incurred
- Investigations conducted

Section 3.5 Findings on information technology systems.

### 3.1 Summary of audit outcomes

The tables below provide details of the 2009-10 audit outcomes of municipalities and municipal entities and reflect the status of completion of the audits as at 31 January 2011.

**Table 8: Summary of audit outcomes**

Audit outcomes	Municipalities		Municipal entities	
	2009-10	2008-09	2009-10	2008-09
Disclaimer	9	18	3	4
Adverse	1	2	0	0
Qualified	6	2	1	1
Financially unqualified with findings on predetermined objectives and/or compliance with laws and regulations	4	3	1	0
Financially unqualified with no findings on predetermined objectives or compliance with laws and regulations	0	0	0	0
<b>Total number of audits reported on</b>	<b>20</b>	<b>25</b>	<b>5</b>	<b>5</b>



Audit outcomes	Municipalities		Municipal entities	
	2009-10	2008-09	2009-10	2008-09
Number of audit reports not issued by 31 January 2011	5	0	1	1
Total number of audits	25	25	6	6
Findings arising from the AGSA's other legal reporting responsibilities:				
Predetermined objectives	20	23	5	3
Compliance with laws and regulations	20	25	5	5

The audit outcomes for the 2008-09 financial year have been updated in respect of the audits of two municipalities and three municipal entities that had not been completed at the cut-off date of the 2008-09 general report. Two municipalities (Tokologo and Metsimaholo) were disclaimed and two municipal entities (Fezile Dabi District Trust and Metsimaholo Mayoral Trust) were disclaimed. The 2008-09 financial statements of the Krynaauwlust Farming Trust were still outstanding at the time of this report.

**Table 9: Audit outcomes for the 2008-09 financial year not included in 2008-09 general report**

Municipality	Audit outcome
Metsimaholo Local Municipality	Disclaimer
Tokologo Local Municipality	Disclaimer
Fezile Dabi District Trust	Disclaimer
Metsimaholo Mayoral Trust	Disclaimer

### Status of completion of the audits

This report only provides details of audits completed as at 31 January 2011. Audits excluded from the analysis in this report are listed in the table below.

**Table 10: Audits outstanding or finalised late**

Entity not reported on	Audit cycle	Annual financial statements received date	Reason not finalised	Actual/expected date finalised
<b>Municipalities</b>				
Masilonyana	2009-10	31-Aug-10	Quality issues with firm who conducted the audit on behalf of the AGSA	31-May-11
Maqhaka	2009-10	17-Feb-11	Late submission of annual financial statements	17-May-11
Naledi	2009-10	7-Oct-10	Late submission of annual financial statements. Team had to withdraw from audit owing to unrest at the municipality. The December/January holiday and the availability of staff impacted on the finalisation of the audit report.	31-Mar-11
Nala	2009-10	Outstanding	Annual financial statements outstanding	3 months from receipt of annual financial statements
Tokologo	2009-10	4-Nov-10	Late submission of annual financial statements	12-Apr-11
<b>Municipal entities</b>				
Krynaauwlust Farming Trust	2008-09 2009-10	Outstanding	Annual financial statements outstanding	3 months from receipt of annual financial statements



In terms of section 133(1)(b) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) the Speaker, the provincial treasury and the MECs for CoGTA and the treasury have been informed of the late submission of annual financial statements by Naledi and Tokologo Local Municipalities and the consolidated annual financial statements by Lejweleputswa District Municipality.

The Speaker, the provincial treasury, the MECs for CoGTA and the treasury and the Free State Legislature have been informed in terms of section 133(2) of the MFMA of the non-submission of annual financial statements by Nala and Moqhaka Local Municipalities.

Where the AGSA was unable to complete the audit within three months of receiving the financial statements from Masilonyana Local Municipality, the municipality and the Free State Legislature has been informed of the reasons for the delay in terms of section 126(4) of the MFMA.

### **Movements in audit outcomes**

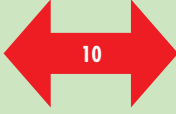




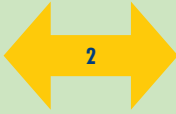
Movements in audit outcomes of the municipalities and municipal entities for the year under review are depicted below.

**Table 11: Movements in audit outcomes**

Type of auditee	Unchanged	Improvement	Regression	Total
Municipalities	13	6	1	20
Municipal entities	3	2	0	5
<b>Total number of audits reported on</b>	<b>16</b>	<b>8</b>	<b>1</b>	<b>25</b>

### **Municipalities**

**Figure 26: Movement in audit outcomes over 2008-09 financial year – Municipalities**

Movement in audit outcomes over 2008 - 09 - Municipalities					
	Improvement	Unchanged	Regressed	Total reported on	Prior year opinion on audits outstanding 2009-10
Disclaimer/Adverse				10	5
Qualified				6	
Financially unqualified with findings				4	

Movement in audit outcomes over 2008 - 09 - Municipalities					
	Improvement	Unchanged	Regressed	Total reported on	Prior year opinion on audits outstanding 2009-10
Financially unqualified with no findings					
Total	6	13	1	20	5

An analysis of movements in audit outcomes of municipalities in the province for the year under review is presented below, supplemented by a five-year movement in table 13.

#### Improvements

- Disclaimer to qualified  
Dihlabeng, Mantsopa and Nketoana Local and Xhariep District Municipalities improved from a disclaimer to a qualification. The progression is mainly attributed to the leadership taking active steps to correct prior year challenges, the submission of documentation and the involvement of consultants (no consultants appointed at Mantsopa Local Municipality).
- Disclaimer to financially unqualified  
Thabo Mofutsanyana District Municipality improved from disclaimer to financially unqualified (with findings) owing to consultants analysing all audit queries and implemented corrective actions. Where irregular expenditure was detected, it was disclosed in the financial statements.
- Qualified to financially unqualified  
Motheo District Municipality improved from qualified to financially unqualified (with findings) owing to focused oversight, supervision and monitoring by the leadership of the municipality to address and correct all material matter items since 2008-09.

#### Unchanged

- Disclaimer of opinions, including adverse  
Ten municipalities, namely Kopanong, Letsemeng (2009-10: Adverse), Mafube, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Mohokare (2008-09: Adverse), Ngwathe and Phumelela Local Municipalities again registered disclaimers of audit opinion. The matters that prevented the municipalities from registering improved audit outcomes were non-compliance with laws and regulations, inadequate governance arrangements and deficient risk management practices. Although the audit outcomes of these municipalities remained unchanged, the basis for the disclaimer of opinion included fewer matters than in the previous financial year.
- Qualified  
One municipality, namely Setsoto Local Municipality, remained qualified mainly due to the ineffective system of managing documentation.



- Unqualified with findings  
Two municipalities, namely Fezile Dabi and Lejweleputswa District Municipalities, remained financially unqualified (with findings).

#### Regression

- Financially unqualified (with findings) to qualification  
Only one municipality, namely Tswelopele Local Municipality, regressed because of GRAP implementation challenges.

### Municipal entities

**Figure 27: Movement in audit outcomes over 2008-09 financial year – Municipal entities**

Movement in audit outcomes over 2008 - 09 - Municipal entities						
	Improvement	Unchanged	Regressed	New public entities	Total reported on	Prior year opinion on audits outstanding 2009-10
Disclaimer/Adverse					3	
Qualified					1	
Financially unqualified with findings					1	
Financially unqualified with no findings						
<b>Total</b>	2	3			6	1 (outstanding since 2004-05)

An analysis of movements in audit outcomes of municipal entities in the province for the year under review is presented below, supplemented by a five-year movement in table 13.

#### Improvements

- Disclaimer to qualified  
Metsimaholo Mayoral Trust improved due to bursary payments no longer paid from the trust.

- Qualified to unqualified with findings  
Increased oversight by the leadership, as well as annual financial statements being compiled by consultants, resulted in the improved audit outcome at Lejweleputswa Development Agency.

#### Unchanged

- Disclaimer  
Three municipal entities (Centlec, Fezile Dabi Trust and Maluti-A-Phofung Water) again received a disclaimer owing to inadequate record keeping over supporting documentation and ineffective control and record keeping over assets.

**Table 12: History of audit outcomes of municipalities and municipal entities disclaimed, adverse or qualified in 2009-10**

Auditee	History of audit opinions					
	Audit opinion 2009-10	Audit opinion 2008-09	Audit opinion 2007-08	Audit opinion 2006-07	Audit opinion 2005-06	Audit opinion 2004-05
Dihlabeng	Qualified	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
Koponong	Disclaimer	Disclaimer	Disclaimer	Qualified	Disclaimer	Qualified
Letsemeng	Adverse	Disclaimer	Disclaimer	Disclaimer	Qualified	Qualified
Mafube	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
Maluti-A-Phofung	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
Mangaung	Disclaimer	Disclaimer	Disclaimer	Qualified	Disclaimer	Qualified
Mantsopa	Qualified	Disclaimer	Qualified	Qualified	Disclaimer	Qualified
Matjhabeng	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Adverse	Adverse
Metsimaholo	Disclaimer	Disclaimer	Disclaimer	Qualified	Disclaimer	Disclaimer
Mohokare	Disclaimer	Adverse	Disclaimer	Disclaimer	Disclaimer	Adverse
Ngwathe	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Qualified
Nketoana	Qualified	Disclaimer	Disclaimer	Disclaimer	Qualified	Qualified
Phumelela	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
Setsoto	Qualified	Qualified	Qualified	Qualified	Disclaimer	Qualified
Tswelopele	Qualified	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Qualified	Financially unqualified with findings
Xhariep District	Qualified	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
Centlec (Pty) Ltd	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Established in 2005-06
Fezile Dabi Trust	Disclaimer	Disclaimer	Established in 2008-09			
Maluti-A-Phofung Water (Pty) Ltd	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Established in 2005-06
Metsimaholo Mayoral trust	Qualified	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer

Although some municipalities have improved over the past six years, for some the audit opinions remained exactly the same as it had been six years ago. Three municipalities, such as Mafube, Maluti-A-Phofung and Pumelela and one municipal entity, Maluti-A-Phofung Water, received a disclaimer of opinion for the past six years. Matjhabeng and Mohokare alternated its opinion over the past six years between the disclaimer and adverse opinion, which is viewed as worst case opinions. In respect of Mangaung and Ngwathe, their



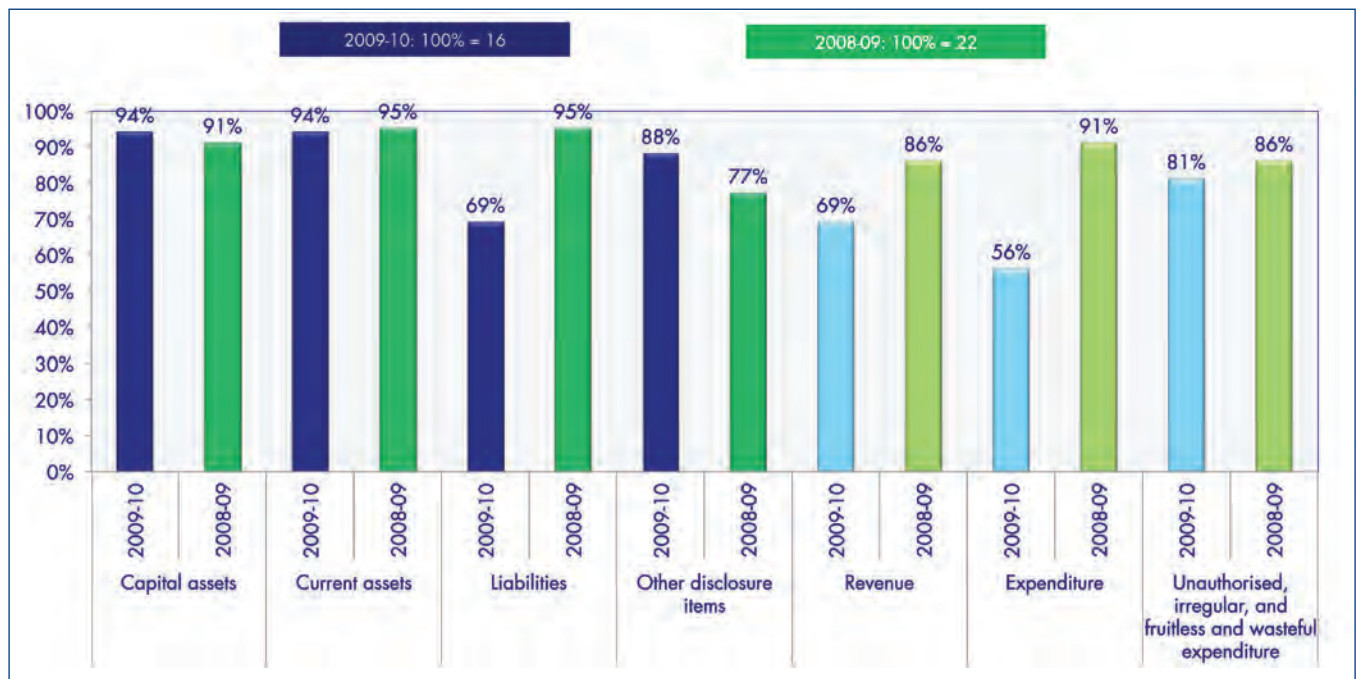
opinions deteriorated from a qualification in 2004-05 to a disclaimer of opinion over the past five years. Centlec and Fezile Dabi Trust have been receiving the disclaimer of opinion since their inception for the past five and two years, respectively.

A concerted effort will therefore be required by the supporting Department of Local Government and the provincial treasury to coordinate efforts to maximise the impact of interventions in the province. The oversight role by the political leadership, the portfolio committees and the mayors will have to be intensified to ensure that all actions are adequately supervised and monitored and that required corrective action is taken when needed.

## 3.2 Findings on financial management

### 3.2.1 Transversal material issues that form the basis for qualified/adverse/disclaimed opinions on the financial statements

**Figure 28: Financial statement areas qualified – Municipalities**



The basis for financial statements of municipalities and municipal entities in the province attracting qualifications is explained below; supplemented by an analysis of movements in financial statement qualification areas in table 13.

#### *Capital assets (94%)*

The following 15 municipalities (94%) were qualified regarding property, plant and equipment: Dihlabeng, Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Mangaung, Mantsopa, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana, Phumelela, Setsoto and Tswelopele Local Municipalities.

The qualifications regarding property, plant and equipment can mainly be attributed to the following common root causes:

- Asset registers and asset management systems were not adequate to provide sufficient details regarding property, plant and equipment and, especially, infrastructure assets.
- The complexity of measuring property, plant and equipment in terms of the relevant accounting standards required a high degree of expertise that was not always available.

#### *Current assets (94%)*

Qualifications in this area related to cash and cash equivalents, receivables and inventory, with 15 municipalities (94%) being qualified regarding receivables, seven municipalities (44%) being qualified regarding cash and cash equivalents, and six municipalities (38%) being qualified regarding inventory. A total of 15 municipalities (94%) were thus qualified with regard to current assets. Only Xhariep District Municipality was not qualified on current asset issues.

The qualifications could be attributed to the following:

- Management not improving the archive and filing systems
- A lack of performing daily and monthly reconciliations
- A lack of knowledge to ensure that accounting is done properly as prescribed by the accounting standards, which include trade and other receivables (debtors) not initially recognised at fair value and subsequently amortised cost using the effective interest method and trade debtors were not impaired as required by assessing the individual debtors or per category, but a general provision for irrecoverable amounts was made.

#### *Liabilities (69%)*

Qualifications in this area related to payables, accruals and borrowings, provisions and guarantees, and taxes and value-added tax (VAT). Eleven municipalities (69%) were qualified in this area, namely Dihlabeng, Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Phumelela and Setsoto Local Municipalities. The remaining municipalities, namely Mangaung, Mantsopa, Nketoana and Tswelopele Local Municipalities, as well as the Xhariep District Municipality did not receive any qualification in this area.

Qualifications regarding liabilities can mainly be attributed to:

- a lack of knowledge/understanding of the related GRAP requirements
- a lack of documentation
- failure to clear suspense accounts due to inadequate monitoring by the leadership.

#### *Other disclosure (88%)*

The following 14 municipalities (88%) obtained qualifications pertaining to presentation and disclosure: Dihlabeng, Kopanong, Letsemeng, Mafube, Mangaung, Mantsopa, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana, Phumelela, Setsoto and Tswelopele. The general areas qualified included inappropriate

disclosure of contingent liabilities and commitments and the fair presentation of the cash flow statement and corresponding figures.

The common root causes of the qualifications in respect of presentation and disclosure included a lack of supporting documentation, a lack of knowledge/understanding in the finance unit of the related GRAP requirements and inadequate monitoring of consultants by the leadership.

*Unauthorised, irregular and fruitless and wasteful expenditure (81%)*

The following six municipalities (38%) obtained qualifications regarding unauthorised expenditure as the amounts were not disclosed in the financial statements: Kopanong, Letsemeng, Maluti-A-Phofung, Matjhabeng, Ngwathe, and Phumelela Local Municipalities. The qualifications regarding unauthorised expenditure during the year under review related to the overspending on various votes as a result of inadequate monitoring of the implementation of budgets by the leadership of municipalities.

This can mainly be attributed to the following common root causes:

- Inadequate leadership oversight, monitoring and supervision by management throughout the year.
- Unrealistic budgeting and inadequate budget control measures.

Twelve municipalities (75%), namely Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana, Phumelela Local Municipalities as well as Xhariep District Municipality, were qualified regarding irregular expenditure mainly due to the lack of supporting documentation of the amounts disclosed in the financial statements. The irregular expenditure was incurred as a result of the non-compliance with supply chain management and other legislation.

The reason for the irregular expenditure is a failure by the leadership of the municipalities to strictly apply legislative prescripts and to prevent irregular expenditure. Control activities and monitoring were ineffective and did not ensure that all instances of non-compliance with applicable legislation resulting in irregular expenditure were identified, investigated and reported.

Eight municipalities (50%), namely Kopanong, Letsemeng, Mafube, Metsimaholo, Mohokare, Ngwathe, Phumelela and Setsoto Local Municipality, were qualified regarding fruitless and wasteful expenditure that was not disclosed in the financial statements.

The common root causes underlying the qualifications regarding fruitless and wasteful expenditure were as follows:

- Leadership oversight, monitoring and supervision were inadequate to prevent fruitless and wasteful expenditure.
- The lack of risk assessment processes resulted in insufficient control measures to identify and investigate fruitless and wasteful expenditure.
- Financial instability and cash flow problems resulted in payments being delayed and consequently in fruitless and wasteful expenditure due to interest and penalties.

Revenue (69%)

Eleven local municipalities (69%), namely Dhlabeng, Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana and Phumelela were qualified with regard to revenue.

The qualifications stemmed mainly from ineffective control activities and inadequate actions taken to mitigate risks as well as a lack of ongoing monitoring to ensure the accuracy of billings (such as setting tariffs and regular reconciliations) and a lack of available supporting documentation.

Expenditure (56%)

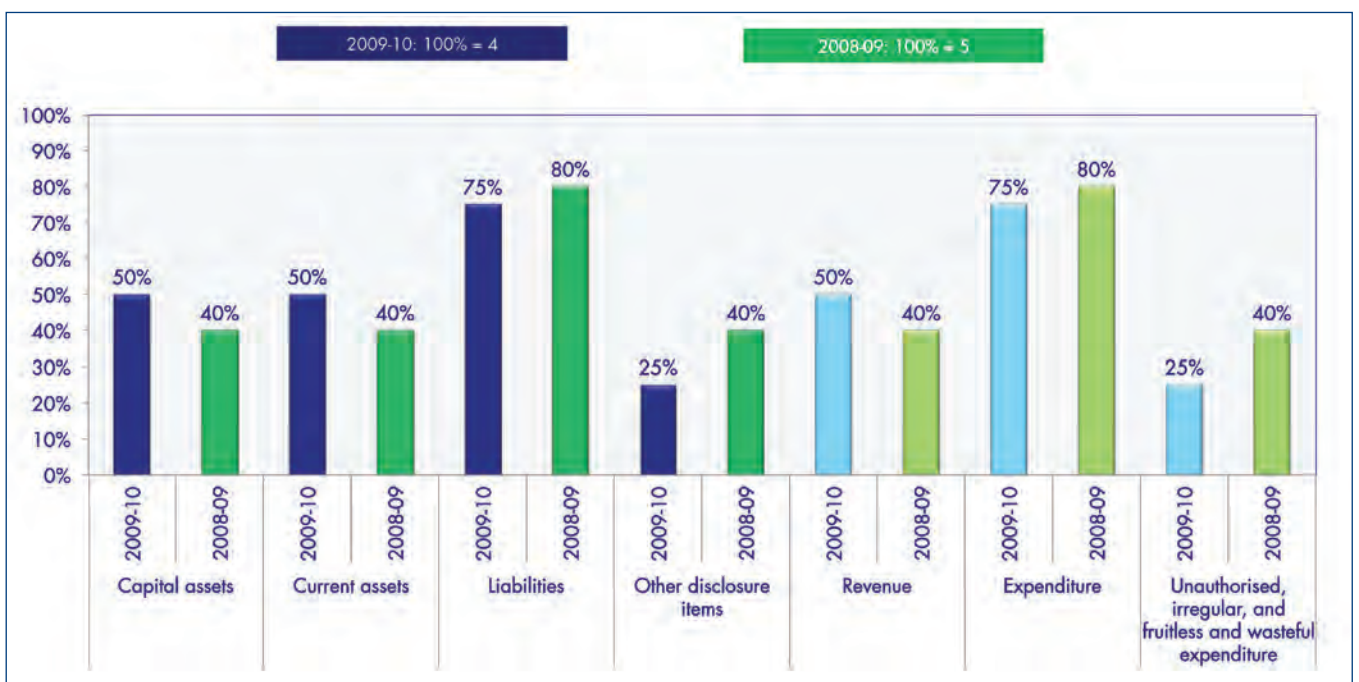
Nine municipalities (56%) attracted qualifications with regard to expenditure. The municipalities qualified in this area were Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Matjhabeng, Mohokare, Ngwathe, Phumelela and Setsoto Local Municipalities.

The qualifications regarding expenditure can mainly be attributed to the following common root causes:

- Inadequate supervision by the accounting officer and management throughout the year.
- Lack of understanding of the accounting framework by employees in the finance section.
- Controls over transactions were lacking, resulting in financial information not being properly supported.
- Lack of accountability for prior year’s negative results (no consequences).

The details of municipalities and municipal entities with findings are listed in annexure 1.

**Figure 29: Financial statement areas qualified – Municipal entities**



### *Capital assets (50%)*

Centlec (Pty) Ltd and Maluti-A-Phofung Water (Pty) Ltd (50%) were qualified regarding property, plant and equipment.

The qualification can mainly be attributed to the following root causes:

- The systems in place at these entities to account for items of property, plant and equipment were not adequate to provide the auditors with sufficient information to verify the existence, valuation and completeness of the amounts disclosed in the financial statements.
- The complexity of measuring property, plant and equipment required a high degree of expertise that was not always available.
- Consultants did not transfer knowledge and skills to staff in the finance units.

### *Current assets (50%)*

As a result of inadequate control and monitoring by the leadership two of the four (50%) municipal entities, namely Centlec and Maluti-A-Phofung Water, were qualified on current assets for the following reasons:

- A lack of sufficient audit evidence in support of the reasons that led to the processing of journals against the current account balances.
- The entities did not have personnel with the required technical expertise regarding the calculation of impairments, the valuation of inventory items and compliance with the prescribed accounting standards.

### *Liabilities (75%)*

Three (75%) municipal entities analysed, namely Centlec (Pty) Ltd, the Metsimaholo Mayoral Trust and Maluti-A-Phofung Water (Pty) Ltd, obtained qualifications regarding payables and borrowings as well as taxes and VAT.

Qualifications regarding liabilities can mainly be attributed to a lack of knowledge/understanding of the accounting framework and insufficient documentation and reconciliations done as a result of inadequate monitoring by the leadership and include the following:

- A lack of supporting documentation, such as loan agreements and supplier statements
- Expenditure incurred during 2008-09, but paid during 2009-10 was not accrued.
- Input VAT was claimed on non-VAT purchases.
- Output VAT was not charged on invoices issued to the parent municipality.

### *Other disclosure (25%)*

Centlec (Pty) Ltd was qualified due to a limitation in scope with regard to the fair presentation of the cash flow statement, contingent liabilities, commitments, distribution losses and the disclosure of budgeted information.

The common root causes of the qualifications in respect of presentation and disclosure included a lack of supporting documentation, a lack of knowledge and monitoring by leadership to ensure complete and accurate information and records.



*Unauthorised, irregular and fruitless and wasteful expenditure (25%)*

Centlec (Pty) Ltd disclosed that they incurred irregular expenditure, but adequate supporting documentation to support the amount disclosed could not be submitted. Control measures by management to ensure the prevention and investigation of the irregular expenditure incurred were insufficient.

*Revenue (50%)*

Centlec (Pty) Ltd and Maluti-A-Phofung Water (Pty) Ltd were qualified with regard to revenue. The qualifications stemmed mainly from inadequate supporting documentation and a lack of knowledge/ understanding of the accounting framework. This was as a result of ineffective control activities by leadership to mitigate risks to ensure the accuracy of transactions such as regular reconciliations.

*Expenditure (75%)*

Three municipal entities (50%) analysed, namely Centlec (Pty) Ltd, Fezile Dabi Development Trust and Maluti-A-Phofung Water (Pty) Ltd, obtained qualifications with regard to expenditure.

The qualifications regarding expenditure can mainly be attributed to the following common root causes:

- Inadequate supervision by the accounting officer and management throughout the year.
- Lack of daily controls to ensure transactions are correctly captured and that documentation supporting the transaction is retained.
- Controls over transactions were lacking, resulting in financial information not being properly supported.

**Table 13: Movements in financial statement qualification areas of municipalities and municipal entities**

Auditee	Audit opinion 2009-10	Movement in addressing 2008-09 qualification areas							Audit opinion 2008-09
		Capital assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I and F&W	
Dihlabeng	Qualified	Repeat	Repeat	Repeat	Repeat	Repeat	Addressed	Addressed	Disclaimer
Kopanong	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Letsemeng	Adverse	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Mafube	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Maluti - A - Phofung	Disclaimer	Repeat	Repeat	Repeat	Addressed	Repeat	Repeat	Repeat	Disclaimer
Mangaung	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Mantsopa	Qualified	Repeat	Repeat	Addressed	Repeat	Addressed	Addressed		Disclaimer
Matjhabeng	Disclaimer	Repeat	Repeat	Repeat	Repeat	New	Repeat	New	Disclaimer
Metsimaholo	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Addressed	Repeat	Disclaimer
Mohokare	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Adverse
Ngwathe	Disclaimer	Repeat	Repeat	Repeat	Repeat	New	Repeat	Repeat	Disclaimer
Nketoana	Qualified	Repeat	Repeat	Addressed	New	Repeat	Addressed	Repeat	Disclaimer
Phumelela	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Setsoto	Qualified	Repeat	Repeat	Repeat	Repeat		New	New	Qualified



Auditee	Audit opinion 2009-10	Movement in addressing 2008-09 qualification areas							Audit opinion 2008-09
		Capital assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I and F&W	
Tswelopele	Qualified	New	New		New				Financially unqualified with findings
Xhariep District	Qualified	Addressed	Addressed	Addressed	Addressed	Addressed	Addressed	Repeat	Disclaimer
Centlec (Pty) Ltd	Disclaimer	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Repeat	Disclaimer
Fezile Dabi DM Trust	Disclaimer						Repeat		Disclaimer
Maluti-A-Phofung Water	Disclaimer	Repeat	Repeat	Repeat	Addressed	Repeat	Repeat	Addressed	Disclaimer
Metsimaholo Mayoral Trust	Qualified			Repeat					Disclaimer

The details of municipalities and municipal entities with findings are listed in annexure 1.

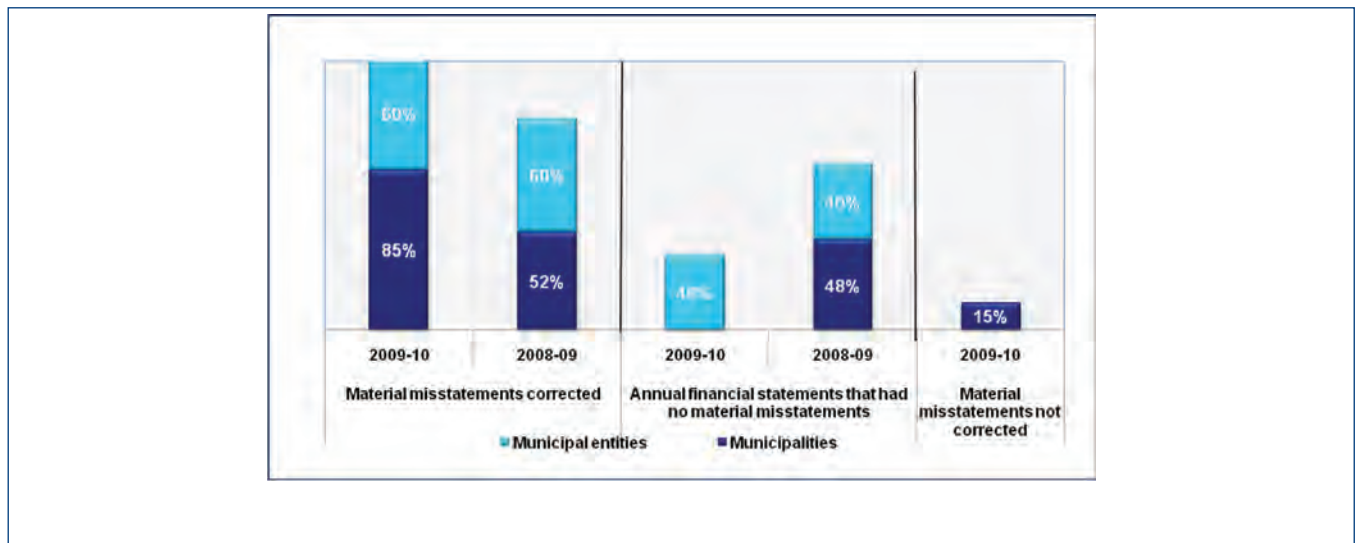
The progressions are mainly attributed to the leadership taking active steps to correct prior year challenges, the submission of documentation and the involvement of consultants. The lack of progressions is mainly attributed to inadequate governance arrangements, deficient risk management practices and ineffective systems of managing documentation.

### 3.2.2 Transversal material misstatements in financial statements submitted for audit purposes

Section 122 of the MFMA directs that municipalities and municipal entities should submit for audit purposes annual financial statements that fairly present the state of affairs and their financial position as at the end of the financial year. Such financial statements are therefore required to be free from material misstatements (i.e. material errors or omissions).

Many of the financial statements of municipalities and municipal entities submitted for auditing on 30 June 2010 were subject to correction in respect of material misstatements identified during the audit process. If these material misstatements had not been corrected they would have resulted in qualifications of the respective auditor's reports which would have impacted negatively on the audit outcomes.

**Figure 30: Material misstatements corrected – Municipalities and municipal entities**



### Municipalities

Of the 20 municipalities reported on, material misstatements were identified in the financial statements of 17 municipalities (85%). The material misstatements at Mafube and Ngwathe Local Municipalities were so extensive that the correction thereof would have delayed the audit process and therefore no corrections were allowed as it would have had no effect on the audit opinion (disclaimer). Senior management attempted to correct the material misstatements identified by the auditors for correction on the annual financial statements of Mohokare Local Municipality. However, due to a lack of skills and resources, the corrections were not corrected properly by the leadership, and the auditors therefore did not accept these corrections.

The adjustments made by the municipalities were material and pervasive. Despite making these pervasive and material adjustments, the audit outcome of nine of the municipalities (Kopanong, Letsemeng, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Phumelela, Setsoto Local Municipality, Lejweleputswa and Fezile Dabi District Municipality) remained unchanged compared to the previous year, while six municipalities (Motho, Thabo Mofutsanyana, Xhariep District Municipality, Dihlabeng, Mantsopa and Nketoana Local Municipality) achieved an improvement in their audit outcomes as a result of the adjustments made and one municipality regressed (Tswelopele Local Municipality).

### Municipal entities

- Fezile Dabi Trust was not in a position to correct the misstatements identified by the auditors owing to lack of supporting documentation.
- Maluti-A-Phofung Water did not correct the misstatements identified by the auditors owing to a lack of skills and capacity.

The following internal control deficiencies were noted as the reason why the municipalities and municipal entities did not identify errors that were identified by the auditors:



- No proper monitoring and supervision by the leadership of the municipalities' and municipal entities' financial statements and supporting records.
- The tendency to manage the financial affairs of the municipalities and municipal entities during the period when the external audit is in progress rather than during the financial period.
- Appropriate actions were not taken against staff who caused these errors in the past.
- The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit purposes.

In order to correct the matters listed above, the leadership of these municipalities and municipal entities should:

- Implement proper monitoring controls and provide leadership regarding financial statements and supporting records
- Take actions against staff that caused errors in financial reporting
- Review the financial statements and other information to be included in the annual report before submission for audit purposes
- Manage the financial affairs of the municipality throughout the year, and not only during the audit process

**Table 14: Material misstatements in financial statements submitted for audit purposes (prepared with/without assistance from consultants)**

Municipality/Entity	Financial statement material misstatement area							Consultant
	Capital assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I, F&W	
<b>District municipality</b>								
Fezile Dabi District Municipality								No
Lejweleputswa District Municipality								Yes
Motheo District Municipality								Yes
Thabo Mafutsanyane District Municipality								Yes
Xhariep District Municipality								Yes
<b>Local municipality</b>								
Dihlabeng Local Municipality								Yes
Kopanong Local Municipality								Yes
Letsemeng Local Municipality								Yes
Mafube Local Municipality								Yes
Maluti - A - Phofung Local Municipality								Yes
Mangaung Local Municipality								Yes
Mantsopa Local Municipality								No
Matjhabeng Local Municipality								Yes
Metsimaholo Local Municipality								Yes
Mohokare Local Municipality								Yes
Ngwathe Local Municipality								Yes
Nketoana Local Municipality								Yes
Phumelela Local Municipality								Yes

Municipality/Entity	Financial statement material misstatement area							Consultant
	Capital assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	U, I, F&W	
Setsoto Local Municipality								No
Tswelopele Local Municipality								Yes
<b>Municipal entity</b>								
Centlec (Pty) Ltd								Yes
Fezile Dabi DM Trust								No
Lejweleputswa Development Agency								Yes
Maluti-A-Phofung Water								Yes
Metsimaholo Mayoral Trust								No
<b>Total</b>	<b>10</b>	<b>16</b>	<b>13</b>	<b>12</b>	<b>16</b>	<b>14</b>	<b>13</b>	

### 3.2.3 Assistance provided by consultants to municipalities in the preparation of financial statements

Of the 20 municipalities analysed, 17 (85%) used consultants to assist with accounting-related services and the compilation of financial statements, while three of the five (60%) municipal entities also used consultants. The use of consultants by municipalities for accounting-related services and the preparation of financial statements has become more prevalent since the introduction of Standards of Generally Recognised Accounting Practice (GRAP).

The lack of skills remains the biggest driver for the appointment of consultants by municipalities and municipal entities. Auditees do not have the necessary capacity to fully implement GRAP and therefore the assistance of consultants is required to support the municipality.

Currently, one of the challenges in the Free State is that the leadership is not monitoring the services of consultants. Consultants are generally appointed late in the process with the mandate to compile financial statements. These consultants are provided with a trial balance and very little supporting documentation and information which then hampers the quality of the financial information. In the Free State the discipline to perform daily and monthly reconciliations is lacking, there is inadequate supervision of staff as well as capacity challenges in the finance units which then puts a question mark next to the credibility of the financial information.

Of the 20 municipalities, 17 (85%) made use of consultants regarding financial management services, namely Lejweleputswa District, Motheo District, Thabo Mofutsanyana District, Xhariep District, Dihlabeng, Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoana, Phumelela and Tswelopele Local Municipalities. Only five of these municipalities, namely Lejweleputswa District, Thabo Mofutsanyana District, Xhariep District, Dihlabeng and Nketoana Local Municipalities, had an improvement in their audit opinion.

Three of the five municipal entities (60%), namely Centlec, Lejweleputswa Development Agency and Maluti-A-Phofung Water, made use of consultants. Only Lejweleputswa Development Agency had an improvement in audit opinion. The use of consultants by municipalities and municipal entities for accounting-related services

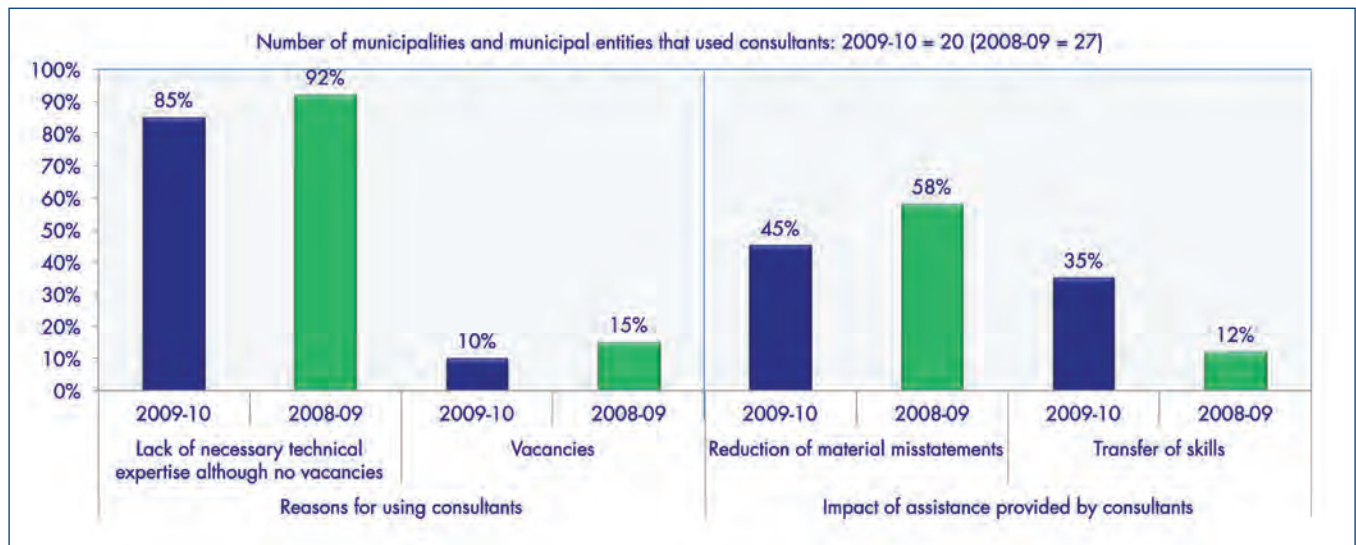


and the preparation of financial statements is related to the introduction of Standards of GRAP.

Skills transfer by consultants occurred at only six municipalities and one municipal entity (35%), namely Motheo District, Xhariep District, Dihlabeng Local, Maluti-A-Phofung Local, Nketoana Local and Tswelopele Local Municipalities and Centlec (Pty) Ltd.

Figure 31 below indicates the details of the assistance by consultants provided to municipalities and municipal entities during the year under review. The first two bars in the graph indicate the reasons for the appointment of consultants and the last two bars indicate the impact and effectiveness of the services of these consultants.

**Figure 31: Use of consultants – Municipalities and municipal entities**



It is, however, important that the leadership, with the assistance of CoGTA and the provincial treasury, should monitor and evaluate the effectiveness of the services rendered by consultants with reference to the audit outcomes and transfer of skills. It should furthermore be noted that the impact of consultants is dependent on the outcomes agreed with the municipality and the accuracy, reliability and completeness of the information the municipality provides to the said consultants. In this regard it is evident that the consultants become involved at too late a stage and compile financial statements on inaccurate and incomplete trial balances.

**Table 15: Assistance by consultants: Cost, reasons and impact**

Municipality/Entity	Cost of consultants	Reason		Impact		Audit opinion 2009-10	Movement in audit outcomes
		Lack of technical expertise	Vacancies	Reduction in material misstatements	Transfer of skills		
<b>District municipality</b>							
Fezile Dabi District Municipality						Financially unqualified with findings	Unchanged
Lejweleputswa District Municipality	548 112					Financially unqualified with findings	Improved

Municipality/Entity	Cost of consultants	Reason		Impact		Audit opinion 2009-10	Movement in audit outcomes
		Lack of technical expertise	Vacancies	Reduction in material misstatements	Transfer of skills		
Motheo District Municipality	1 552 818					Financially unqualified with findings	Unchanged
Thabo Mafutsanyane District Municipality						Financially unqualified with findings	Improved
Xhariep District Municipality	809 000					Qualified	Improved
<b>Local municipality</b>							
Dhlabeng Local Municipality	3 489 856					Qualified	Improved
Kopanong Local Municipality	852 150					Disclaimer	Unchanged
Letsemeng Local Municipality	845 000					Adverse	Unchanged
Mafube Local Municipality						Disclaimer	Unchanged
Maluti - A - Phofung Local Municipality	99 999					Disclaimer	Unchanged
Mangaung Local Municipality	2 954 994					Disclaimer	Unchanged
Mantsopa Local Municipality						Qualified	Improved
Matjhabeng Local Municipality	904 200					Disclaimer	Unchanged
Metsimaholo Local Municipality						Disclaimer	Unchanged
Mohokare Local Municipality	1 712 850					Disclaimer	Unchanged
Ngwathe Local Municipality						Disclaimer	Unchanged
Nketoana Local Municipality	7 409 626					Qualified	Improved
Phumelela Local Municipality	1 074 967					Disclaimer	Unchanged
Setsoto Local Municipality						Qualified	Unchanged
Tswelopele Local Municipality	1 160 304					Qualified	Regressed
<b>Municipal entity</b>							
Centlec (Pty) Ltd	2 181 696					Disclaimer	Unchanged
Fezile Dabi DM Trust						Disclaimer	Unchanged
Lejweleputswa Development Agency	65 949					Financially unqualified with findings	Unchanged
Maluti-A-Phofung Water	1 130 206					Disclaimer	Unchanged
Metsimaholo Mayoral Trust						Qualified	Improved
<b>Estimated total</b>	<b>26 791 727</b>						
Costs paid by parent municipality			Cost not available			Not assisted by consultants	

### 3.2.4 Material losses, material impairment of assets and underspending of the vote/ conditional grants

Material losses totalling R1 13 861 and material impairments totalling R811 581 occurred at 15 municipalities. The table below depicts the municipalities that incurred the **highest amounts** of material losses and impairment of assets. For details of material losses and material impairment of assets refer to annexure 3.



**Table 16: Examples of material losses and material impairments – Municipalities**

No.	Auditee	Material losses Amount (R'000)	Material impairment of assets Amount (R'000)	Reason
1	Matjhabeng Local Municipality	71 400	208 760	Material losses: Distribution losses for water and electricity Material impairment: Poor payment history of consumer debtors
2	Mafube Local Municipality	17 010	38 555	Material losses: Distribution losses for electricity Material impairment: Impairment of accounts receivable
3	Letsemeng Local Municipality	12 947		Material losses: Bad debts written off as per note 2 to the annual financial statements
4	Kopanong Local Municipality	12 504	53 193	Material losses: Distribution losses Material impairment: Impairment of accounts receivable
5	Dihlabeng Local Municipality		100 133	Material impairment: Impairment of accounts receivable
6	Mangaung Local Municipality		83 081	Material impairment: Decrease in value of consumer receivables
7	Ngwathe Local Municipality		132 345	Material impairment: Impairment of accounts receivable
8	Setso Local Municipality		58 651	Material impairment: Impairment of accounts receivable
9	Metsimaholo Local Municipality		53 239	Material impairment: Poor collection rates of consumer debtors
<b>Grand total of all entities</b>		<b>R113 861</b>	<b>R811 581</b>	

Centlec (Pty) Ltd incurred material impairment totalling R10 525 297.

**Table 17: Material losses and material impairments – Municipal entities**

No.	Auditee	Material losses Amount (R 000)	Material impairment of assets Amount (R 000)	Reason
1	Centlec (Pty) Ltd		10 525 297	Material impairment: Impairment of accounts receivable

### **Material underspending of the vote and underspending of conditional grants**

Material underspending of votes (municipality only) and grants (municipalities and municipal entities) is depicted in the table below.

**Table 18: Material underspending of the vote (municipality only) and underspending of conditional grants (municipalities and municipal entities)**

No.	Auditee	Budget (R 000)	Material underspending of vote (R 000)	Percentage underspent	Conditional grant (R 000)	Material underspending of conditional grant (R 000)	Percentage underspent
<b>Municipalities</b>							
1	Motheo District Municipality	151 945 367	25 948 996	17%			
2	Mohokare Local Municipality				20 431 283	8 583 409	42%
<b>Total</b>		<b>151 945 367</b>	<b>25 948 996</b>	<b>17%</b>	<b>20 431 283</b>	<b>8 583 409</b>	<b>42%</b>

The impact of the underspending on service delivery is as follows:

- Mohokare could not deliver basic sanitation services, make drought relief payments on time or improve on their financial administration function.
- Local municipalities under Motheo District could not deliver basic services.

#### *Conditional grants not used for the intended purpose*

In Mohokare Local Municipality instances were identified where the infrastructure and drought relief grants as depicted on the table above were utilised for operating expenditure. This is a result of poor cash-flow projections and budget monitoring by the leadership of the municipality. On some municipalities, no evidence could be obtained that conditional grants were utilised for projects other than what the funds were intended for due to lack of reconciliations and/or supporting documents.

### **3.2.5 Funding of operations/financial sustainability/going concern**

The table below depicts the entities where concerns were raised with regard to funding of operations, financial sustainability and going concern.

**Table 19: Auditees with concerns related to funding of operations/financial sustainability/going concern**

<b>Auditee</b>	<b>Reasons for financial sustainability concerns</b>	<b>Details of the auditee's financial recovery plans</b>
Kopanong Local Municipality	Significantly dependent on government grants, serious challenges in recovering consumer debtors and inability to pay creditors within 30 days	The municipality has developed, but not yet implemented a revised credit control policy and a revenue enhancement programme.
Letsemeng Local Municipality	Significantly dependent on government grants, serious challenges in recovering consumer debtors and inability to settle creditors within 30 days	No recovery plan has been developed, although actions have been implemented to improve the financial position.
Mafube Local Municipality	The accumulated deficit increased by more than 500%, the current assets: current liability ratio deteriorated significantly and the inability to settle creditors within 30 days	No recovery plan has been developed.
Mohokare Local Municipality	Debt collection period is significantly higher than the industry norm and project funds are utilised to fund operations	No recovery plan has been developed, although actions have been implemented to improve the financial position.
Motheo District Municipality	Possible establishment of a metropolitan municipality	No recovery plan was drawn up as no financial problems exist.
Ngwathe Local Municipality	Serious challenges are experienced in the recovery of consumer debtors	No recovery plan has been developed.
Phumelela	Serious challenges are experienced in the recovery of consumer debtors	Yes
Setsoto Local Municipality	Serious challenges are experienced in the recovery of consumer debtors	No recovery plan has been developed.
Maluti-A-Phofung Water	The net deficit amounts to more than R10 million and the current liabilities far exceed the total assets	No recovery plan has been developed.
Metsimaholo Mayoral Trust	Significant accumulated deficit and unfavourable current ratio	No recovery plan has been developed as the trust will be dissolved.

Of the 20 municipalities and five municipal entities analysed in this report, eight (40%) municipalities and two (40%) municipal entities displayed indicators of risk relating to financial sustainability. This resulted in material uncertainty that may cast significant doubt on the municipalities' ability to continue as a going concern. These municipalities may therefore be unable to realise their assets and discharge their liabilities in the normal course of business. Furthermore, these risk factors are indicators that the municipalities may be facing serious financial problems as envisaged in section 138 of the MFMA.

The following were the main reasons for material uncertainty regarding the financial sustainability of the above municipalities:

- Leadership does not adequately monitor and implement persuasive/punitive measures to improve debtor collection period.
- Indigent debtors are continuously written off without effective leadership monitoring.
- Lack of prioritising spending
- Difficulties in recovering amount owing to the municipality
- Difficulties to meet some obligations
- Cash-flow shortages
- The possible de-establishment of Motheo District Municipality owing to the establishment of a metropolitan municipality in the Mangaung area
- As the Metsimaholo Mayoral Trust is dormant, the council of Metsimaholo Local Municipality passed a resolution to dissolve the trust. The responsibilities of the trust will be taken over by the municipality.

*Possible implications of the findings for operations/financial sustainability or going concern*

- Non-collection of short- and long-term debtors, resulting in cash-flow problems at municipalities.
- Key vacancies not filled due to cash-flow constraints thus negatively impacting on service delivery at municipalities.
- Suppliers are not being paid on time, which contributes to fruitless and wasteful expenditure due to interest and penalties charged by suppliers.

## **Way forward**

For municipalities and municipal entities to address the financial matters referred to above a concerted effort will have to be made to:

- coordinate efforts by CoGTA and the provincial treasury to ensure that interventions are not duplicated, that interventions are implemented, monitored and that corrective action is taken where needed
- implement an oversight mechanism by the provincial treasury and CoGTA to evaluate the costs of consultants and devise a concerted approach in ensuring that benefit is realised
- ensure the implementation of oversight mechanisms by the political leadership as well as legislative oversight. The aim of the supervision will be to monitor the implementation of interventions and actions and to ensure that the required impact is achieved.
- improve the quality of financial information by implementing daily and monthly reconciliations and to ensure that the basic control disciplines are adhered to and adequately supervised
- improve reliable billing by implementing daily and monthly reconciliations of meter readings to ensure that all revenue due to the municipality is collected
- monitor electricity and water distribution losses on a monthly basis and prioritise repairs and maintenance to maximise profits
- implement financial recovery plans with a view to promoting own financial sustainability
- review the need for maintaining the existence of the municipal entities, such as trusts, and its impact on service delivery.

### 3.3 Findings on reporting on predetermined objectives

The objective of an audit of performance information is to enable the auditor to conclude whether the reported performance against predetermined objectives is reliable, accurate and complete, in all material respects, based on predetermined criteria.

All municipalities and municipal entities who receive funds for a public purpose have to report on their performance against predetermined objectives and are required to submit their annual performance reports for auditing, together with the annual financial statements.

The figures in the table refer to those municipalities and municipal entities that had findings on the reporting on performance against predetermined objectives calculated as a percentage of the total number of entities audited. The comparatives for 2008-09 have been restated to include audits finalised since the previous general report was issued.

**Table 20: Summary of findings on reporting on predetermined objectives**

Category of finding	Municipalities		Municipal entities	
	2009-10	2008-09	2009-10	2008-09
Information on performance against predetermined objectives not submitted for auditing by 31 August	20%	43%	40%	33%
Non-compliance with regulatory requirements	95%	100%	80%	67%
Information on performance against predetermined objectives not useful	80%	48%	40%	33%
Information on performance against predetermined objectives not reliable	65%	43%	20%	33%
<b>Total number of audits with findings</b>	<b>20</b>	<b>23</b>	<b>5</b>	<b>3</b>
Number of audits with no findings	0	2	0	2
Number of audits not issued by 31 January 2011	5	0	1	1
Number of audits where the report on predetermined objectives is not applicable	0	0	0	0
<b>Total number of audits</b>	<b>25</b>	<b>25</b>	<b>6</b>	<b>6</b>

\* Only audits where performance information was received and reviewed are included in the analyses for usefulness and reliability of information.

#### Explanation of the various audit finding categories

##### *Non-compliance with regulatory requirements*

Findings related to compliance with predetermined objectives regulations were raised at 19 of the 20 municipalities which are reported on and at four of the five municipal entities reported on.

Findings related mainly to the inadequate content of the strategic plans, which did not include measurable objectives, indicators and targets for all programmes, the lack of effective, efficient and transparent systems and internal controls regarding performance management and a lack of or inadequate quarterly reporting on performance information.



*Usefulness of information on performance against predetermined objectives*

The audit in terms of usefulness focused on the consistency, relevance and measurability of planned and reported performance information. Findings were raised on the usefulness of performance information at 16 of the 19 municipalities reported on and two of the five municipal entities reported on.

The findings related mainly to the fact that targets and indicators reported on are not consistent with targets and indicators as set in the strategic/corporate/business plans of the municipalities and municipal entities, as well as to targets which are not specific, measurable and time bound.

*Reported information on performance against predetermined objectives not reliable*

The audit focused on whether the reported performance information could be traced back to the source data or documentation and whether the reported information is accurate, complete and consistent in relation to the source data, evidence or documentation. In the case of 13 out of 19 municipalities and one of five municipal entities, deviations were noted in terms of the reliability of the reported performance information.

Findings related to a lack of sufficient appropriate audit evidence in relation to the reported performance information, a lack of appropriate systems generating performance information and the source information or evidence provided to support the reported performance information which did not adequately support the accuracy and completeness of the facts throughout.

*The details of municipalities and municipal entities with findings are listed in annexure 1.*

The high prevalence of findings in the above three categories can be attributed to the following:

- Lack of adequate performance management system
- Lack of understanding of the performance management system and/or performance management process
- Allocation of responsibility to specific personnel within the municipality
- Lack of resources to manage the performance management process, e.g. compilation of performance report, filing performance-related documentation etc.
- Lack of consistent reporting of performance objectives
- Lack of supporting documentation for reported performance

Action to be taken by leadership includes the following:

- Develop the performance management system
- Establish a unit responsible for performance information
- Provide training for the staff responsible for performance information
- Establish proper record-keeping management system for performance information
- Establish monitoring mechanism for performance reporting

### 3.4 Findings on compliance with laws and regulations

#### 3.4.1 Transversal findings on compliance with laws and regulations

In total, 20 out of 20 municipalities and all five municipal entities had findings on compliance with laws and regulations.

**Table 21: Summary of findings on compliance with laws and regulations**

Top 5 categories of non-compliance	Number	Percentage
<b>Municipalities</b>		
SCM issues that resulted in irregular expenditure	19	95%
Transversal material misstatements corrected	17	85%
SCM issues not resulting in irregular expenditure	13	65%
Payments not made within 30 days	13	65%
Reasonable steps not taken to ensure an effective, efficient and transparent system of financial management and internal controls	12	60%
<b>Municipal entities</b>		
SCM issues that resulted in irregular expenditure	2	40%
Transversal material misstatements corrected	3	60%
SCM issues not resulting in irregular expenditure	2	40%
Payments not made within 30 days	2	40%
Reasonable steps not taken to ensure an effective, efficient and transparent system of financial management and internal controls	2	40%

Transversally the most common findings are the material misstatements in the submitted financial statements (refer to section 3.2.2 above) and non-compliance with legislation on supply chain management (refer to section 5). The table above indicates the most pervasive findings on non-compliance. Details of other findings are as follows:

Municipalities did not comply with laws and regulations relating to the following:

- 13 municipalities and two municipal entities did not pay their expenditure within the required 30 days from the receipt of an invoice, or such a period as prescribed for certain categories of expenditure
- 12 municipal managers and two chief executive officers did not adhere to his/her legislative responsibilities of managing the financial administration of the municipality, by not taking reasonable steps to ensure that the municipality had and maintained effective, efficient and transparent systems of financial management and internal controls. Daily, weekly and monthly reconciliations and controls should be implemented to ensure that financial transactions are accurately recorded and substantiated.

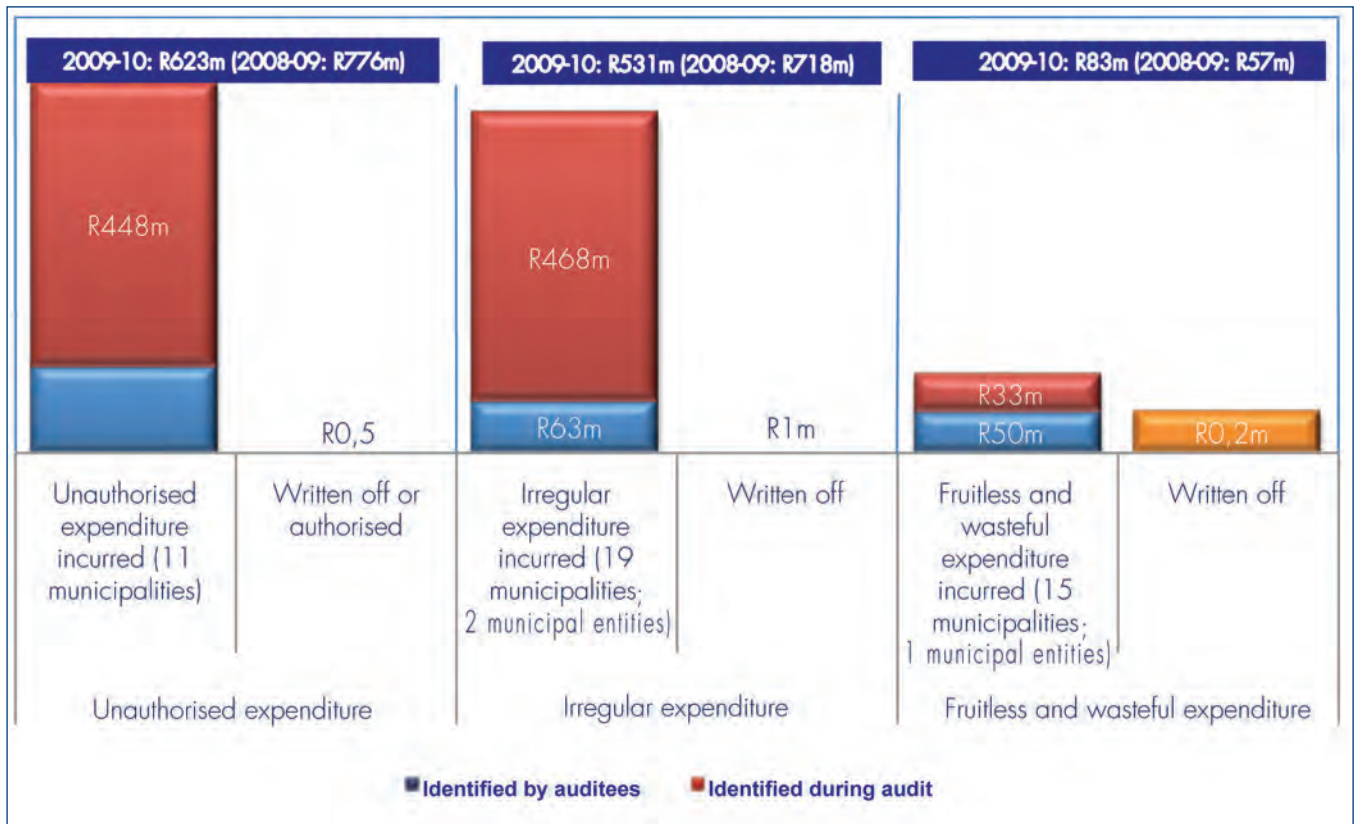
The compliance findings for municipalities and municipal entities are analysed in annexure 2.

#### 3.4.2 Unauthorised, irregular, and fruitless and wasteful expenditure incurred during the year

The figures below depict the unauthorised, irregular, and fruitless and wasteful expenditure incurred by municipalities and municipal entities for the financial year ended 30 June 2010.



**Figure 32: Unauthorised, irregular, and fruitless and wasteful expenditure and additional expenditure identified during the audit**



### Unauthorised expenditure – R622,7 million

Unauthorised expenditure in relation to a municipality, means any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3), and includes—

- overspending of the total amount appropriated in the municipality's approved budget;
- overspending of the total amount appropriated for a vote in the approved budget;
- expenditure from a vote unrelated to the department or functional area covered by the vote;
- expenditure of money appropriated for a specific purpose, otherwise than for that specific purpose;
- spending of an allocation referred to in paragraph (b), (c) or (d) of the definition of "allocation" otherwise than in accordance with any conditions of the allocation; or
- a grant by the municipality otherwise than in accordance with this Act;

**Table 22: Unauthorised expenditure**

Type of auditee	Nature and extent of unauthorised expenditure											
	Overspending			Expenditure unrelated to functional area			Spending not in accordance with conditions of allocation			Non-permissible grant		
	Number	%	R'000	Number	%	R'000	Number	%	R'000	Number	%	R'000
Municipalities	11	100%	622 669	0	0%	0	0	0%	0	0	0%	0
Municipal entities	0	0%	0	0	0%	0	0	0%	0	0	0%	0
<b>Total</b>	<b>11</b>		<b>622 669</b>	<b>0</b>		<b>0</b>	<b>0</b>		<b>0</b>	<b>0</b>		<b>0</b>

The nature of the unauthorised expenditure related to the overspending on various votes as a result of inadequate monitoring of the implementation of budgets by the leadership of municipalities and can mainly be attributed to the following common root causes:

- Inadequate leadership oversight, monitoring and supervision by management throughout the year to ensure that expenditure within the budgeted figures was incurred.
- Unrealistic budgeting as a result of inadequate financial information and inadequate budgetary control measures.
- Insufficient control measures to ensure reliable in-year management information to enable effective monitoring of spending against the approved budget.
- Lack of accountability, i.e. no consequences for not limiting spending within the approved budget.

For details of unauthorised expenditure incurred at specific municipalities and municipal entities, refer to annexure 3.

### Irregular expenditure – R531 million

*Irregular expenditure in relation to a municipality or municipal entity, means*

- expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of this Act, and which has not been condoned in terms of section 170;*
- expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the Municipal Systems Act, and which has not been condoned in terms of that Act;*
- expenditure incurred by a municipality in contravention of, or that is not in accordance with, a requirement of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998); or*
- expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the supply chain management policy of the municipality or entity or any of the municipality's by-laws giving effect to such policy, and which has not been condoned in terms of such policy or by-law, but excludes expenditure by a municipality which falls within the definition of "unauthorised expenditure";*

The table below analyses the irregular expenditure incurred and provides a breakdown of such expenditure.

**Table 23: Irregular expenditure**

Type of auditee	Nature and extent of irregular expenditure											
	Supply chain management related			Compensation of employees related			Other			Total		
	Number	%	R'000	Number	%	R'000	Number	%	R'000	Number	%	R'000
Municipalities	19	90%	396 535	8	100%	10 683	5	100%	56 808	19	90%	464 026
Municipal entities	2	10%	67 465	0	0%	0	0	0%	0	2	10%	67 465
<b>Total</b>	<b>21</b>		<b>464 000</b>	<b>8</b>		<b>10 683</b>	<b>5</b>		<b>56 808</b>	<b>21</b>		<b>531 491</b>



The common root causes underlying the qualifications regarding irregular expenditure were as follows:

- Insufficient management knowledge and training to identify the occurrence of irregular expenditure.
- Failure by the leadership of the municipalities to enforce the appropriate supply chain management regulations.
- Where control measures for procurement existed, control activities and monitoring were ineffective and did not ensure that all instances of non-compliance with applicable legislation resulting in irregular expenditure were identified, recorded and reported.
- Insufficient oversight by management to ensure that instances of irregular expenditure were identified, investigated and corrective measures implemented.

For details of irregular expenditure incurred at specific municipalities and municipal entities, refer to annexure 3.

### Fruitless and wasteful expenditure – R83 million

*Fruitless and wasteful expenditure means expenditure that was made in vain and would have been avoided had reasonable care been exercised*

The table below lists the top five municipalities and one municipal entity that incurred the highest amounts of fruitless and wasteful expenditure in the province. For details of fruitless and wasteful expenditure incurred at specific municipalities and municipal entities, refer to annexure 3.

**Table 24: Fruitless and wasteful expenditure**

No.	Auditee	Fruitless and wasteful expenditure (R'000)	% of total for province
<b>Municipalities</b>			
1	Ngwathe Local Municipality	21 660	26%
2	Matjhabeng Local Municipality	14 171	17%
3	Mafube Local Municipality	7 914	10%
4	Mangaung Local Municipality	6 431	8%
5	Motheo District Municipality	6 317	8%
<b>Subtotal municipalities</b>		<b>56 493</b>	
<b>Municipal entities</b>			
1	Centlec (Pty) Ltd	12 688	15%
<b>Subtotal municipal entities</b>		<b>12 688</b>	
<b>Total</b>		<b>69 181</b>	

Findings relating to fruitless and wasteful expenditure include:

- penalties and interest charged on late payments
- the payment of settlement costs
- legal costs being paid
- VAT not claimed on valid tax invoices
- allowances paid in excess of SARS rates
- payments made, without any evidence that goods were delivered or services rendered

- payments made toward unfulfilled contracted services
- double payments being made
- charges paid on termination of contract.

The main causes of fruitless and wasteful expenditure were:

- leadership oversight, monitoring and supervision regarding the acquiring of goods and services as well as required service delivery were inadequate to prevent fruitless and wasteful expenditure
- the lack of risk assessment processes resulted in insufficient control measures being implemented by chief financial officers to ensure that value for money is obtained
- financial instability and cash-flow problems resulted in payments being delayed and consequently resulted in fruitless and wasteful expenditure due to interest and penalties
- insufficient utilisation of the creditor control systems to ensure that creditor payments are prioritised and paid within the required time frames.

### 3.4.3 Investigations and performance audits

#### Investigations

The following investigations were finalised or were in progress at the date of finalising the audit reports on the individual municipalities and municipal entities. These investigations were not necessarily performed by the AGSA, but were assessed as material for purposes of inclusion in the auditor’s report.

These investigations are indicators of risk that internal controls may either not be functioning or are being overridden. It is important that those charged with governance pay attention to addressing the internal control deficiencies that are indicated by the results of the investigations.

**Table 25: Investigations in progress or completed**

Municipality	Nature of investigation		
	Supply chain management	Other fraud	SCM, other fraud and other misconduct
Dhlabeng Local Municipality			
Mangaung Local Municipality			
Maluti-A-Phofung Local Municipality			
Matjhabeng Local Municipality			
Mohokare Local Municipality			

#### Performance audits

Details of performance audit reports tabled at the provincial legislature during the period under review are as follows:



**Table 26: Tabling dates for performance audit reports**

Detail of performance audits	Date tabled
Mangaung Local Municipality	Not tabled yet.
Audit objectives: Infrastructure projects	
To determine:	
<ul style="list-style-type: none"> <li>if infrastructure projects, sanitation, water and roads, are planned and designed to ensure effective service delivery.</li> <li>whether the most appropriate contractors and consultants were appointed for planning and construction of projects.</li> <li>whether the project management of the projects ensured that it was completed on time, within budget and at the required level of quality.</li> <li>whether completed projects were utilised immediately after completion to deliver services to the community.</li> </ul>	

### 3.5 Findings on information technology systems

Audits were conducted on the information technology employed at 20 municipalities in the province, focusing on computer general controls, which are controls relating to the information technology (IT) infrastructure and which are imbedded in information system management processes. The objective of audits of general controls is the evaluation of the effectiveness of IT controls to ensure that:

- financial and sensitive computer systems are only accessed by authorised officials
- systems are developed, enhanced, configured and implemented so that they are effective, functional and secure
- critical information is recoverable and usable in the event of disasters and disruptions
- financial information processes as stored in the computer systems are reliable for financial reporting purposes.

Municipalities/entities are currently using various systems, ranging from off-the-shelf and in-house developed systems to customised systems. The municipalities/entities vary in size from small to large and are responsible for managing their IT financial systems without the assistance of the National Treasury (NT) and SITA.

The following table indicates the prevalence of common focus area findings in municipalities and municipal entities:

**Table 27: Transversal information systems findings**

Focus area findings	Percentage of audited municipalities with finding	Percentage of audited municipal entities with finding
IT governance	95%	100%
Security management	95%	100%
User access control	95%	100%
Program change management	95%	0%
Facilities and environmental control	95%	0%
Data centre management	100%	100%
IT service continuity	95%	100%

The extent to which IT exposures have been or need to be addressed is highlighted in table 28.

## Key risks

- Lack of IT governance process to ensure that IT functions are operational and capacitated
- Lack of business continuity and disaster recovery plans and centres to ensure the availability of financial information in instances of data loss
- High dependency on service providers due to a lack of specialist skills and support to implement and manage system security functions
- Lack of prescripts to ensure the selection of cost-effective financial systems at municipalities, resulting in seven different systems being used at 20 municipalities and one municipal entity audited

## Key matters to be addressed by coordinating ministries (DPSA, CoGTA, NT)

- The National Treasury should provide prescripts regarding financial systems to minimise excessive/duplicate systems and maintenance costs.
- The National Treasury should explore the possibility of incorporating municipalities into the IFMS.
- CoGTA should clarify how the current operational clean audit plan would address the issues of system deficiencies and duplication at municipalities.
- The DPSA, in consultation with the GITO Council, should extend the currently established IT framework to also incorporate municipalities.
- SITA should provide technical support centrally to municipalities.
- TROIKA should establish a governance process that will promote knowledge sharing and shared IT technical support per district/province.

In some instances, the systems did not produce GRAP compliant financial statements without the intervention of either financial statement software, or the use of computer spreadsheets. In addition, they also employ a host of different business application programmes, which are not integrated with the financial accounting systems. Details of computer systems in use in the province are set out in the table below.

**Table 28: Accounting and financial application systems used by municipalities and municipal entities**

Financial reporting system	Municipalities	Municipal entities	IT Manager position not filled
ABAKUS	Phumelela Local Municipality		✓
Finstel	Setsoto Local Municipality		✓
Hercules	Thabo Mofutsanyane District Municipality		✓
Pastel	Xhariep District Municipality		
SAMRAS	Lejweleputswa District Municipality		
	Motheo District Municipality		
Sebata	Kopanong Local Municipality		✓
	Letsemeng Local Municipality		✓
	Mantsopa Local Municipality		✓
	Mohokare Local Municipality		✓
	Tswelopele Local Municipality		
	Nketoana Local Municipality		✓



Financial reporting system	Municipalities	Municipal entities	IT Manager position not filled
Venus	Dhlabeng Local Municipality	Centlec (Pty) Ltd	✓
	Fezile Dabi District Municipality		
	Mafube Local Municipality		✓
	Maluti - A - Phofung Local Municipality		✓
	Mangaung Local Municipality		
	Matjhabeng Local Municipality		
	Metsimaholo Local Municipality		
	Ngwathe Local Municipality		✓
<b>7</b>	<b>20</b>	<b>1</b>	<b>18</b>

Findings are outlined under paragraph 4.1.4 of this report. Common observations noted were:

#### *IT governance*

There is no IT governance framework to facilitate the performance of IT governance practices, which would include the establishment of an IT steering committee, the maintenance of an IT risk register and the development of IT policies and procedures. Where the information security officer positions have not been filled or the security functions have not been performed, it has resulted in inadequate IT operations and insufficient capacitating of IT functions.

#### *Security management*

The security controls required to safeguard access to financial data and to ensure that access and login violation reports within financial systems are periodically reviewed, have not been adequately implemented due to a lack of specialist IT skills to perform these tasks.

#### *User access control*

The excessive access rights assigned to a high number of users of financial systems have had a considerable impact on the separation of duties as these rights are not reviewed to ensure that they have remained commensurate with the users' job responsibilities. Unassigned positions and the inadequacy of skills have contributed to a great extent to this inefficiency as users may be required to perform conflicting duties, while compensating controls, such as reviewing system audit trails, are not executed by management.

#### *Program change management*

High reliance is placed on system vendors who currently provide system support to municipalities, due to a lack of specialist skills within municipalities. This has led to the programmers who develop the systems being granted access to the systems' production environments, which enables them to make amendments to financial data residing on these applications. Moreover, due to a lack of knowledge of how these application systems operate, compensating controls, such as reviews of audit trails, have not been instituted by management to detect unauthorised changes.

*Facilities and environmental control*

Municipalities and municipal entities do not have a centralised location for their IT equipment that contains financial data and, as a result, municipalities operate their own IT/server rooms. Access to these rooms is not adequately controlled by the systems administrators, which exposes sensitive financial data to loss.

*IT service continuity*

A lack of business continuity plans in municipalities has resulted in IT not developing disaster recovery plans and back-up procedures that would ensure the availability of financial information and the continued availability of IT services in instances of loss and disruption.

*Data centre management*

The performance and capacity of IT systems are not monitored and reported on due to inadequate IT policies and procedures to drive this process and the absence of appropriate skills to perform the required tasks. As a result, service delivery may be inadequate as some services may be affected by the unavailability of systems.

## SECTION 4: DRIVERS OF AUDIT OUTCOMES

This section of the general report analyses the following matters:

- The drivers of audit outcomes
- Information technology as a potential area of risk to financial and performance reporting, losses and service delivery
- Actions taken by role players, provincial political leadership, and oversight bodies to address matters reported
- Emerging risks to future audit outcomes

### 4.1 Drivers of audit outcomes

The drivers of audit outcomes are analysed under the three fundamentals of internal control. These controls are three-dimensional and should address financial, performance and compliance matters.

The reported internal control deficiencies can be directly linked to the basis for the qualification/adverse/disclaimer of opinion on the financial statements, the findings on predetermined objectives and compliance with applicable laws and regulations.

Six municipalities and two municipal entities showed improvements in the audit outcomes. Two municipalities remained financially unqualified (with findings). These improvements can be attributed to the implementation and effective monitoring of the three fundamentals of internal control. A detailed analysis is included below.

An outline of drivers of audit outcomes is presented below the analysis of the presence/absence of the key controls represented.

#### 4.1.1 Leadership

**Table 29: Drivers of audit outcomes – Leadership**

Leadership	Municipalities			Municipal entities		
	Good	In progress	Intervention required	Good	In progress	Intervention required
Provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the best interests of the entity						
• Financial	30%	50%	20%	20%	60%	20%
• Performance	20%	55%	25%	20%	80%	0%
• Compliance	15%	60%	25%	20%	80%	0%
Exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls						
• Financial	25%	45%	30%	0%	60%	40%
• Performance	15%	50%	35%	0%	60%	40%
• Compliance	10%	50%	40%	0%	80%	20%
Implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored						
• Financial	10%	60%	30%	0%	60%	40%

Leadership	Municipalities			Municipal entities		
	Good	In progress	Intervention required	Good	In progress	Intervention required
• Performance	10%	55%	35%	0%	60%	40%
• Compliance	10%	65%	25%	0%	100%	0%
Establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes, and responsibilities						
• Financial	15%	50%	35%	0%	80%	20%
• Performance	10%	55%	35%	0%	80%	20%
• Compliance	5%	65%	30%	0%	80%	20%
Develop and monitor the implementation of action plans to address internal control deficiencies						
• Financial	5%	70%	25%	0%	80%	20%
• Performance	5%	65%	30%	0%	80%	20%
• Compliance	5%	65%	30%	0%	80%	20%
Develop and monitor the implementation of action plans to address internal control deficiencies in the IT environment						
• Financial	0%	2%	98%	40%	20%	40%
Establish an IT governance framework that supports and enables the business, delivers value and improves performance						
• Financial	0%	0%	100%	0%	0%	100%

It is important that the mayor should play an active oversight role to ensure that the key elements of good internal control and governance are adhered to. Notwithstanding the commitment that we received from the mayors during the door-to-door visits that were conducted in the province, the mayors did not perform the oversight that was discussed and agreed upon. During these visits the role and responsibilities between the mayor, the municipal manager and the chief financial officer were cleared and there was no uncertainty regarding what role the mayor will have to play to ensure that the municipalities move to better audit outcomes.

The need for competent and skilled staff to support the municipal manager was identified as a priority to improve on the prior year audit outcomes and the production of regular and quality financial and performance information. The successful appointment of competent and skilled staff, together with training interventions, led to improvements in the audit outcomes. Thus the leadership needs to take active steps in ensuring that adequately skilled staff are recruited and appointed. The contracting of independent consultants in specialised areas that are adequately monitored and where skills are transferred also contributed to the improvement in the audit outcomes. Future improvement in audit outcomes will depend on stability at senior management level and continued direction provided by the leadership.

Where IT systems are not adequate, the leadership has not established an IT governance framework due to a lack of skills in the IT section and did not prioritise action plans or the implementation of the action plans to address the deficiencies. Performance information structures and systems need to be integrated within existing management processes and systems to improve audit outcomes. Furthermore, municipalities and municipal entities need to develop and implement a strategic IT plan that supports business requirements.

The leadership needs to be involved in the financial management and performance management and set the tone at the top to create an environment conducive to good financial management and service delivery; thereby improving the audit outcomes. The audit outcomes indicate that the leadership tone on human resource capacity and the monitoring of action plans is crucial.



## 4.1.2 Financial and performance management

**Table 30: Drivers of audit outcomes – Financial and performance management**

Financial and performance management	Municipalities			Municipal entities		
	Good	In progress	Intervention required	Good	In progress	Intervention required
Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting						
• Financial	10%	60%	30%	0%	40%	60%
• Performance	5%	55%	40%	0%	40%	60%
• Compliance	5%	70%	25%	0%	60%	40%
Implement controls over daily and monthly processing and reconciling of transactions						
• Financial	15%	60%	25%	0%	40%	60%
• Performance	10%	60%	30%	0%	60%	40%
• Compliance	5%	70%	25%	0%	80%	20%
Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information						
• Financial	10%	35%	55%	0%	40%	60%
• Performance	10%	45%	45%	0%	60%	40%
• Compliance	0%	55%	45%	0%	60%	40%
Review and monitor compliance with applicable laws and regulations						
• Financial	10%	50%	40%	0%	80%	20%
• Performance	0%	70%	30%	0%	80%	20%
• Compliance	0%	60%	40%	0%	80%	20%
Design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information						
• Financial	0%	45%	55%	0%	40%	60%
• Performance	0%	45%	55%	0%	40%	60%
• Compliance	0%	45%	55%	0%	40%	60%
Application systems susceptible to compromised data integrity (Information Systems)						
• Financial	0%	1%	99%	33%	17%	50%

The auditee's internal control status regarding the financial, performance and compliance dimensions of an audit is assessed for the following drivers:

- Implementing proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting
- Implementing controls over daily and monthly processing and reconciling of transactions
- Preparing regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information
- Reviewing and monitoring compliance with applicable laws and regulations
- Designing and implementing formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information

Although the audit outcomes of municipalities and municipal entities have improved from the prior year, the quality of the financial statements submitted for auditing is still not adequate based on the increase in the material misstatements identified and corrected. The municipalities and municipal entities did not have competent individuals who understand the financial reporting framework and performance management

requirements to perform proper reviews prior to the submission of the financial statements. This is the main reason for the appointment of consultants. The pervasive material misstatements identified by auditors were mainly the result of a lack of supervision and review of monthly reports used in the preparation of the financial statements by the leadership, particularly the chief financial officers. Furthermore, it is critical for the leadership to ensure that the required skills are transferred to staff where consultants are appointed.

Pertinent information should be identified and captured in a form and time frame to support effective financial and performance reporting, which reduces instances of material amendments resulting from the audit. Adherence to basic financial controls throughout the financial year, i.e. daily processing of transactions, monthly reconciliation of accounts and the continuous review thereof, needs to be actively monitored by management in order to improve audit outcomes.

Documents supporting the financial statements and other information should be readily available, without any significant delay, when requested throughout the audit process. There were municipalities and municipal entities that were not able to supply documentation that supports the information in the financial statements or the report on predetermined objectives due to an inadequate archive system.

Findings on predetermined objectives and the design and implementation of formal controls over IT systems give cause for concern. Targets set by municipalities are not always clear and measurable and supporting documentation to substantiate the outcomes cannot always be submitted. IT systems to report on predetermined objectives are generally not in place.

The IT environment, with specific reference to controls regarding access control and protection of information which are not in place, is also of concern. Furthermore, manual or automated controls were not always adequately designed to ensure that the transactions did occur, were authorised, and were completely and accurately processed to ensure compliance with all applicable laws and regulations.

Basic reporting disciplines, such as proper record keeping, regular processing of transactions and reconciliations, preparation of monthly reporting, and controls over compliance with fiduciary responsibilities, also require leadership attention. Monthly monitoring of these key controls will enhance the level of accountability to executive authorities and improve the quality of reporting on financial and service delivery information.

### 4.1.3 Governance

**Table 31: Drivers of audit outcomes – Governance**

Governance	Municipalities			Municipal entities		
	Good	In progress	Intervention required	Good	In progress	Intervention required
Implement appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored						
• Financial	0%	70%	30%	0%	40%	60%
• Performance	0%	65%	35%	0%	60%	40%
• Compliance	0%	75%	25%	0%	60%	40%



Governance	Municipalities			Municipal entities		
	Good	In progress	Intervention required	Good	In progress	Intervention required
Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively						
• Financial	15%	75%	10%	0%	60%	40%
• Performance	15%	70%	15%	0%	60%	40%
• Compliance	15%	80%	5%	0%	80%	20%
Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations						
• Financial	10%	65%	25%	20%	60%	20%
• Performance	0%	70%	30%	0%	80%	20%
• Compliance	5%	65%	30%	0%	80%	20%

The auditee’s internal control status regarding the financial, performance and compliance dimensions of an audit is assessed for the following drivers:

- Implementing appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.
- Ensuring that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively.
- Ensuring that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Strengthening governance practices is another area that requires attention. The leadership needs to ensure that comprehensive risk assessments are performed that cover all critical areas to improve audit outcomes. There is a need to adequately resource the internal audit function to ensure that it operates effectively by identifying internal control deficiencies in a timely manner and by recommending and monitoring corrective action.

In addition, while audit committees have in general been appointed and are meeting, there is scope for improving the interaction of the mayor and the municipal manager with a view to providing feedback on the identification of risk areas and an assessment of the effectiveness of the control environment.

To improve audit outcomes it is critical that audit committees and internal audit units function effectively by reviewing the financial statements submitted for audit purposes, and ensuring that measures have been implemented to correct previous year audit findings by monitoring the action plans to correct audit findings.

#### 4.1.4 Information technology as a specific driver of audit outcomes and service delivery

Information technology is a key driver of financial and performance management and compliance. The following control objectives apply to the management of information technology:



- Establish an IT governance framework that supports and enables the business, delivers value and improves performance
- Develop and monitor the implementation of action plans to address internal control deficiencies in the IT environment
- Design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information

The table below provides an assessment of findings raised from common IT focus areas, where audited during the year under review. Details of findings under these focus areas are provided below table 32:

**Table 32: Assessment of attention required by IT focus areas**

Number	Auditee	Focus areas						
		IT governance	Security management	User access control	Program change management	Facilities and environmental control	Data centre management	IT service continuity
<b>Municipalities</b>								
<b>District municipalities</b>								
1	Fezile Dabi District							
2	Lejweleputswa District							
3	Motheo District							
4	Thabo Mofutsanyana District							
5	Xhariep District							
<b>Local municipalities</b>								
6	Dihlabeng							
7	Kopanong							
8	Letsemeng							
9	Mafube							
10	Maluti - A - Phofung							
11	Mangaung							
12	Mantsopa							
13	Matjhabeng							
14	Metsimaholo							
15	Mohokare							
16	Ngwathe							
17	Nketoana							
18	Phumelela							
19	Setsotho							
<b>Municipal entities</b>								
1	Centlec (Pty) Ltd							

	<b>Good</b>		<b>Intervention required</b>
	<b>In progress</b>		<b>Not tested</b>



### *IT governance*

IT governance is the responsibility of the executive management. It is the integral part of the organisation's governance and consists of the leadership and organisational structures and processes that ensure that the organisation's IT sustains and extends the organisation's strategies and objectives. IT governance is important as it allows the organisation to manage IT risks, derive value from IT investments and also support the achievement of business objectives that are dependent on IT systems. An IT control framework is integral to IT governance and provides overall guidance on the implementation of IT governance within the organisation and also ensures the positioning of IT, resource requirements, risk and internal control management.

Key findings that were commonly identified during these audits:

- No approved IT strategic plan or not implemented or not monitored
- IT steering committee had not been established or had not been functioning effectively
- Lack of a formal IT risk register
- Policies and procedures either not in place or incomplete
- The functions of the information security officer were either not allocated or were not performed
- No service level agreements were in place or monitored

### *Security management*

The IT section is responsible for ensuring that there are security measures in place to prevent unauthorised access to networks and operating systems that grant access to the application systems.

Key findings that were commonly identified during these audits:

- Operating system standards and procedures not implemented
- Security management and administration were inadequate to ensure the security of the network environment
- Operating system security parameters not adequately set to provide optimal security
- Excessive number of users had administrator access rights
- Access and logon violation reports not reviewed

Specialist skills are needed to implement and manage these functions and these controls were not strong enough due to the lack of adequate skills.

Commitment to address the weaknesses identified for this focus area had been received from 14 municipalities and one municipal entity analysed.

### *User access control*

User access control is the systematic process of managing the access of users to the application. The process includes creation, reviewing, disabling and removing of user accounts. CFOs are responsible for these functions. These controls also act as compensating controls for ineffective security management controls.

Key findings that were commonly identified during these audits:

- Lack of or incomplete user account management procedures
- Access request forms not completed
- Users' access not reviewed to ensure that they remained commensurate with their job responsibilities
- Activities of the system administrators/controllers not monitored
- Inactive or unused user identification was not timeously removed from the system or deactivated
- Excessive access rights assigned to some or a high number of users

A good practice guide, user account management, had also been compiled and distributed to municipalities. Presentations were also made where requested.

#### *Program change management*

Program change management ensures that any proposed changes to the existing information system environment are coordinated, scheduled, authorised and tested to prevent unnecessary disruptions, erroneous changes and unauthorised and inappropriate access.

Key audit findings that were commonly identified:

- Change control procedures/standards not in place/in place but not approved/inadequate/not adhered to.
- Procedures in respect of change request, approval of change, testing, closure of change, configuration management, source code version control, definition of environment (development, quality assurance/testing and production), patch management, application upgrade not adequate.
- Programmers allowed access to production environment.

#### *Facilities and environmental control*

Facilities and environmental control relating to the information systems ensure the security, integrity, condition, performance and accessibility of the systems and the system information.

Key audit findings that were commonly identified:

- Physical access to sensitive areas was not controlled
- Environmental controls such as the uninterruptible power supply (UPS), generators, air-conditioning system and wiring cables were not maintained

#### *Data centre management*

Data centre management relates to the management of scheduled processing, protecting sensitive output, monitoring infrastructure performance and ensuring preventive maintenance of hardware.

Key audit findings that were commonly identified:

- Scheduled processing not monitored
- Policies and procedures related to the operations of the network either not in place or incomplete
- Maintenance procedures/schedules for system software/devices not in place or inadequate

- System performance not monitored and reported to management

#### IT service continuity

Information technology service continuity is the process of managing the availability of hardware, system software, application software and data to enable an organisation to recover/establish information system services in the event of a disaster. The process includes business continuity planning, disaster recovery plans and backups.

Key audit findings that were commonly identified were the following:

- Lack of formally documented and approved or incomplete business continuity and/or disaster recovery plans.
- Lack of or inadequate backup standards and procedures.
- Disaster recovery plans not fully implemented, or not regularly tested and updated.
- Backups not kept off site.

## 4.2 Action to address matters reported

Key stakeholders committed to the following actions to support improved audit outcomes:

**Table 33: Actions to support improved audit outcomes**

Key role players	Initiatives
CoGTA (Operation Clean Audit) and the provincial treasury	Consultants have been appointed to assist municipalities, where interventions had been approved, with the drafting of financial recovery plans, providing guidance towards Operation Clean Audit 2014 and conducting transaction verification exercises
	CoGTA and the provincial treasury developed and commenced with the implementation of the following four transversal projects aimed at supporting municipalities in terms of the Local Government Turnaround Strategy (LGTAS) in an effort to improve on audit outcomes: <ul style="list-style-type: none"> <li>• Municipal GRAP compliance support project</li> <li>• Municipal policies and business process project</li> <li>• Information technology support project</li> <li>• Implementation of CaseWare at 13 municipalities</li> </ul>
	CoGTA commissioned an investigation into possible maladministration and fraud at Matjhabeng Local Municipality. The investigation has been finalised and the report submitted to CoGTA.
	CoGTA has appointed consultants to deliver advisory services in respect of Operation Clean Audit with the Xhariep District Municipality and its local municipalities as pilot.
	CoGTA and the provincial treasury combined efforts to align IDPs and budgets.
	The provincial treasury and CoGTA supported municipalities with the implementation of the key controls, and the compilation and implementation of policies, and clearing asset-related and other problems.
	Financial assistance was provided to two municipalities through section 139 interventions, financing of a dedicated six-month CFO support programme at one municipality and the finance of CFO packages for three years at four municipalities.
SALGA	Discussed audit outcomes with all municipalities
	Busy with the development of a method of work for MPACs

Key role players	Initiatives
Provincial political leadership (Premier, MEC Local Government and MEC Finance)	Political heads have taken responsibility for oversight functions.
	Consultants were appointed to support all municipalities in the Xhariep District as well as Masilonyana LM, Nala LM and Thabo Mofutsanyana DM.
	The premier and various MECs adopted municipalities to monitor progress.
	MECs are involved in the appointment of qualified and competent CFOs at four municipalities and further vacancies are earmarked to be filled with qualified staff.
	Municipalities were and will be placed under administration, where necessary.
Oversight (Public Accounts Committee)	The public accounts committee has invited all municipalities on a regular basis to record progress and to make recommendations for improvements.

**Table 34: Assessment of commitments from key role players to address audit outcomes at the time of the audit**

Role players	Assessment of monitoring capacity and effectiveness								
	Supply chain management	Predetermined objectives	Financial management	Turnaround plans	IT controls	Human resource management	Use of consultants	Municipalities under administration	Governance structures
Joint coordinating effort (Provincial CoGTA and the provincial treasury: Operation Clean Audit)	In progress	Intervention required	In progress	In progress	Intervention required	In progress	In progress	In progress	Intervention required
SALGA	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required
Provincial leadership (Premier, MEC for Local Government and MEC for Finance)	Intervention required	Intervention required	In progress	In progress	Intervention required	In progress	In progress	In progress	Intervention required
Provincial oversight (Public Accounts Committee)	In progress	Intervention required	In progress	In progress	Intervention required	Intervention required	In progress	Intervention required	In progress

■ Intervention required     
 ■ In progress     
 ■ Good progress

The provincial leadership, legislative committees, the provincial treasury and CoGTA rolled out extensive initiatives to municipalities and municipal entities. However, the monitoring thereof, the follow-through on commitments and the cooperation received from municipalities and municipal entities remain a challenge in reaching the desired results.

**Table 35: Assessment of commitments from key role players to address audit outcomes since the audit**

Role players	Assessment of monitoring capacity and effectiveness								
	Supply chain management	Predetermined objectives	Financial management	Turnaround plans	IT controls	Human resource management	Use of consultants	Municipalities under administration	Governance structures
Joint coordinating effort (Provincial CoGTA and Provincial Treasury: Operation Clean Audit)	In progress	Intervention required	In progress	In progress	In progress	In progress	In progress	Good progress	Intervention required
SALGA	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required	Intervention required



Role players	Assessment of monitoring capacity and effectiveness								
	Supply chain management	Predetermined objectives	Financial management	Turnaround plans	IT controls	Human resource management	Use of consultants	Municipalities under administration	Governance structures
Provincial leadership (Premier, MEC for Local Government and MEC for Finance)	Red	Red	Yellow	Yellow	Red	Yellow	Yellow	Green	Red
Provincial oversight (Public Accounts Committee)	Yellow	Red	Yellow	Yellow	Red	Red	Yellow	Red	Yellow
	Red Intervention required		Yellow In progress		Green Good progress				

The only changes on assessment of monitoring capacity and effectiveness of role players are in respect of IT and municipalities placed under administration.

- The provincial treasury and CoGTA introduced CaseWare at 13 municipalities, which is in the process of being rolled out to other municipalities.
- Administrators are appointed from CoGTA and report to the HoD on the progress made. Thabo Mofutsanyana was placed under administration until September 2010, which resulted in an improved audit outcome from disclaimer to financially unqualified (with findings).
- The provincial treasury and CoGTA supported municipalities with the implementation of key controls, clearing of asset-related and other problem areas.
- CoGTA and the provincial treasury combined efforts to align IDPs and budgets, which resulted in the success of nine municipalities having budgets aligned to its IDP for 2010-11.

Those charged with governance made themselves available for stakeholder interactions with the AGSA, which led to an overall improvement in the audit outcomes for 2009-10. The mayors acknowledged the importance of key internal controls and provided support in the follow-up of the implementation of the controls to address internal control deficiencies and commitments made during the stakeholder interactions. In addition, the actions and initiatives taken by the National Treasury and CoGTA provided further support to municipalities and municipal entities, which led to the improved audit outcomes. These initiatives included provision of tools and guidance for proper financial and performance management, as well as regular interaction to resolve matters of concern.

Municipalities made firm commitments to improve the implementation of key controls, which were agreed upon during the AG's door-to-door visits, in order to improve on their audit outcomes in the 2009-10 financial year. The commitments made by the mayors and municipal managers during the door-to-door visits are as follows:

- Confirmation of daily disciplines of reconciling cash receipts, deposits and payments and proper document management.
- Monitoring that all monthly reconciliations and disciplines are performed.
- Confirmation of monthly asset count and asset reconciliations to the mayor, including progress on record keeping of infrastructure assets.
- Monthly feedback to the mayor on revenue and expenditure linked to the performance targets.
- Monthly feedback to the mayor on the monitoring of compliance with laws and reconciliations with special attention to compliance with the conditions of conditional grants.

Not all municipalities were successful in implementing all the commitments made as evidenced by the 2009-10 audit outcomes. Similarly, municipal entities made commitments, but were also not successful in all instances.

The following are some of the reasons why the mayors did not honour their commitment to oversee the implementation of adequate oversight at the municipalities:

- Mayors, municipal managers and CFOs are not clear on their respective roles and responsibilities.
- Political instability and inadequate oversight by the leadership resulted in the administration at the municipalities not being actively monitored.
- The leadership did not set the right tone to ensure that the performance of staff is aligned to the desired audit outcomes. No action is taken against municipal managers and CFOs where the municipalities continue to receive disclaimers. No culture of consequences is evident at municipalities.
- Deployment to municipalities occurs without considering the adequacy of the skills for the relevant positions.
- Mayors fail to follow through on the commitments made.
- The initiatives and requirements of CoGTA and the National Treasury and provincial treasury are not coordinated by the municipalities. Municipalities do not appreciate the interventions and there is limited buy-in to the solutions.

*The details of municipalities and municipal entities with challenges are listed in annexure 8.*

#### *Commitments by provincial leadership*

During the Auditor-General's roadshow on 3 March 2011 to present the 2009-10 MFMA audit outcomes, the executive leadership of the province, together with the AGSA, CoGTA and the provincial treasury committed to the coordination and monitoring of follow-up action plans as summarised below:

- An orientation workshop will be presented to incoming councillors after the local government elections scheduled for May 2011 with special emphasis on the importance of the correct leadership tone.
- A team of highly competent people will be appointed in the province to provide support to municipalities. This includes a person at chief director level to oversee municipalities within the provincial treasury. This will be complemented by a joint team to be established between CoGTA and the provincial treasury to support municipalities and to monitor the implementation of action plans by municipalities.
- The premier committed to ensure that a hands-on approach is followed by all leaders at all levels and he also committed to ensure that the right leadership tone is set in the province.
- Training on role clarification for mayors, municipal managers and chief financial officers will be presented.
- The premier will possibly redeploy mayors of municipalities with good outcomes to problem municipalities.
- The MEC: Provincial Treasury envisages possible financial support to struggling municipalities during the next budget cycle.
- Engagements are envisaged at national level to clarify the role of SALGA.

#### *Commitments and actions taken by the municipal council*

Since May 2010 the AGSA initiated discussions with the mayors, boards of directors and municipal managers/chief executive officers on key controls and the drivers of internal control. During these sessions firm

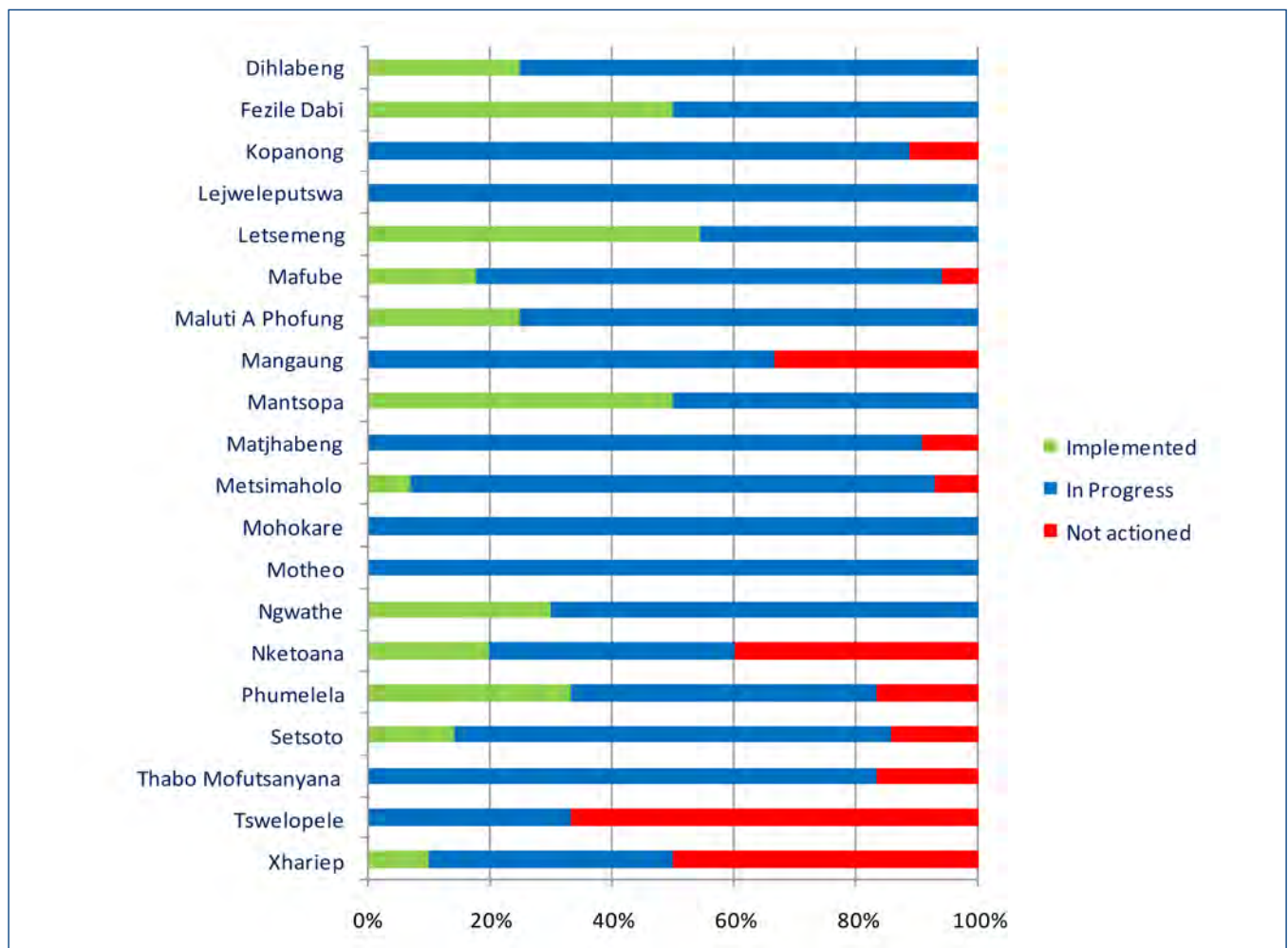
commitments were made to address the internal control deficiencies that resulted in qualification areas, findings on predetermined objectives, compliance with laws and regulations, HR, SCM and IT matters detailed in this report.

The commitments made by the mayors at municipalities and boards of directors at municipal entities were not actioned by 39% and 27% of municipalities and municipal entities, respectively, at the finalisation of the audits for 2009-10.

*Status of implementation of oversight resolutions*

The lack of commitment by municipalities and municipal entities to address audit outcomes can also be seen by the response to addressing SCOPA resolutions. At year-end 24 oversight resolutions out of a total of 160 had been implemented, 111 were in progress and 25 had not yet been actioned. The status of the SCOPA resolutions for municipalities and municipal entities is as follows:

**Figure 33: SCOPA resolutions status**



It is clear that the municipal leadership does not prioritise the implementation of SCOPA resolutions. In some instances, even though the resolutions have been significantly resolved, some municipalities are still qualified, which is an indication that the resolutions are not always addressing the root cause to the qualifications. It is imperative that in developing the resolutions, PROPAC should ensure that they address the root cause and that the provincial treasury should also ensure that the implementation of these resolutions eliminate the qualifications from recurring.

The leadership and management of the Free State Local Government still face a challenging journey ahead on the road to clean financial administration. Those charged with oversight and governance in the province ought to become more active in fulfilling their monitoring roles and responsibilities by interrogating the reasons for matters included in the audit reports and passing resolutions that require action to address them. The leadership (political as well as management) of municipalities and municipal entities should set the right tone from the top to implement action plans that address all audit findings and to enhance the personal accountability and commitment of all staff.

### 4.3 Emerging risks to future audit outcomes

The following matters require additional guidance or monitoring by the provincial accountant-general to prevent a possible negative impact on the audit outcomes of 2010-11:

#### *Predetermined objectives*

The majority of municipalities and municipal entities whose audits were finalised by 31 January 2011 had findings on predetermined objectives. Actions should be taken to address the significant deficiencies relating to the audit of predetermined objectives. Should actions not be taken and regularly monitored and reviewed for completeness and implementation, the audit outcomes of the municipalities might be modified once the decision is made to elevate the conclusion on predetermined objectives to the auditor's report.

#### *Accounting matters*

Municipalities and municipal entities should take particular note of any changes to the applicable financial reporting framework and take timely action to put processes in place to ensure compliance therewith. It is important that a risk analysis is prepared before the new standards become effective.

The following SA Standards of GRAP have been issued by the ASB, but are not yet effective:

- GRAP 21 – Impairment of non-cash-generating units
- GRAP 23 – Revenue from non-exchange transactions
- GRAP 24 – Presentation of budget information in financial statements
- GRAP 25 – Employee benefits
- GRAP 26 – Impairment of cash-generating units
- GRAP 103 – Heritage assets
- GRAP 104 – Financial instruments

*Susceptibility and subjectivity of complex accounting estimates and fair values*

Certain accounting standards require complex accounting estimates to be made. The typical concerns are:

- Determining the provision amount for loans and advances in terms of SA Statements of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*.
- Assumptions in determining the fair value, residual values and useful lives of assets in terms of SA Statements of GRAP, GRAP 17, *Property, plant and equipment*.

Auditees are cautioned that these matters should be supported by clear and available information to avoid qualifications in these areas.

*Risks related to computerised information systems and the mitigation thereof*

Along with the benefits, the use of computerised information systems by municipalities and municipal entities comes with a number of monetary and financial reporting risks. Ineffective information system controls may contribute to financial management weaknesses, inaccurate financial and performance information, poor performance of the entity, and fruitless and wasteful expenditure, and may even contribute to non-compliance with applicable laws and regulations. Furthermore, weak information system controls make the systems vulnerable to be used to perpetrate fraud. The leadership of municipalities and municipal entities should assess the risks associated with computerised information systems and the mitigation thereof and prioritise it appropriately, as well as review the adequacy of governance arrangements required to oversee information system issues.

## SECTION 5: FINDINGS ARISING FROM THE AGSA'S SPECIFIC FOCUS AREAS

This section of the report presents the results of the audit of supply chain management under the following headings:

- Significant findings from audits of supply chain management
- Limitations on audit of awards
- Awards to persons in the service of the state
- Awards to family members of persons in the service of the state
- Uncompetitive or unfair procurement processes
- Inadequate contract management
- Inadequate SCM controls

### 5.1 Significant findings from audits of supply chain management

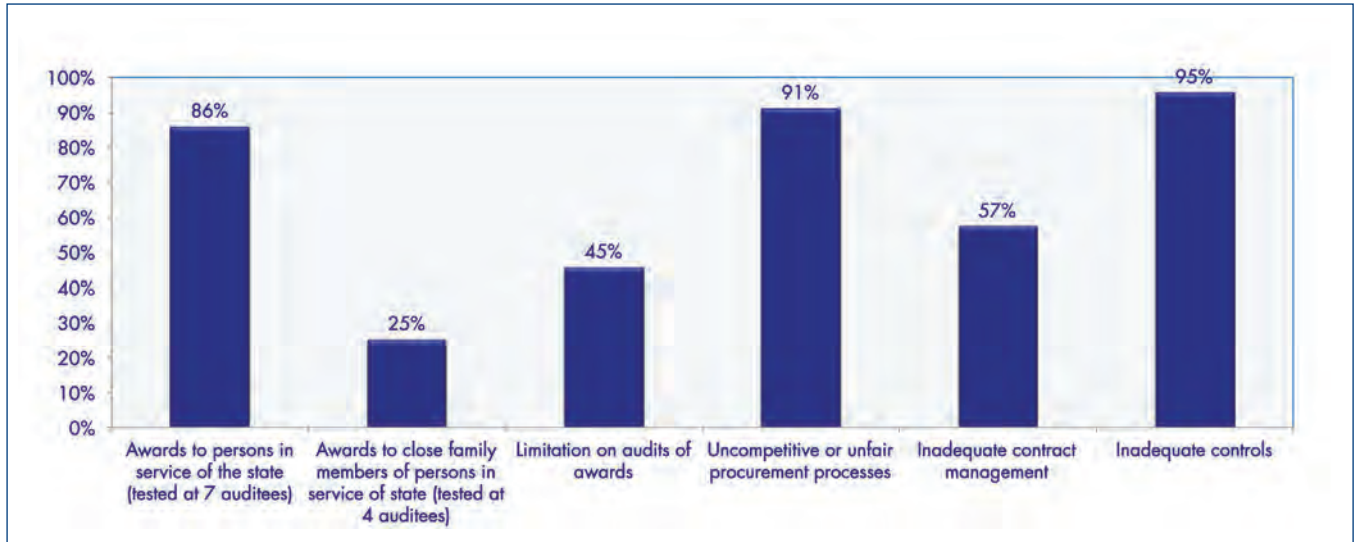
The audits conducted at municipalities and municipal entities for the year ended 30 June 2010 included an assessment of procurement processes, contract management and the controls in place to ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system that complies with legislation and that minimises the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices. The assessment was not performed at the following auditees as their audits have not been finalised: Masilonyana, Moqhaka, Naledi, Nala, Tokologo and Krynaauwlust Farming Trust.

As is evident from the analysis of irregular expenditure (section 3), R463 415 183 (87%) of the irregular expenditure incurred by auditees was as a result of the contravention of the SCM policy and legislation. Eighty-eight per cent of the total irregular expenditure incurred was identified during the audit process. At the majority of the auditees, the incomplete identification of SCM irregular expenditure was as a result of the following:

- Management did not implement processes for the identification and recording of irregular expenditure, or where such processes were implemented, they did not function adequately.
- There is also a lack of understanding of the SCM requirements and what constitutes irregular expenditure, resulting in the misinterpretation of the definition of irregular expenditure.
- There was inadequate oversight to ensure that irregular expenditure is identified, investigated and reported.

Audits with no or limited procurement during the year: Fezile Dabi Trust, Lejwe Le Putswa Development Agency (Pty) Ltd and Metsimaholo Mayoral Trust.

**Figure 34: Summary of findings on supply chain management**



The figure above presents a summary of findings on SCM. The most prevalent findings are presented below under the headings as depicted in the figure. The SCM findings per auditee are included in annexure 6.

**Table 36: Summary of findings on SCM**

Auditees	Limitation on audit of awards	Awards to persons in service of state	Awards to close family members of persons in service of state	Uncompetitive or unfair procurement processes	Inadequate contract management	Inadequate controls
<b>Municipalities</b>						
Dihlabeng						
Kopanong						
Lejweleputswa						
Letsemeng						
Mafube						
Maluti-A-Phofung						
Mangaung						
Mantsopa						
Matjhabeng						
Metsimaholo						
Mohokare						
Motheo						
Ngwathe						
Nketoane						
Phumelela						
Setsoto						
Thabo Mafutsanyane						
Tswelopele						

Auditees	Limitation on audit of awards	Awards to persons in service of state	Awards to close family members of persons in service of state	Uncompetitive or unfair procurement processes	Inadequate contract management	Inadequate controls
Xhariep						
<b>Municipal entities</b>						
Centlec (Pty) Ltd						
Maluti-A-Phofung Water						

## 5.2 Limitation on audits of awards

Sufficient appropriate audit evidence could not be provided that contracts had been awarded and quotations had been accepted (hereinafter referred to as "awards") in accordance with the requirements of the SCM policy and legislation. No alternative audit procedures could be performed to obtain reasonable assurance that the expenditure incurred on these awards was not irregular.

**Table 37: Limitations experienced**

Auditees	No. of awards	Value of awards	Reason for limitation
<b>Municipalities</b>			
Kopanong	5	R1 105 045	Bidding documents could not be submitted
Letsemeng	17	R16 836 324	Limitations were placed on the scope of the work performed relating to the procurement of assets
Mafube	52	R12 624 927	Management did not implement monitoring control measures to ensure that internal controls are functioning as designed
Mangaung	18	R1 017 482	Procurement documentation regarding the awarding of preference points could not be submitted
Matjhabeng	66	R198 250 627	Tender registers and other bidding documents could not be submitted
Metsimaholo	4	R10 098 222	Bidding documents for tenders awarded in prior years not submitted
Ngwathe	50	R2 583 370	Information is not filed and safeguarded in a manner which ensures that information is available for audit purposes
Phumelela	102	R45 320 583	Bidding documentation, tax clearance certificates and payment vouchers could not be submitted
Xhariep	32	R2 122 637	Information was not available that the SCM policy was followed and all pre-conditions were met
<b>Municipal entities</b>			
Centlec (Pty) Ltd	21	R38 902 347	Bidding documentation and quotations could not be submitted
<b>Total</b>		<b>R328 861 564</b>	

As a result of the limitations experienced, the findings reported in the rest of this section might not reflect the true extent of irregularities and SCM weaknesses at the auditees where the limitations were identified.

## 5.3 Awards to persons in service of the state

SCM Regulation 44 prohibits awards to persons or entities whose directors, members, principal shareholders or stakeholders are in the service of the state. Expenditure incurred in this regard is also considered to be irregular.



In order for the auditee to determine whether a potential provider is in the service of the state, reliance is placed on the declaration of the provider and the person in the service of the auditee.

A provider is required by SCM Regulation 13(c)(i) and (ii) to declare whether he/she is in the service of the state or, if not a natural person, if any of its directors, members, principal shareholders or stakeholders are in the service of the state. Non-disclosure constitutes a corrupt and fraudulent act and should be investigated and dealt with in accordance with the measures outlined in the SCM policy and SCM Regulation 38, which includes cancelling the contract with the provider.

Persons in the service of the auditee must declare their interests in providers, as required by the municipal SCM code of ethics and/or through their annual declarations required by the code of conduct for councillors and municipal staff members in terms of the Municipal Systems Act (MSA).

The identification and audit of awards to persons in the service of the state were this year limited to all metropolitan and high-capacity municipalities and their entities as well as two lower-capacity municipalities. The awards identified were also tested to determine whether additional irregularities identified could be an indication that decisions or recommendations were unlawfully and improperly influenced.

The table below depicts the audit findings for the auditees where the prohibited awards were identified.

**Table 38: Awards to persons in the service of the state**

Auditees	Awards made to persons in service of state		Further irregularities regarding awards made	
	In service of auditee	In service of other state institution	Provider did not declare interest	Person in service of the auditee did not declare interest
<b>Municipalities</b>				
Matjhabeng		Five awards (R2 213 717)		
Metsimaholo	One award (R319 193)	Three awards (R1 163 136)		
Mangaung	Two awards (R131 412)	Nine awards (R5 781 355)	Nine awards (R5 781 355)	
Mafube		One award (R360 000)	One award (R360 000)	
Maluti-A-Phofung	Two awards (R1 462 557)			Two awards (R1 462 557)
<b>Municipal entities</b>				
Centlec (Pty) Ltd		Three awards (R1 929 162)	Three awards (R1 929 162)	

At the following auditees the persons in the service of the auditee held positions of influence:

**Table 39: Positions of persons in the service of the auditee to whom awards were made**

Auditees	Position					
	Councillor	Mayor	Municipal manager	Senior manager	SCM official	Other officials
<b>Municipalities</b>						
Metsimaholo						
Mangaung						
Maluti-A-Phofung						

#### 5.4 Awards to family members of persons in service of the state

Awards to persons or entities whose directors, members, principal shareholders or stakeholders are close family members of persons in the service of the state, whether at the auditee or any other state institution, are not prohibited, but any such awards of more than R2 000 must be disclosed in the financial statements of the auditee as required by SCM Regulation 45.

In order for the auditee to determine whether a potential provider is a close family member of a person in the service of the state, reliance is placed on the declaration of the provider and the person in the service of the auditee.

The identification of awards to close family members of persons in the service of the state was this year limited to those auditees where information on family members could be obtained (four auditees). The awards identified were also tested to determine whether additional irregularities identified are an indication that decisions or recommendations were unlawfully or improperly influenced.

The table below depicts the audit findings for the auditees where the awards were identified.

**Table 40: Awards to close family members of persons in the service of the state**

Auditees	Awards to close family members of persons in service of state	
	In service of auditee	In service of other state institution
<b>Municipal entities</b>		
Centlec (Pty) Ltd	One award (R797 551)	

At the following auditees the persons in the service of the auditee held positions of influence:

**Table 41: Positions of persons in the service of the auditee whose close family member received awards**

Auditees	Positions					
	Councillor or director	Mayor	Municipal manager or chief executive officer	Senior manager	SCM official	Other officials
<b>Municipal entities</b>						
Centlec (Pty) Ltd						

## 5.5 Uncompetitive or unfair procurement processes

Findings on non-compliance with legislation which resulted in uncompetitive or unfair procurement processes are summarised in the table below. If applicable to the finding, the irregular expenditure incurred is also included.

**Table 42: Findings on uncompetitive or unfair procurement processes**

Auditees	Competitive bids not invited	Deviations from procurement processes not justifiable	Three price quotations not obtained	Preference points not applied	Construction contracts awarded to contractors with lower grading	Other
<b>Municipalities</b>						
Dhlabeng	R26 210 087					
Kopanong	R19 332 714	R403 705	R1 393 818	R3 227 033		
Lejweleputswa	R11 078 114					
Letsemeng			R676 646			
Mafube	R26 181 151		R1 443 211		R12 407 723	
Maluti-A-Phofung	R8 592 492	R67 365 103	R2 063 412			
Mangaung		R53 472 760	R3 343 231			
Mantsopa			R969 132			
Matjhabeng	R3 218 598	R9 392 753	R9 278 081			
Metsimaholo	R13 251 954		R133 000	R525 084		
Mohokare	R21 818 654			R2 250 424		
Motheo			R612 177			
Ngwathe	R308 415		R434 650			
Nketoane	R219 946		R48 400			
Phumelela			R9 306 924			
Setsoto	R399 671					
Thabo Mofutsanyane	R31 696 555					
Xhariep	R790 074	R292 949	R287 142	R696 374		
<b>Municipal entities</b>						
Centlec (Pty) Ltd	R42 277 579					
Maluti-A-Phofung Water			R8 184 063	R14 810 244		

Auditees	Competitive bids not invited	Deviations from procurement processes not justifiable	Three price quotations not obtained	Preference points not applied	Construction contracts awarded to contractors with lower grading	Other
Total irregular expenditure	R205 376 004	R130 927 270	R38 173 987	R21 509 159	R12 407 723	R0
Percentage of tested auditees with finding	67%	25%	64%	23%	6%	0%

Further details on the legislation not complied with are provided in the paragraphs that follow.

### **Competitive bids not invited**

In terms of SCM Regulation 12(1)(d), a competitive bidding process should be followed for procurement of goods and services above a transaction value of R200 000 (VAT included) and a deviation from the process should be approved by the accounting officer or someone designated by him/her. At the following municipalities and municipal entity, it was noted that a competitive bidding process was not followed for all procurement of goods and services above a transaction value of R200 000: Dihlabeng, Kopanong, Lejweleputswa, Mafube, Maluti-A-Phofung, Matjhabeng, Metsimaholo, Mohokare, Ngwathe, Nketoane, Setsoto, Thabo Mofutsanyane, Xhariep and Centlec (Pty) Ltd.

### **Deviations from procurement processes not justifiable**

In terms of SCM Regulation 36(1), an accounting officer may dispense with the official procurement processes and procure any required goods or services through any convenient process, but only:

- (i) in an emergency
- (ii) if such goods or services are only produced or available from a single provider
- (iii) in any other exceptional case where it is impractical or impossible to follow the official procurement process.

In addition, SCM Regulation 17(1) allows less than three quotations if it is not possible to obtain the required number of quotations.

A further analysis of the non-compliance identified follows:

At Mangaung (R53 472 760) and Maluti-A-Phofung (R67 365 103) deviations from the competitive bidding process were approved on the basis of it being an emergency, even though immediate action was not necessary and sufficient time was available for the bidding process to be followed.

At Xhariep (R292 949) deviations from the competitive bidding process were approved on the basis of it being an emergency, even though proper planning would have prevented such an emergency.

At Kopanong (R403 705) deviations from the competitive bidding process were approved on the basis of the goods and services only being produced by, or available from, a sole service provider, even though other suitable suppliers were available in the market.

At Matjhabeng (R9 392 753) approval was obtained to deviate from inviting at least three written price quotations from accredited prospective providers or providers that meet the listing criteria, even though it was possible to comply with the requirement.

### **Three price quotations not invited**

In terms of SCM Regulation 12(1)(c), formal written price quotations should be obtained for the procurement of goods and services of a transaction value between R10 000 and R200 000 (VAT included). In terms of SCM Regulation 17(1), quotations must be obtained in writing from at least three different providers whose names appear on the list of accredited prospective providers or, if not on the list, from providers that meet the listing criteria. If it is not possible to obtain at least three quotations, the reasons must be recorded and approved by the CFO or someone designated by him/her. Findings were identified at the following municipalities and municipal entity: Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Mangaung, Mantsopa, Matjhabeng, Metsimaholo, Motheo, Ngwathe, Nketoane, Phumelela, Xhariep and Maluti-A-Phofung Water.

### **Preference points not applied**

In terms of section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000), an organ of state must determine its preferential procurement policy and a preference point system must be followed. Furthermore, in terms of SCM Regulation 28(1)(a)(ii), a bid evaluation committee must evaluate bids in accordance with the points system as prescribed in terms of this act.

A further analysis of the non-compliance identified follows:

At three municipalities (Kopanong, Metsimaholo and Xhariep) and one municipal entity (Maluti-A-Phofung Water) irregular expenditure (totalling R17 545 473) was incurred as a result of non-compliance with this requirement for procurement of goods and services above R30 000 through written price quotations.

At one municipality (Mohokare) and one municipal entity (Maluti-A-Phofung Water) irregular expenditure (totalling R3 963 686) was incurred as a result of non-compliance with this requirement for procurement of goods and services above R200 000 through competitive bids.

### **Construction contracts awarded to contractors with lower grading or incorrect class of works**

In terms of CIDB Regulation 17, a contractor registered in a contractor grading designation is considered to be capable of undertaking a contract in the range of tender indicated in that grading in the class of the construction works to which the category of registration of that contractor relates. It was identified that at Mafube, this regulation was not complied with, resulting in irregular expenditure of R12 407 723.

### **Other findings**

The other cases of non-compliance with legislation, which resulted in uncompetitive or unfair procurement processes, are the following:

- Invitation to submit price quotations above R30 000 was not advertised (36%).

- Deviation and ratification were not disclosed in the notes to the annual financial statements (39%).
- List of accredited prospective providers for price quotations was not in place (27%).
- List of accredited prospective providers not administered in accordance with SCM requirements (43%).
- Procurement was deliberately split into parts to avoid complying with SCM requirements (5%) (R606 693).
- Construction contract awarded to contractors not registered with CIBD (13%) (R2 347 187).
- Quotation accepted from providers without tax clearance from SARS (18%) (R5 808 908).
- Contract awarded to bidder without tax clearance from SARS (5%) (R2 744 910).

## 5.6 Inadequate contract management

Findings on contract management are summarised in the table below.

**Table 43: Findings on contract management**

Auditees	Performance of contractors not monitored	Unfair or non-compliant contract amendment, extension or renewal	No written contract	Payment in excess of approved amount	Other
<b>Municipalities</b>					
Lejweleputswa					
Mafube					
Maluti-A-Phofung					
Mangaung					
Matjhabeng					
Metsimaholo					
Mohokare					
Motheo					
Ngwathe					
Nketoane					
Phumelela					
Setsoto					
Percentage of tested auditees with findings	30%	24%	11%	10%	

Further details on the findings are provided in the paragraphs that follow.

### Performance of contractors not monitored on a monthly basis

In terms of section 116(2)(b) of the MFMA, the accounting officer must, on a monthly basis, monitor the performance of the contractor in terms of the contract or agreement. Our audits have revealed that this was not done at the following municipalities: Lejweleputswa, Maluti-A-Phofung, Mangaung, Metsimaholo, Motheo and Setsoto.



## **Unfair or non-compliant contract amendment, extension or renewal**

In terms of section 116(3) of the MFMA, a contract or agreement procured through the SCM policy of the municipality or municipal entity may be amended by the parties, but only after:

- a) the reasons for the proposed amendment have been tabled in the council of the municipality or, in the case of a municipal entity, in the council of its parent municipality
- b) the local community:
  - i) has been given reasonable notice of the intention to amend the contract or agreement
  - ii) has been invited to submit representations to the municipality or municipal entity.

A further analysis of the non-compliance identified follows:

At three municipalities (Mangaung, Metsimaholo and Mohokare) the above requirements were not complied with.

At Matjhabeng irregular expenditure totalling R1 515 774 was identified based on contracts that were extended or renewed without approval by a delegated official.

At Metsimaholo and Ngwathe, irregular expenditure totalling R3 541 337 was identified based on contracts that were extended or renewed to such an extent that the competitive bidding process was circumvented.

## **No written contract**

In terms of section 116(1)(a)(i) of the MFMA, a contract procured through an SCM system must be in writing. At Mafube and Phumelela it was noted that goods and services were supplied by suppliers and payments were made to the suppliers without a written contract being in place.

## **Payments made in excess of the approved amount**

Irregular expenditure totalling R2 568 280 was identified as a result of payments for goods and services that exceeded the approved contract or quoted amount. This was identified at Metsimaholo and Nketoana.

## **Other findings**

The other findings on contract management are as follows:

- Capacity not established in auditee to ensure proper enforcement and monitoring of contracts (11%).
- No action taken against non-performing contractors (17%).
- Contract of longer than three years not reviewed at least once every three years (5%).
- Payment made for goods/services not received/not delivered in accordance with quotation/contract (5%).
- Payment at prices/rates different from contract/quotation (10%).

## 5.7 Inadequate SCM controls

Findings on deficiencies in fundamental SCM controls are summarised in the table below.

**Table 44: Findings on SCM controls**

Auditees	Lack of proper record keeping	Internal audit did not evaluate SCM processes	No risk assessment performed	Inadequate fraud prevention plan	Lack of control over declaration of gifts	Other
<b>Municipalities</b>						
Dihlabeng						
Kopanong						
Lejweleputswa						
Letsemeng						
Mafube						
Maluti-A-Phofung						
Mangaung						
Mantsopa						
Matjhabeng						
Metsimaholo						
Mohokare						
Matheo						
Ngwathe						
Nketoane						
Phumelela						
Setsoto						
Thabo Mafutsanyane						
Tswelopele						
Xhariep						
<b>Municipal entities</b>						
Centlec (Pty) Ltd						
Maluti-A-Phofung Water						
Percentage of tested auditees with finding	68%	59%	59%	59%	53%	

Further details on the findings are provided in the paragraphs that follow.

### Lack of proper record keeping

Records should be properly kept and managed to ensure that requested information is made available for audit purposes. At 15 of the municipalities and municipal entities our audits revealed inadequate record keeping, resulting in requested information not being available or supplied after a significant delay. This was identified at the following: Kopanong, Letsemeng, Mafube, Maluti-A-Phofung, Mangaung, Mantsopa, Matjhabeng,

Metsimaholo; Mohokare, Motheo, Nketoane, Phumelela, Tswelopele, Xhariep, Centlec (Pty) Ltd and Maluti-A-Phofung Water.

### **Internal audit did not evaluate SCM processes**

Internal audit should evaluate the controls, processes and compliance with laws and regulations with regard to SCM, as procurement is generally considered a high fraud risk area. The high number of instances where the internal audit unit was not fully operational is of great concern. The municipalities and municipal entities where the internal audit units did not evaluate SCM processes were identified at the following municipalities and municipal entities: Letsemeng, Maluti-A-Phofung, Mangaung, Mantsopa, Matjhabeng, Metsimaholo; Mohokare, Ngwathe, Phumelela, Tswelopele, Xhariep; Centlec (Pty) Ltd and Maluti-A-Phofung Water.

### **No risk assessment performed**

In terms of SCM Regulation 41(1), an SCM policy must provide for an effective system of risk management for the identification, consideration and avoidance of potential risks in the SCM system. A risk assessment was not performed at the following municipalities and municipal entities: Lejweleputswa, Letsemeng, Maluti-A-Phofung, Mangaung, Matjhabeng, Metsimaholo, Mohokare, Motheo, Nketoana, Phumelela, Thabo Mofutsanyana, Centlec (Pty) Ltd and Maluti-A-Phofung Water.

### **Inadequate fraud prevention plan**

The fraud prevention plan is expected to include specific measures for preventing and detecting fraud in the procurement processes, as procurement is generally considered a high fraud risk area. For the following municipalities and municipal entities it was noted that the fraud prevention plans did not adequately address fraud in the procurement process: Dihlabeng, Lejweleputswa, Maluti-A-Phofung, Mangaung, Mantsopa, Matjhabeng, Mohokare, Motheo, Nketoana, Phumelela, Tswelopele, Centlec (Pty) Ltd and Maluti-A-Phofung Water.

### **Lack of control over declaration of gifts**

In terms of SCM Regulation 46(2)(d), an SCM official or other role player must declare to the accounting officer details of any reward, gift, favour, hospitality or other benefit promised, offered or granted to that person or to any close family member, partner or associate of that person. At the following municipalities and municipal entity there was a lack of control over declaration of gifts: Kopanong, Mafube, Maluti-A-Phofung, Mangaung, Matjhabeng, Mohokare, Ngwathe, Phumelela, Xhariep and Centlec (Pty) Ltd.

### **Other findings**

The other deficiencies in fundamental SCM controls are the following:

- Lack of an effective internal monitoring of SCM processes (52%)
- Allegations of corruption/misconduct SCM non-compliance not investigated within reasonable time (36%)
- Processes not established for SCM officials to report SCM irregularities and fraud (35%)
- Annual declarations of interest not made by the mayor/councillors/senior managers/municipal manager (33%)

- Accounting officer did not submit annual report on implementation of SCM policy to the council (33%)
- SCM officials were not adequately trained (29%)
- Bidders/suppliers not made aware of process for lodging SCM disputes, objections and complaints (29%)
- Accounting officer did not delegate powers and duties in writing to officials (27%)
- SCM officials not aware of established processes for reporting SCM irregularities and fraud (27%)
- SCM policy in conflict with MFMA and SCM regulations (24%)
- Allegations of corruption/misconduct/SCM non-compliance not appropriately dealt with after being investigated (23%)

## 5.8 Conclusion

It is evident from the information included in paragraph 5.1 – 5.7 that municipalities and municipal entities in the Free State experience several challenges with regard to procurement and contract management. Not only is the high occurrence of irregular expenditure with regard to supply chain management of concern, but also the fact that this was not identified and properly reported on by management.

At nine municipalities and one municipal entity a limitation was placed on the audit of procurement and contract management, which might be an indication of possible fraud and might require investigations.

Accounting officers need to ensure the availability of supporting documentation of all procurement processes, and make these available for audit purposes. Furthermore, weaknesses in the SCM control need to be addressed as a matter of urgency and the SCM regulations need to be complied with in all respects.

## SECTION 6: STATUS OF TABLING OF ANNUAL REPORTS

In accordance with section 127(1) of the MFMA, the accounting officer of a municipal entity must, within six months after the end of a financial year, or on such earlier date as may be agreed between the entity and its parent municipality, submit the entity's annual report for that financial year to the municipal manager of the entity's parent municipality.

The mayor of a municipality must, within seven months after the end of a financial year, table in the municipal council the annual report of the municipality and of any municipal entity under the municipality's sole or shared control.

Details of the annual reports tabled are listed in the table below.

### 6.1 Summary of annual reports tabled

#### *Status of tabling of annual reports*

Municipalities in the Free State did not have any oversight committees in place, as a result none of the annual reports for 2008-09 were adopted in terms of section 129(1) of the MFMA.

**Table 45: Timeliness of tabling 2009-10 annual reports**

Auditee	Reason
Non-tabling of the annual report of the municipality and the municipal entity in the municipal council by the mayor at 31 January - S127(2)	
Lejweleputswa District	Late submission of annual financial statements for Lejweleputswa Development Agency. Consolidated report only issued on 31 January 2011.
Metsimaholo	Oversight committee referred the annual report back to the finance section for corrections
Mafube	No reasons provided by municipality
Ngwathe	No reasons provided by municipality
The accounting officer of the municipality did not make public the annual report - S127(5)	
Lejweleputswa District	Late submission of annual financial statements for Lejweleputswa Development Agency. Consolidated report only issued on 31 January 2011.
Mafube	No reasons provided by municipality
Maluti-A-Phofung	Municipality awaits report from oversight committee
Metsimaholo	Oversight committee referred the annual report back to the finance section for corrections
Ngwathe	No reasons provided by municipality
Setsoto	Municipality awaits report from oversight committee

## CONCLUSION

The AGSA has embarked on a drive to positively influence the audit outcomes of municipalities and municipal entities by promoting the practice of institutionalising on a daily basis decisive leadership, quality financial and performance management and strong governance.

The matters highlighted throughout this report relate to the three fundamentals which should be addressed to achieve sustained clean administration.

### *Leadership*

The leadership interventions required focus on monitoring and supervisory functions to ensure that actions are taken and to monitor the effectiveness of these actions and initiatives.

Municipalities and municipal entities should focus on addressing shortcomings regarding controls over capital assets, both movable and immovable, accuracy of current assets, lack of supporting documentation in respect of revenue and expenditure, lack of evidence in reporting or reporting in incorrect financial period in respect of liabilities, compliance with laws and regulations, and an increasing trend in the incurrence of irregular expenditure.

For both municipalities and municipal entities, a concerted effort should be made to ensure that matters concerning the compilation, verification and reporting on predetermined objectives and compliance with laws and regulations are given attention to prevent recurring findings on these matters.

The executive leadership should give specific focus to their fiduciary responsibilities concerning municipalities and municipal entities where financial statements have not been prepared or which did not report on predetermined objectives.

In ensuring sustainable interventions, the premier, with the support of the provincial treasury and CoGTA, should implement monitoring processes that promote ethical business practices and good governance to enhance and protect the best interest of the municipalities/entities. Particular attention should be given to the implementation of action plans to address internal control deficiencies and the establishment of an IT governance framework that supports and enables the business values and improvement of performance.

### *Financial and performance management*

The quality and completeness of financial information depend on well-designed and secure computerised systems. In the Free State, matters relating to the transversal weaknesses that result in application systems susceptible to compromised data integrity that require specific attention are the focus on the security management, user access controls, program change management, facilities and environmental control, data centre management, IT service continuity and other IT governance matters.

The financial management systems should be enhanced to enable management to produce regular financial statements to ensure that possible material misstatements are detected before the audit commences. Monthly reconciliations should become an embedded discipline for all account balances and assets should be counted monthly. This should be monitored continuously at the appropriate level.

It is also important that municipalities and municipal entities ensure that the necessary systems and controls are in place which will result in protection of information, accurate reporting, continuous monitoring of achievements of the measurable objectives and overall compliance with the reporting requirements in respect of predetermined objectives. Checklists should be used to prevent further irregular expenditure.

### *Governance*

Regular risk assessments should be conducted and strategies put in place to address the risks identified. A fully operational internal audit function is crucial in assisting management to establish a sound internal control environment and to perform ongoing evaluation and monitoring of management's compliance with predefined controls and progress in implementing the action plans. These governance structures should be critically questioned and monitored by the audit committee to ensure their objectivity.

The audit outcomes depicted in this report are the direct result of the mayors' limited involvement in the oversight of administrative functions of the municipalities. Mayors should focus their attention on capacitating the municipalities with necessary skilled staff to strengthen the financial management functions, and identify shortcomings in the daily and monthly activities to actively monitor action plans. Risk management activities should be implemented to ensure that risk assessments are conducted regularly, including the consideration of IT risks and fraud prevention and that a risk strategy to address the risks is developed and monitored.

### *In conclusion*

To reiterate the underlying message of this report to oversight bodies, those charged with governance and management: it is possible to obtain an unqualified audit report and achieve clean administration if the fundamentals of internal control are institutionalised and constantly monitored by the leadership. The challenges are not insurmountable and the staff of the AGSA remain committed to assisting in the process of identifying and communicating good practices to improve governance and accountability, share insights and solicit commitments, ascertain and report back on the implementation of commitments by stakeholders so as to build public confidence in government's ability to account for public resources in a transparent manner.

## ANNEXURES TO GENERAL REPORT

Annexure 1	Listing of audit outcomes, areas qualified and findings on predetermined objectives
Annexure 2	Listing of auditees with findings related to compliance with laws and regulations
Annexure 3	Listing of auditees with unauthorised, irregular, and fruitless and wasteful expenditure and material losses
Annexure 4	Listing of audit findings raised on common IT focus areas
Annexure 5	Drivers of audit outcomes
Annexure 6	Listing of key findings related to supply chain management
Annexure 7	Listing of timeliness: 2008-09 and 2009-10 annual reports
Annexure 8	Challenges experienced during the regularity audits at municipalities and municipal entities







## ANNEXURE 2: Listing of auditees with findings related to compliance with laws and regulations

Number	Auditee	Prohibited action/non-adherence													The statutory requirements of the Companies Act (only applicable to institutions registered in terms of the Companies Act)		
		Annual budget	Responsibilities: The mayor	Responsibilities: The accounting officer	Responsibilities: Municipal officials	Audit Committee	Internal Audit Unit	Payments	Transfer and disposal of assets	Transfer of funds and subsidies (for municipalities only)	Supply Chain Management legislative requirements	Disciplinary and criminal proceedings for instances of financial conduct	The financial statements were not prepared in accordance with applicable legislation	Unauthorised expenditure (for municipalities only)		Irregular expenditure	Fruitless and wasteful expenditure
<b>District municipalities</b>																	
1	Fezile Dabi District																
2	Lejweleputswa District																
3	Motheo District																
4	Thabo Mofutsanyana District																
5	Xhariep District																
<b>Local municipalities</b>																	
6	Ditlhabeng																
7	Kopanong																
8	Letsemeng																
9	Mafube																
10	Maluti - A - Phofung																
11	Mangung																
12	Mantsopa																
13	Matjhabeng																
14	Metsimahalo																
15	Mohale																
16	Ngwatho																
17	Nketoana																
18	Phumelela																
19	Setsoto																
20	Tswelopele																

**ANNEXURE 2: Listing of auditees with findings related to compliance with laws and regulations**

Number	Auditee	Prohibited action/non-adherence															
		Annual budget	Responsibilities: The mayor	Responsibilities: The accounting officer	Responsibilities: Municipal officials	Audit Committee	Internal Audit Unit	Payments	Transfer and disposal of assets	Transfer of funds and subsidies (for municipalities only)	Supply Chain Management legislative requirements	Disciplinary and criminal proceedings for instances of financial conduct	The financial statements were not prepared in accordance with applicable legislation	Unauthorised expenditure (for municipalities only)	Irregular expenditure	Fruitless and wasteful expenditure	The statutory requirements of the Companies Act (only applicable to institutions registered in terms of the Companies Act)
<b>Municipal entities</b>																	
21	Centlec (Pty) Ltd																
22	Fezile Dabi District Municipality Trust																
23	Lejwe Le Putswa Development Agency (Pty) Ltd																
24	Maluti-A-Phofung Water (Pty) Ltd																
25	Metsimaholo Mayoral Trust																



### ANNEXURE 3: Listing of auditees with unauthorised, irregular, and fruitless and wasteful expenditure and material losses

Number	Auditee	Nature and extent of unauthorised expenditure					Nature and extent of irregular expenditure					Fruitless and wasteful expenditure	Material losses	Material impairment of assets		
		Overpending	Expenditure unrelated to functional area	Spending not in accordance with conditions of allocation	Non-permissible grant	Total	Supply chain management related	Compensation of employees related	Other	Total						
<b>District municipalities</b>																
1	Fezile Dabi District						970 445						970 445			
2	Lejweleputswa District						11 078 114	1 068 606					12 146 720			
3	Motheo District						1 090 217	1 346 899					2 437 116	6 317 076		
4	Thabo Mofutsanyana District	23 833 069				23 833 069	31 696 555	1 702 667	54 413 160				87 812 382	1 091 526		
5	Xhariep District	2 934 185				2 934 185	3 875 642	50 545					3 926 187	6 754		679 115
<b>Local municipalities</b>																
6	Ditlhabeng						26 210 087						26 210 087	2 021 273		100 132 551
7	Kopanong	58 414 061				58 414 061	33 604 734						33 604 734	641 488	12 503 838	53 192 467
8	Letsemeng						676 646						676 646		12 946 984	
9	Mafube						42 442 960	1 502 010					43 944 970	7 914 155	17 009 714	38 555 473
10	Maluti - A - Phofung	731 230				731 230	80 321 364	778 484					81 099 848			
11	Mangoung	56 213 592				56 213 592	63 920 143						63 920 143	6 431 067		83 081 404
12	Mantsopa	3 302 696				3 302 696	2 478 868						2 478 868	29 986		6 505 373
13	Mafikabeng	216 155 588				216 155 588	28 140 651	2 888 042					31 028 693	14 171 466	71 400 000	208 760 412
14	Metsimahalo						23 001 113	162 395					23 163 508	2 960 894		53 238 790
15	Mohalele						25 788 492		1 480 066				27 268 558	834 841		45 661 073
16	Ngwathe	168 885 987				168 885 987	3 773 146						3 773 146	21 660 397		132 344 941
17	Nketoana	13 212 201				13 212 201	2 067 793						2 067 793	1 498		4 734 059
18	Phumelela						9 953 715						9 953 715	5 842 409		19 215 711
19	Seisoto	72 195 227				72 195 227	5 444 347	1 183 153	914 496				7 541 996	736 718		58 650 913
20	Tswelopele	6 791 189				6 791 189										6 828 833

**ANNEXURE 3: Listing of auditees with unauthorised, irregular, and fruitless and wasteful expenditure and material losses**

Number	Auditee	Nature and extent of unauthorised expenditure					Nature and extent of irregular expenditure				Fruitless and wasteful expenditure	Material losses	Material impairment of assets	
		Over-spending	Expenditure unrelated to functional area	Spending not in accordance with conditions of allocation	Non-permissible grant	Total	Supply chain management related	Compensation of employees related	Other	Total				
<b>Municipal entities</b>														
21	Centlec (Pty) Ltd						44 470 536					44 470 536	12 688 200	10 525 297
22	Fezile Dabi District Municipality Trust													
23	Lejwe Le Putswa Development Agency (Pty) Ltd													
24	Maluti-A-Phofung Water (Pty) Ltd											22 994 308	111 372	
25	Metsimaholo Mayoral Trust													



**ANNEXURE 4: Listing of audit findings raised on common IT focus areas**

Number	Auditee	Focus areas						
		IT governance	Security management	User access control	Program change management	Facilities and environmental control	Data centre management	IT service continuity
<b>District municipalities</b>								
1	Fezile Dabi District							
2	Lejweleputswa District							
3	Motheo District							
4	Thabo Mofutsanyana District							
5	Xhariep District							
<b>Local municipalities</b>								
6	Dihlabeng							
7	Kopanong							
8	Letsemeng							
9	Mafube							
10	Maluti - A - Phofung							
11	Mangaung							
12	Mantsopa							
13	Matjhabeng							
14	Metsimaholo							
15	Mohokare							
16	Ngwathe							
17	Nketoana							
18	Phumelela							
19	Setsoto							
20	Tswelopele							
<b>Municipal entities</b>								
21	Centlec (Pty) Ltd							
22	Fezile Dabi District Municipality Trust							
23	Lejwe Le Putswa Development Agency (Pty) Ltd							
24	Maluti-A-Phofung Water (Pty) Ltd							
25	Metsimaholo Mayoral Trust							





**ANNEXURE 6: Listing of key findings related to supply chain management**

Number	Auditee	Limitation on audit of awards	Awards to persons in service of state	Awards to close family members in service of state	Uncompetitive/unfair processes	Inadequate contract management	Inadequate controls
<b>District municipalities</b>							
1	Fezile Dabi District Municipality						
2	Lejweleputswa District Municipality						
3	Motheo District Municipality						
4	Thabo Mafutsanyane District Municipality						
5	Xhariep District Municipality						
<b>Local municipalities</b>							
6	Dihlabeng Local Municipality						
7	Kopanong Local Municipality						
8	Letsemeng Local Municipality						
9	Mafube Local Municipality						
10	Maluti - A - Phofung Local Municipality						
11	Mangaung Local Municipality						
12	Mantsopa Local Municipality						
13	Matjhabeng Local Municipality						
14	Metsimaholo Local Municipality						
15	Mohokare Local Municipality						
16	Ngwathe Local Municipality						
17	Nketoana Local Municipality						
18	Phumelela Local Municipality						
19	Setsotho Local Municipality						
20	Tswelopele Local Municipality						
<b>Municipal entities</b>							
21	Centlec (Pty) Ltd						
22	Fezile Dabi DM Trust						
23	Lejweleputswa Development Agency						
24	Maluti-A-Phofung Water						
25	Metsimaholo Mayoral Trust						



**ANNEXURE 7: Listing of timeliness: 2008-09 and 2009-10 annual reports**

Number	Auditee	Status of tabling of 2008-09 annual reports		Timeliness of tabling of 2009-10 annual reports	
		Oversight report not adopted within 2 months of tabling in Council - S129(1)	Annual report not submitted to provincial legislature within 7 days of adoption of oversight report - S132(1) and (2)	Annual report not tabled in Council within 7 months after financial year end - S127(2)	Annual report not made public - S127(5)
<b>District municipalities</b>					
1	Fezile Dabi District Municipality				
2	Lejweleputswa District Municipality				
3	Motheo District Municipality				
4	Thabo Mofutsanyane District Municipality				
5	Xhariep District Municipality				
<b>Local municipalities</b>					
6	Dihlabeng Local Municipality				
7	Kopanong Local Municipality				
8	Letsemeng Local Municipality				
9	Mafube Local Municipality				
10	Maluti - A - Phofung Local Municipality				
11	Mangaung Local Municipality				
12	Mantsopa Local Municipality				
13	Masilonyana Local Municipality				
14	Matjhabeng Local Municipality				
15	Metsimaholo Local Municipality				
16	Mohokare Local Municipality				
17	Moqhaka Local Municipality				
18	Nala Local Municipality				
19	Naledi Local Municipality				
20	Ngwathe Local Municipality				
21	Nketoana Local Municipality				
22	Phumelela Local Municipality				
23	Setsoto Local Municipality				
24	Tokolologo Local Municipality				
25	Tswelopele Local Municipality				
<b>Municipal entities</b>					
26	Centlec (Pty) Ltd				
27	Fezile Dabi DM Trust				
28	Lejweleputswa Development Agency				
29	Maluti-A-Phofung Water				
30	Metsimaholo Mayoral Trust				

### ANNEXURE 8: Root causes why mayors did not provide adequate leadership

Number	Auditee	Roles and responsibilities not clear between the Mayor, MM and CFO	Political instability and inadequate oversight	Tone at the top - Performance of staff not aligned to desired audit outcome and no consequences for poor performance	Deployment to municipalities without considering the adequacy of skills for positions	No follow-through on commitments	Lack of co-ordination of initiatives and requirements of CoGTA/Treasury by the municipality
<b>District municipalities</b>							
1	Fezile Dabi District						
2	Lejweleputswa District						
3	Motheo District						
4	Thabo Mofutsanyana District						
5	Xhariep District						
<b>Local municipalities</b>							
6	Dihlabeng						
7	Kopanong						
8	Letsemeng						
9	Mafube						
10	Maluti - A - Phofung						
11	Mangaung						
12	Mantsopa						
13	Matjhabeng						
14	Metsimaholo						
15	Mohokare						
16	Ngwathe						
17	Nketoana						
18	Phumelela						
19	Setsoto						
20	Tswelopele						
<b>Municipal entities</b>							
21	Centlec (Pty) Ltd						
22	Fezile Dabi District Municipality Trust						
23	Lejwe Le Putsa Development Agency (Pty) Ltd						
24	Maluti-A-Phofung Water (Pty) Ltd						
25	Metsimaholo Mayoral Trust						



**GLOSSARY**

Disclaimer	<p>The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive</p> <p>The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.</p>
Adverse	<p>The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.</p>
Qualified	<p>The auditor shall express a qualified opinion when:</p> <ul style="list-style-type: none"> <li>(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or</li> <li>(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.</li> </ul>

