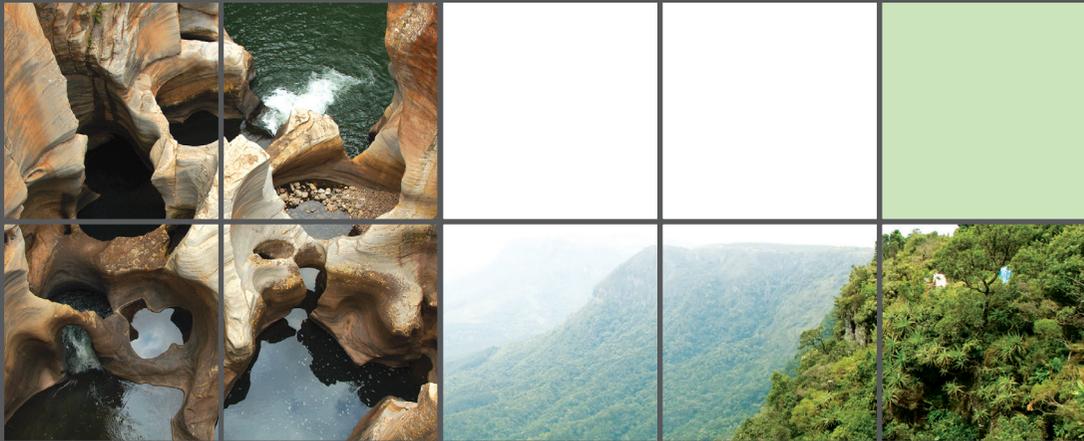


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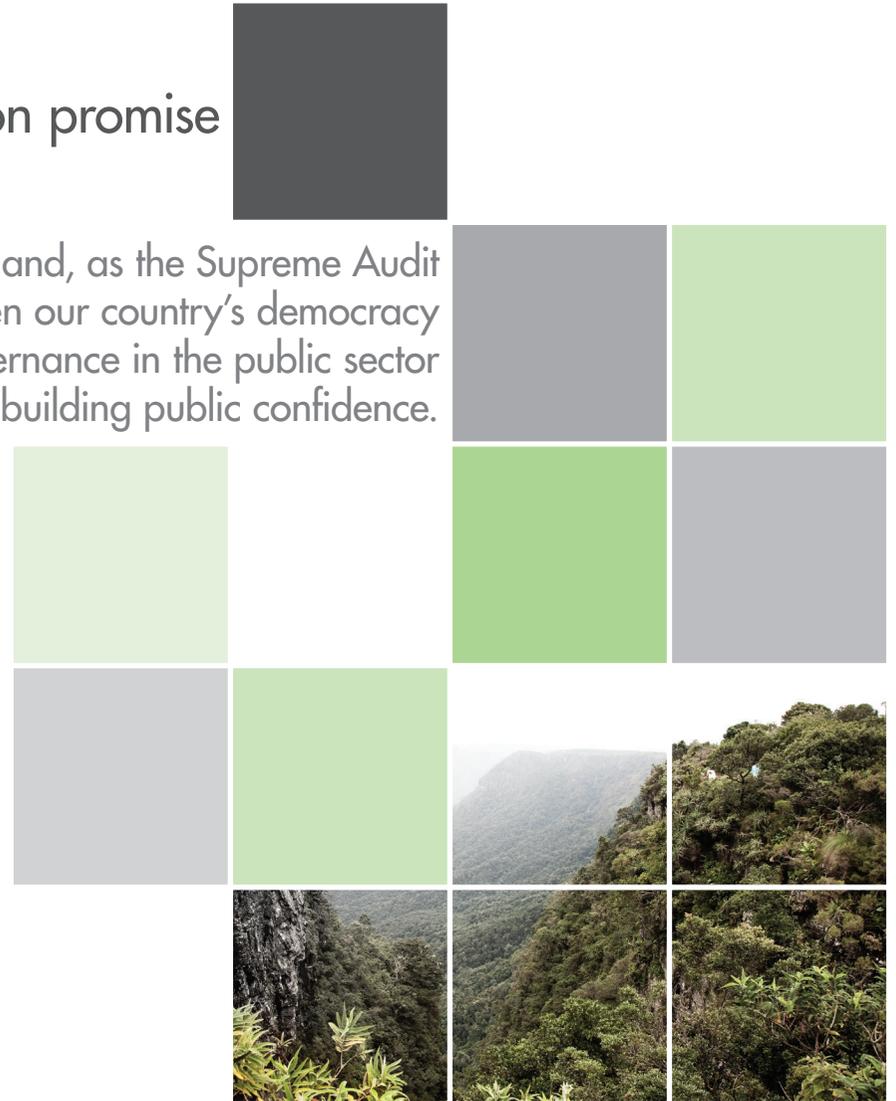
General report on the audit outcomes of  
local government **MPUMALANGA**



AUDITOR-GENERAL  
SOUTH AFRICA

## Our reputation promise

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



# General report on the audit outcomes of Local Government **MPUMALANGA** 2011-12



*Our responsibility  
extends to citizens  
who trust us to make  
a contribution towards  
a better South Africa*

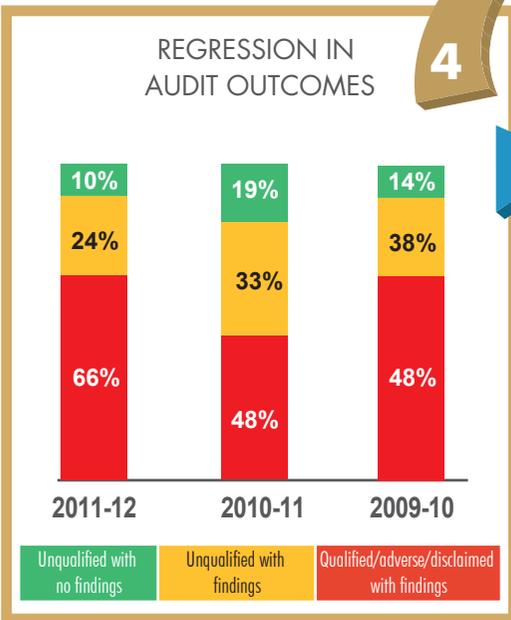
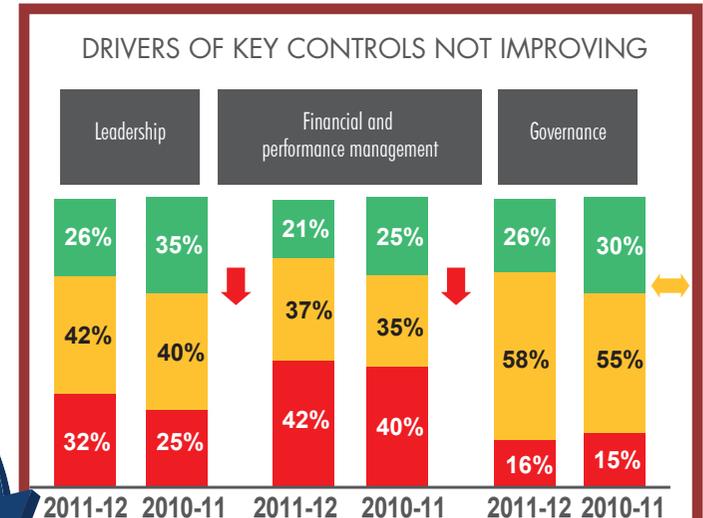
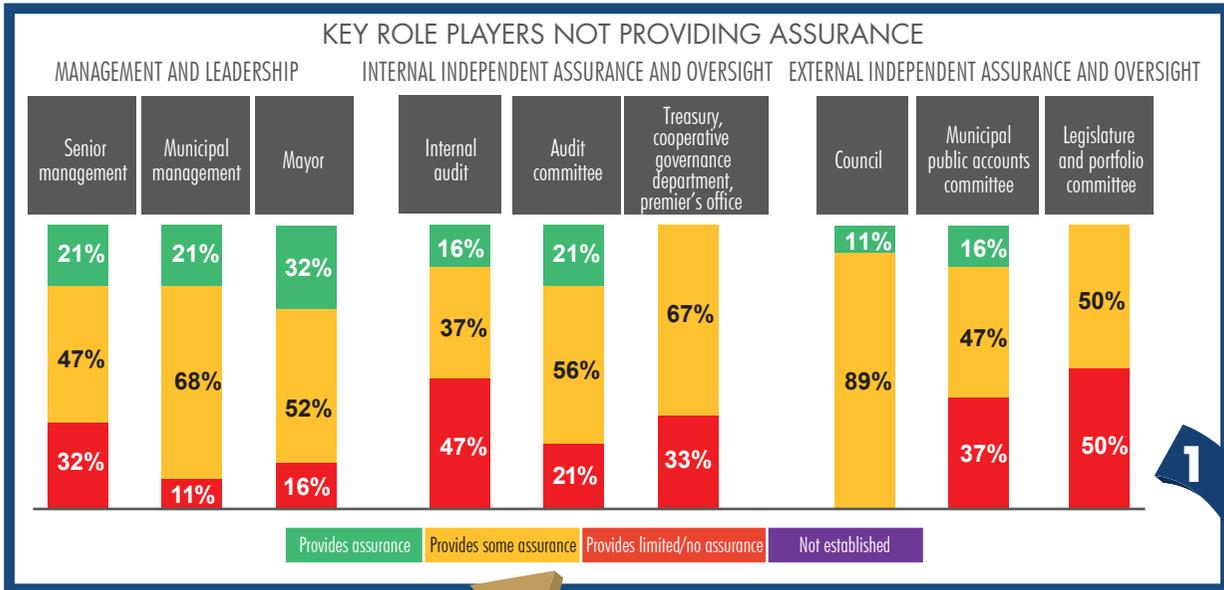
**AUDITOR-GENERAL: TERENCE NOMBEMBE**

The information and insights presented in this flagship publication of my office are aimed at empowering oversight structures and local government and provincial leaders to focus on those issues that will result in reliable financial statements, credible reporting on service delivery and compliance with laws and regulations.

This publication also captures the commitments that leaders have made to improve audit outcomes.

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## THE KEY ROLE PLAYERS NEED TO...

...TO ENSURE IMPROVED RESULTS...

...TAKE SOME VITAL ACTIONS...

...IN SIX KEY AREAS...

### KEY RISK AREAS NOT RECEIVING REQUIRED ATTENTION



### ROOT CAUSES NOT BEING ADDRESSED

Key positions vacant or key officials lacking appropriate competencies

A root cause of **53%** of auditees

Lack of consequences for poor performance and transgressions

A root cause of **57%** of auditees

Slow response by political leadership in addressing the root causes of poor audit outcomes

A root cause of **79%** of auditees

## FOREWORD

I hereby present to the legislature and municipal councils of the Mpumalanga province my 2011-12 general report on local government audit outcomes. The leadership of the Mpumalanga province committed to achieving clean audits by 2014. However, the year that should have marked a considerable advancement towards achieving the goal of clean audits by 2014 was characterised by a net regression. The 2011-12 outcomes show a year-on-year regression with five improvements in the audit outcomes being overshadowed by seven regressions. Two of the province's municipalities were unable to retain the clean audit outcomes obtained in the prior year. A total of 66% of the province's municipalities received qualified or disclaimed audit opinions, marking a 12% regression from the prior year.

The internal control environment in the province's municipalities continued to weaken, as evidenced by the regression in the design and implementation of the drivers of key controls. This is despite the commitments made by the executives during the quarterly key control visits to address the weaknesses reported. Although governance structures were in place at all the municipalities, their impact on audit outcomes was inhibited by the lack of implementation of their recommendations and the limited depth of internal audit work undertaken.

The root cause of the regression in the internal controls at 53% of the municipalities was the recurring vacancies in key positions, coupled with officials who lacked the appropriate competencies and skills. The relevant checks and balances were not implemented or monitored, as competent officials were not available in key positions to enforce compliance with the relevant policies and procedures, which in turn resulted in a regression in internal controls. At 57% of the municipalities, the executives were very slow in adopting a culture of performance management at all levels to ensure that consequences for poor performance and transgressions became the norm.

The poor quality of the financial statements submitted for auditing (79% of municipalities), together with the recurring findings on supply chain management (95% of municipalities), continued to be the major contributor to findings on non-compliance with laws and regulations. The prevalence of one or more types of unauthorised, irregular or fruitless and wasteful expenditure also remains a concern. Findings on predetermined objectives (79% of municipalities) are of special concern too, as they relate directly to the service delivered to the citizens of the province. There has been no improvement in the number of municipalities with such findings. Ineffective budget planning and management processes, weaknesses in internal control and poor debt-collection processes had a negative impact on the province's financial health and compromised sustainable service delivery. Municipalities still experienced challenges with the design of information technology controls, due to the continued lack of adequately skilled resources.

At the centre of the regression in the audit outcomes is the slow response by the political leadership at 79% of the municipalities to exercise the level of monitoring and oversight committed to in response to the previous year's audit outcomes. In general, the oversight structures were ineffective, as they did not perform the required oversight work throughout the period and therefore limited assurance could be obtained from their activities. It is evident that the drive towards improved transparency and accountability in the municipalities of the province will not gain the required momentum until the leadership sets the right tone by consistently pursuing this desirable goal.

In order to improve the audit outcomes and achieve clean audit outcomes by 2014, the key role players should have a clear, coherent and well-coordinated approach to address the drivers of key controls in leadership, financial and performance management as well as governance. The capacity of the councillors should also be strengthened. This will empower councillors to ensure that key vacancies are filled with competent and skilled individuals who will be instrumental in improving the drivers of key controls in municipalities. Performance management systems at all levels should be implemented and adequately monitored to ensure that consequences for poor performance become the norm.

I am encouraged by the willingness of the coordinating institutions to find a consistent approach to assisting municipalities to improve their audit outcomes. In addition, the Department of Cooperative Governance and Traditional Affairs, the Department of Finance and the South African Local Government Association

have allocated adequate resources in their budgets for the 2013-14 financial year to provide the required support to municipalities and intensify their oversight responsibilities.

Furthermore, the speaker and the provincial legislature committed to convene quarterly meetings with the provincial oversight group to intensify and monitor areas in municipalities that hinder the achievement of positive results. This includes training to empower councillors as well as oversight visits to municipalities.

It is critical that the commitments made by the leadership in local and provincial government be honoured and implemented with urgency. Indeed, with the leadership setting the right tone for building and sustaining a culture of transparency and accountability, the opportunities for improving governance in local government – and thereby enhancing public confidence – are unlimited.

I want to thank the audit teams from my office and the audit firms that assisted in the province for their diligent efforts towards fulfilling our constitutional mandate and the manner in which they continue to strengthen cooperation with the leadership of the province.

Auditor-General

Pretoria

## SECTION 1: EXECUTIVE SUMMARY

Local government in Mpumalanga consists of three district and 18 local municipalities. The audit outcomes relating to 19 of these municipalities are analysed in this report. The annual financial statements of two municipalities (Emalahleni and Mkhondo Local Municipalities) were submitted late for audit purposes and therefore do not form part of the analyses in this report.

The table below summarises significant aspects of the 2011-12 audit outcomes of local government in Mpumalanga, followed by a summary of the root causes.

**Table 1: Significant aspects of the audit outcomes and root causes**

Aspect	Indicator	Key outcomes and trends
Overall audit outcomes	Overall regression in audit outcomes	<ul style="list-style-type: none"> <li>The net overall audit outcomes of local government <b>regressed</b>, as five auditees (26%) [Albert Luthuli, Dr JS Moroka, Dipaliseng, Pixley Ka Seme and Umjindi Local Municipalities] improved, but seven auditees (37%) [Bushbuckridge, Emakhazeni, Govan Mbeki, Msukaligwa, Nkomazi and Victor Khanye Local Municipalities as well as Gert Sibande District Municipality] regressed.</li> <li>Local government was <b>unable to sustain, or build momentum towards improving</b>, its 2010-11 clean audit outcomes. This is evidenced by the number of clean audits increasing from three [Ehlanzeni and Gert Sibande District Municipalities as well as Steve Tshwete Local Municipality] in 2009-10 to four [Ehlanzeni and Gert Sibande District Municipalities as well as Steve Tshwete and Victor Khanye Local Municipalities] in 2010-11, but thereafter declining to two [Ehlanzeni District Municipality and Steve Tshwete Local Municipality] in 2011-12.</li> </ul>
	Retained clean audit status	<ul style="list-style-type: none"> <li>Both auditees (11%) with clean audit opinions were able to <b>sustain their clean status</b> for the past three financial years.</li> </ul>
	Lost clean audit status	<ul style="list-style-type: none"> <li>Gert Sibande District Municipality and Victor Khanye Local Municipality were <b>unable to sustain their clean audit status</b> from the previous financial year and regressed to financially unqualified with findings on predetermined objectives and/or compliance with laws and regulations.</li> </ul>
	Stagnated in financially unqualified with findings category	<ul style="list-style-type: none"> <li>Two auditees (11%) [Nkangala District Municipality and Mbombela Local Municipality] were <b>unable to tip the scales and progress to clean audits</b>, as they failed to address or did not avoid material findings on predetermined objectives and non-compliance reported in the previous year.</li> </ul>
	Regressed from financially unqualified to qualified or	<ul style="list-style-type: none"> <li>The <b>planned improvements</b> for auditees from financially unqualified with material findings to clean opinions in 2011-12 <b>were not achieved</b>. Instead, five auditees (26%) [Bushbuckridge, Emakhazeni, Govan Mbeki, Nkomazi and Msukaligwa Local Municipalities] regressed from this opinion category to qualified and disclaimed opinions.</li> </ul>

Aspect	Indicator	Key outcomes and trends
	<b>disclaimed</b>	
	<b>Little or no progress in addressing prior year qualifications</b>	<ul style="list-style-type: none"> <li>A further seven auditees (37%) [Albert Luthuli, Dr JS Moroka, Lekwa, Pixley Ka Seme, Thembisile Hani, Thaba Chweu and Umjindi Local Municipalities) <b>failed to address their 2010-11 qualification areas.</b></li> </ul>
<b>Submission of financial statements for auditing</b>	<b>Financial statements not timeously submitted</b>	<ul style="list-style-type: none"> <li>Two auditees (10%) [Emalahleni and Mkhondo Local Municipalities] <b>had not submitted annual financial statements by 31 August 2012</b>, as required by the Municipal Finance Management Act – a regression compared to one auditee (5%) in the previous year. By 31 March 2013, we had not finalised the audits of these municipalities as a result of the late submission of their annual financial statements.</li> </ul>
<b>Opinions on financial statements</b>	<b>Submitted financial statements contained material misstatements</b>	<ul style="list-style-type: none"> <li>Fifteen auditees (79%) <b>submitted financial statements with material misstatements.</b> Had the misstatements not been corrected at three auditees (16%) [Gert Sibande District Municipality as well as Govan Mbeki and Victor Khanye Local Municipalities], the number of auditees with unqualified audit opinions would have been only four (21%) [Ehlanzeni and Nkangala District Municipalities as well as Mbombela and Steve Tshwete Local Municipalities], instead of seven (36%).</li> </ul>
	<b>Financial statements again disclaimed</b>	<ul style="list-style-type: none"> <li>The annual financial statements of two auditees (11%) [Lekwa and Thaba Chweu Local Municipalities] were <b>again disclaimed</b> due to the unavailability of documentation or information on which to form an audit opinion. The opinions of a further three auditees (16%) [Bushbuckridge, Nkomazi and Msukaligwa Local Municipalities] regressed to disclaimers.</li> </ul>
	<b>Increase in the number of qualified opinions</b>	<ul style="list-style-type: none"> <li>There has been an increase in the number of annual financial statements that were <b>qualified</b> (qualified or disclaimed with findings), with five [Bushbuckridge, Emakhazeni, Govan Mbeki, Nkomazi and Msukaligwa Local Municipalities] regressing and only one improving. All the auditees that regressed were unqualified with material findings on predetermined objectives and/or non-compliance in the previous year.</li> <li>The annual financial statements of seven auditees (37%) [Albert Luthuli, Dr JS Moroka, Lekwa, Pixley Ka Seme, Thaba Chweu, Thembisile Hani and Umjindi Local Municipalities] were qualified or disclaimed again; six (32%) of which [Albert Luthuli, Dr JS Moroka, Pixley Ka Seme, Thaba Chweu, Thembisile Hani and Umjindi Local Municipalities] <b>failing to obtain unqualified audit opinions for the past three years.</b></li> </ul>
	<p>The <b>most common qualification areas</b> related to the existence, valuation and completeness as well as rights or obligations pertaining to assets (property, plant, infrastructure and equipment) and liabilities (payables, accruals and borrowings) disclosed in the financial statements. Three auditees (16%) [Bushbuckridge, Thaba Chweu and Thembisile Hani Local Municipalities] had qualifications on the completeness of the disclosure of irregular expenditure relating to supply chain management.</p>	

Aspect	Indicator	Key outcomes and trends
<i>Reporting on predetermined objectives</i>	<b>Reduction in number of auditees without findings on predetermined objectives</b>	<ul style="list-style-type: none"> <li>Four auditees (21%) [Ehlanzeni and Gert Sibande District Municipalities as well as Mbombela and Steve Tshwete Local Municipalities] did not have <b>any material findings on the usefulness and reliability</b> of their annual performance reports; regressing from six (28%) [Ehlanzeni and Gert Sibande District Municipalities as well as Emakhazeni, Nkangala, Umjindi and Victor Khanye Local Municipalities] in the previous year. The regression was due to a relaxation of the monitoring and oversight performed on reporting on predetermined objectives.</li> </ul>
	<b>Material misstatements in annual performance reports submitted for auditing</b>	<ul style="list-style-type: none"> <li>Sixteen auditees (84%) submitted <b>annual performance reports that contained material misstatements</b>. Pixley Ka Seme Local Municipality was unable to avoid findings on the presentation and reliability of the report, even though they had corrected some of the misstatements identified as a result of the audit.</li> </ul>
	<b>Planned service delivery targets not attained</b>	<ul style="list-style-type: none"> <li>Based on the annual performance reports, 17 auditees (89%) <b>achieved 80% or fewer of their planned service delivery targets</b>.</li> </ul>
	<p>The <b>most common material finding on the usefulness of the reported information</b> was that the performance targets were not specific or measurable so that the required performance could be measured meaningfully.</p> <p><b>Findings on the reliability of the annual performance reports</b> mostly related to the accuracy and validity of the information.</p>	
<i>Findings on non-compliance with laws and regulations</i>	<b>No reduction in high level of non-compliance with laws and regulations</b>	<ul style="list-style-type: none"> <li><b>Material findings on non-compliance with laws and regulations</b> were reported for 16 auditees (84%). There was minimal improvement when compared to the 17 (81%) in the previous year. Only municipalities in the Nkangala district addressed their prior year findings on non-compliance, while two auditees (11%) [Gert Sibande District Municipality and Victor Khanye Local Municipality] had material findings for the first time this year.</li> </ul>
	<b>Some auditees close to being fully compliant</b>	<ul style="list-style-type: none"> <li>Two (11%) auditees [Nkangala District Municipality and Mbombela Local Municipality] with findings on non-compliance, had <b>findings in one of our focus areas only</b>. Full compliance with key laws and regulations is therefore within their reach.</li> </ul>
	<p>The <b>top three areas of non-compliance</b> related to material misstatements in the submitted financial statements, procurement and contract management (supply chain management), and asset and liability management – which together accounted for 37% of all findings on non-compliance.</p> <p>The other areas of non-compliance included expenditure management, audit committees, prevention and detection of unauthorised, irregular as well as fruitless and wasteful expenditure, annual financial statements and performance reports.</p>	
<i>Focus area – supply chain management</i>	<b>No reduction in overall level of findings on supply chain management</b>	<ul style="list-style-type: none"> <li><b>Findings on supply chain management</b> were reported in the management reports of 18 (95%) of the auditees [2010-11: 20 (95%)], while at 15 (79%) [2010-11: 14 (67%)] the findings were material enough to be reported in the audit report. At an overall level, there has been a regression.</li> </ul>

Aspect	Indicator	Key outcomes and trends
	<b>Marginal reduction in awards to suppliers in which employees had an interest</b>	<ul style="list-style-type: none"> <li>Contracts to the value of R2,6 million identified at 17 auditees (89%) were <b>awarded to suppliers in which employees of the auditee had an interest</b>. This represents a decrease compared to the R11,3 million identified in the previous year at 15 (79%) auditees.</li> </ul>
	<b>Marginal reduction in contracts awarded to suppliers in which close family members of employees of the auditee had an interest</b>	<ul style="list-style-type: none"> <li>Contracts to the value of R2,1 million identified at 17 auditees (89%) were <b>awarded to suppliers in which close family members of employees of the auditee had an interest</b>. This represents a decrease compared to the R3,5 million identified in the previous year at 17 auditees (81%).</li> </ul>
	<b>Some contracts awarded could not be audited</b>	<ul style="list-style-type: none"> <li><b>We could not audit contracts and quotations to the value of R343,1 million [2010-11: R28,4 million] selected for auditing</b> due to the auditees not making the required information or documentation available. These limitations had an impact on the extent of identified irregularities and supply chain management weaknesses.</li> </ul>
	<b>No reduction in findings on unfair and uncompetitive bidding</b>	<ul style="list-style-type: none"> <li>We raised findings on <b>unfair and uncompetitive bidding</b> at 12 auditees (63%) [2010-11: 12 (63%)]. The most common findings related to competitive bidding and quotation processes not being followed to select suppliers, and suppliers not submitting their tax certificates and declarations of independence. The preference point system was also not always applied in the procurement process.</li> </ul>
<b>Unauthorised, irregular as well as fruitless and wasteful expenditure</b>	<b>Increase in findings on unauthorised, irregular as well as fruitless and wasteful expenditure</b>	<ul style="list-style-type: none"> <li>We identified findings on non-compliance relating to <b>unauthorised, irregular as well as fruitless and wasteful expenditure</b> at 11 auditees (58%). This marks a regression from the eight auditees (38%) in the previous year.</li> </ul>
	<b>Unauthorised expenditure remained at same level</b>	<ul style="list-style-type: none"> <li><b>Unauthorised expenditure</b> of R747,2 million was incurred by 10 auditees (53%) – one auditee more than in the 2010-11 financial year, while the value increased by R363 million compared to the previous year.</li> </ul>

Aspect	Indicator	Key outcomes and trends
	<p style="text-align: center;"><b>Irregular expenditure remained at same level</b></p>	<ul style="list-style-type: none"> <li>• <b>Irregular expenditure</b> of R248,5 million was incurred by 14 auditees (74%). The number of auditees incurring irregular expenditure increased by two, while the value decreased by R25,2 million compared to the previous year.</li> <li>• A total of R78,6 million of the irregular expenditure had been incurred in previous years and was only identified and reported in the current year.</li> </ul>
	<p style="text-align: center;"><b>Increase in level of fruitless and wasteful expenditure</b></p>	<ul style="list-style-type: none"> <li>• <b>Fruitless and wasteful expenditure</b> of R27 million was incurred by 11 auditees (58%). The number of auditees incurring fruitless and wasteful expenditure increased by nine and the value by R17 million, compared to the previous year.</li> </ul>
<p style="text-align: center;"><b>Focus area – human resource management</b></p>	<p style="text-align: center;"><b>No significant progress in filling vacancies</b></p>	<ul style="list-style-type: none"> <li>• The <b>average overall vacancy rate</b> for municipalities at year-end was 14%. The highest vacancy rate was at Thembisile Hani Local Municipality (50%) and the lowest at Nkangala District Municipality (5%).</li> <li>• The <b>average vacancy rate at senior management level</b> for municipalities at year-end was 27%. The highest vacancy rate was at Lekwa Local Municipality at 100% and the lowest at Nkangala District Municipality at 5%.</li> <li>• At four auditees (21%) [Govan Mbeki, Lekwa, Pixley Ka Seme and Umjindi Local Municipalities] the <b>overall vacancy rate has increased</b> since 2010-11.</li> </ul>
	<p style="text-align: center;"><b>Signed performance agreements and performance management systems not in place</b></p>	<ul style="list-style-type: none"> <li>• Two (11%) of the <b>municipal managers</b> appointed in the province [at Dr JS Moroka and Pixley Ka Seme Local Municipalities] did not have <b>signed performance agreements</b> for 2011-12.</li> <li>• At two (11%) auditees [Dr JS Moroka and Pixley Ka Seme Local Municipalities], 20% or more of the <b>senior managers</b> did not have <b>signed performance agreements</b> for 2011-12.</li> <li>• Six auditees (32%) [Bushbuckridge, Dipaliseng, Lekwa, Pixley Ka Seme, Thaba Chweu and Umjindi Local Municipalities] had not established appropriate <b>performance management systems</b> to monitor, measure and evaluate the performance of officials other than the municipal manager and senior managers.</li> </ul>
	<p style="text-align: center;"><b>All municipal managers met the minimum competency levels</b></p>	<ul style="list-style-type: none"> <li>• By 30 June 2012 (six months from the effective date of the municipal regulations on minimum competency levels), all of the appointed <b>municipal managers</b> in the province had <b>met the minimum competency levels</b> defined in the regulations.</li> </ul>

Aspect	Indicator	Key outcomes and trends
<i>Financial reporting assistance provided by consultants</i>	Low skills transfer rate from consultants to auditee staff	<ul style="list-style-type: none"> <li>• Most of the municipalities (68%) <b>used consultants</b> for preparing the financial statements.</li> <li>• Consultants were used at four municipalities (31%) where <b>no vacancies existed</b>, as the finance staff lacked the necessary competencies.</li> <li>• Consultants were appointed at nine auditees (47%) where vacancies existed. The appointment of consultants was prioritised over the filling of vacancies.</li> <li>• Consultants <b>did not transfer skills</b> to municipal staff at 10 (77%) of the municipalities that engaged consultants.</li> <li>• At 10 (77%) of the auditees, the consultants were <b>unable to ensure that auditees progressed</b> towards financially unqualified audit opinions.</li> </ul>
<i>Focus area: information technology management</i>	Information technology risks remained at same level	<ul style="list-style-type: none"> <li>• Most municipalities experienced challenges with the <b>design of information technology controls</b>. Adequate progress had not been made in addressing previous findings, as risks remained in all of the focus areas.</li> <li>• The lack of adequate progress can be attributed to <b>inadequate oversight</b> by those charged with governance, a lack of consequences for not resolving audit findings, and a lack of consistent monitoring by internal audit units and audit committees of the progress made in implementing management commitments.</li> <li>• There was also a <b>lack of adequately skilled resources</b> to design and implement user access management controls, specifically regarding the monitoring and review of users' access rights and system controllers' activities, which was made worse by vacant posts not being filled.</li> </ul>
<i>Auditees' system of internal control</i>	Auditees' system of internal control deteriorate	<ul style="list-style-type: none"> <li>• There was an <b>overall reduction</b> in the number of auditees whose key internal control drivers were assessed as 'good' at the end of the 2010-11 audits.</li> <li>• Overall, the increase in the number of auditees requiring intervention in controls related to <b>financial and performance management</b>.</li> </ul>
<i>Audit committees and internal audit units</i>	Audit committees and internal audit units did not have a positive impact	<ul style="list-style-type: none"> <li>• <b>Audit committees and internal audit units</b> were in place at all municipalities, but at 15 (79%) of the auditees, the audit committees and internal audit units did not have a positive impact on the audit outcomes, as their recommendations were not implemented.</li> </ul>
<i>Assurance provided by key role players</i>	Minimal assurance by key role players	<ul style="list-style-type: none"> <li>• At an overall level, the key role players in local government are only <b>providing minimal assurance</b>. Significant strides will have to be made if the required level of assurance is to be provided on credible decision-making.</li> </ul>
<i>Councils and speakers</i>	Minimal assurance by councils and speakers	<ul style="list-style-type: none"> <li>• <b>Councils did not take timeous action</b> in instances of identified weaknesses or failure by management and staff to perform statutory duties.</li> <li>• Speakers failed to insist on <b>the credibility of the information</b> submitted to the council.</li> <li>• Councillors must receive <b>induction training and continuous further development</b> to</li> </ul>

Aspect	Indicator	Key outcomes and trends
<i>Legislature and portfolio committee</i>	<b>Minimal assurance by legislature and portfolio committee</b>	<ul style="list-style-type: none"> <li>empower them to fulfil their responsibilities.</li> <li>The portfolio committee on cooperative governance and traditional affairs did not have any impact on the audit outcomes of the province. We did not note any <b>direct interventions</b> by the committee.</li> <li>The provincial legislature did not have any visible impact; however, coupled with <b>the new commitments from the speaker</b>, we hope that progress will be now be made to move to improved, sustainable audit outcomes.</li> </ul>
<i>Coordinating institutions</i>	<b>Minimal assurance by coordinating institutions</b>	<ul style="list-style-type: none"> <li>Coordinating institutions had a <b>minimal impact</b> on the audit outcomes, as previous commitments were not honoured or were not adequately monitored.</li> </ul>
<i>District municipalities</i>	<b>District municipalities were unable to transfer best practices</b>	<ul style="list-style-type: none"> <li><b>There was a lack of effective coordination</b> between the district and local municipalities, as the district municipalities did not assist their local municipalities by centralising certain services, such as information technology, consultant and engineering support.</li> </ul>
<i>Municipal public accounts committees</i>	<b>Municipal public accounts committees did not have the desired impact on audit outcomes</b>	<ul style="list-style-type: none"> <li>Municipal public accounts committees did not have the desired impact on audit outcomes and clean administration in local government due to their <b>late establishment</b>. These committees have, however, gained momentum after the 2011-12 audits, but they still have a long way to go before they will achieve their intended oversight effectiveness and have a positive impact on audit outcomes.</li> </ul>
<i>Status of commitments from key role players</i>	<b>Ineffective implementation of commitments to improve the audit outcomes</b>	<ul style="list-style-type: none"> <li>The slow progress in addressing the previous year's audit findings indicates that the leadership <b>did not adequately monitor</b> progress made with the effective implementation of commitments to improve the audit outcomes.</li> </ul>
<i>Root causes of audit outcomes</i>		<ul style="list-style-type: none"> <li>Key officials lacked minimum competencies and skills.</li> <li>Lack of consequences for poor performance and transgressions.</li> <li>Leadership's unwillingness to take ownership of key controls and respond to our messages.</li> <li>A lack of commitment to own action plans.</li> <li>Ineffective monitoring by audit committees and internal audit units.</li> <li>A lack of basic financial disciplines.</li> </ul>

Good

Concerned

Poor

## SECTION 2: OVERVIEW OF AUDIT OUTCOMES

This section of the report provides the 2011-12 local government audit outcomes (section 2.1), followed by further details on findings arising from the audit of the financial statements (section 2.2), reporting by auditees against their predetermined objectives (PDOs) (section 2.3) and compliance by auditees with key laws and regulations (section 2.4).

Section 3 presents the root causes of audit findings and recommended best practices.

### 2.1 Summary of audit outcomes

#### 2.1.1 Summary of overall audit outcomes

Local government in the province consists of three district municipalities and 18 local municipalities. At local government level, the province is divided into three districts.

We completed the audits of 13 (68%) of the 19 auditees that had submitted financial statements by 31 August 2012 within the legislated time frame of three months from receipt of the financial statements. Due to the late submission of financial statements for auditing, we had not finalised the audits of two auditees (11%) at 31 March 2013, which is the cut-off date we set for inclusion of audit outcomes in this report. Section 2.1.4 provides the status of these outstanding audits.

The following table summarises the audit outcomes of the 2011-12 financial year for audits completed by 31 March 2013, and lists the audit outcomes of the previous year.

'With findings' denotes findings on PDOs and/or non-compliance with laws and regulations. Clean audits are achieved when the financial statements are unqualified and there are no reported audit findings in respect of either reporting on PDOs or non-compliance with laws and regulations.

Table 2: Summary of audit outcomes of current and previous year

Audit outcomes	Total		Municipalities in the Ehlanzeni District		Municipalities in the Gert Sibande District		Municipalities in the Nkangala District	
	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11	2011-12	2010-11
Unqualified with no findings (clean audits)	2	4	1	1	0	1	1	2
Unqualified with findings	5	7	1	3	2	2	2	2
Unqualified financial statements	33% ↓	52%	33% ↓	67%	25% ↓	38%	43% ↓	57%
Qualified opinion, with findings	7	3	1	0	3	1	3	2
Adverse opinion, with findings	0	0	0	0	0	0	0	0
Disclaimer of opinion, with findings	5	7	3	2	2	4	0	1
Number of audit reports not issued by 31 March 2013	2	0	0	0	1	0	1	0
Outstanding audits and qualified financial statements	67% ↓	48%	67% ↓	33%	75% ↓	63%	57% ↓	43%
Total number of audits	21	21	6	6	8	8	7	7
Findings on reporting on predetermined objectives (PDO) only	1	0	0	0	0	0	1	0
Findings on compliance with laws and regulations only	2	3	1	1	1	0	0	2
Findings on both PDO and compliance	14	14	4	4	6	7	4	3
Total number of audits "with findings"	17	17	5	5	7	7	5	5

Legend: ↓ Significant regression

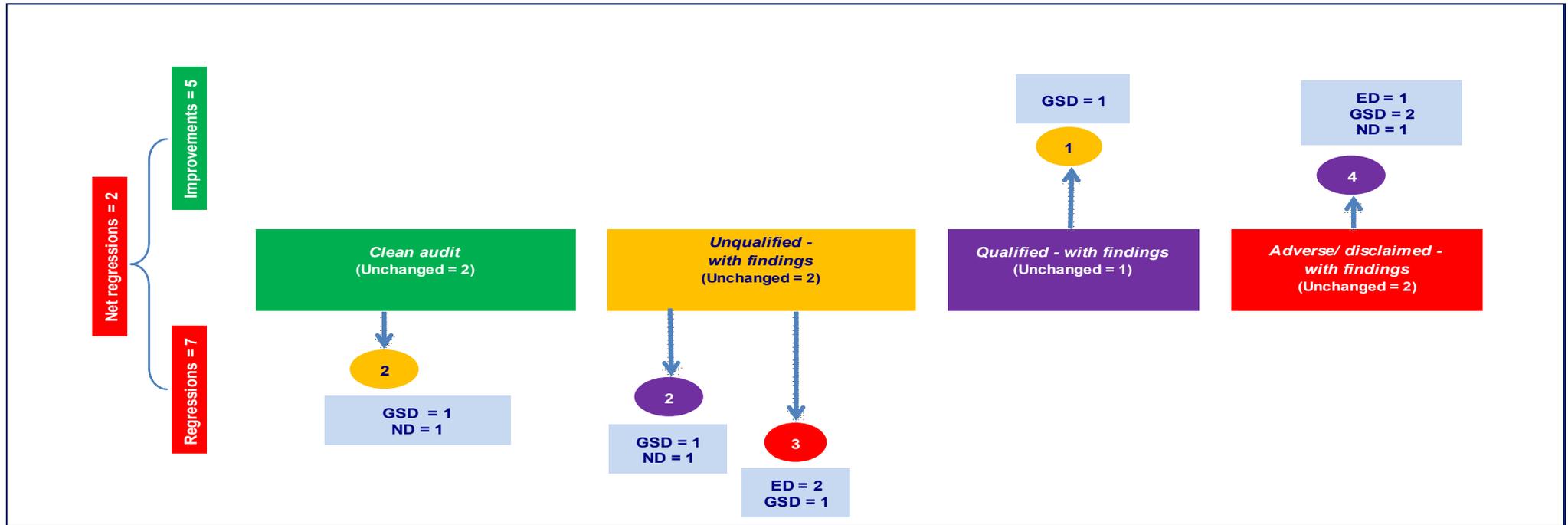
Three (16%) of the auditees avoided qualified financial statements by correcting the material misstatements identified during the audit process. Had the misstatements not been corrected, the number of unqualified financial statements would have been as follows:

	Total	Municipalities in the Ehlanzeni district	Municipalities in the Gert Sibande district	Municipalities in the Nkangala district
Unqualified financial statements (with and without findings)	4	2	0	2

Also refer to section 2.2.1 for further detail in this regard, while annexure 1 lists all the auditees with their current and prior year audit outcomes.

While the preceding table shows the net change in audit outcomes compared to the previous year, the following figure highlights the detail of improvement and regression that caused the net change.

**Figure 1: Improvement and regression in the audit opinions**



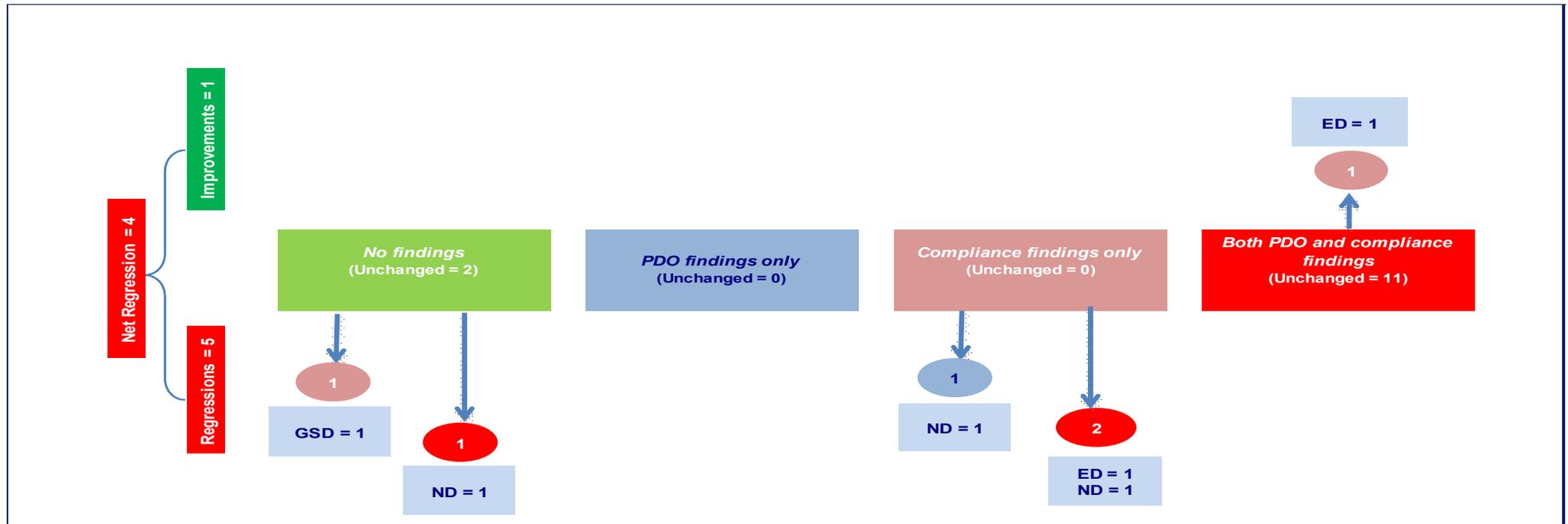
ED - Municipalities in the Ehlanzeni District

GSD - Municipalities in the Gert Sibande District

ND - Municipalities in the Nkangala District

Table 2 and figure 1 clearly show that the audit outcomes of most auditees remained in the categories of unqualified, qualified or disclaimed with material findings on reporting on PDOs and/or non-compliance. The following figure shows the improvement and regression of the auditees in these areas.

**Figure 2: Improvement and regression in findings on predetermined objectives and non-compliance**



**ED** - Municipalities in the Ehlanzeni District

**GSD** - Municipalities in the Gert Sibande District

**ND** - Municipalities in the Nkangala District

The following observations are made regarding the overall audit outcomes and the improvements and regressions since the previous year.

**Table 3: Significant aspects of the 2011-12 audit outcomes**

Indicator	Key outcomes and trends
<b>Overall audit outcomes</b>	<ul style="list-style-type: none"> <li>The net overall audit outcomes for local government <b>regressed</b>, as five auditees (26%) [Albert Luthuli, Dr JS Moroka, Dipaliseng, Pixley Ka Seme and Umjindi Local Municipalities] improved, while seven auditees (37%) [Gert Sibande District Municipality as well as Bushbuckridge, Emakhazeni, Govan Mbeki, Msukaligwa, Nkomazi and Victor Khanye Local Municipalities] regressed.</li> </ul>
<b>Sustained clean audit opinions</b>	<ul style="list-style-type: none"> <li>Ehlanzeni District Municipality and Steve Tshwete Local Municipality have been able to <b>sustain their clean audit status</b> for the past three years.</li> </ul>
<b>Regression from clean audit opinions</b>	<ul style="list-style-type: none"> <li>Gert Sibande District Municipality and Victor Khanye Local Municipality, which were unable to avoid material findings on PDOs and non-compliance, <b>regressed from clean audits</b> to unqualified opinions with findings.</li> </ul>
<b>Loss of momentum towards clean audit opinions</b>	<ul style="list-style-type: none"> <li>Local government was <b>unable to sustain, or build momentum towards improving</b>, its 2010-11 clean audit outcomes. This was evident in the number of clean audits increasing from three [Ehlanzeni District Municipality as well as Steve Tshwete and Victor Khanye Local Municipalities] in 2009-10 to four [Ehlanzeni and Gert Sibande District Municipalities as well as Steve Tshwete and Victor Khanye Local Municipalities] in 2010-11, but thereafter declining to two [Ehlanzeni District Municipality and Steve Tshwete Local Municipality] in 2011-12.</li> <li>The <b>anticipated improvement of seven auditees</b> (37%) [Nkangala District Municipality as well as Bushbuckridge, Emakhazeni, Govan Mbeki, Nkomazi, Mbombela and Msukaligwa Local Municipalities] from financially unqualified with material findings on PDOs and/or non-compliance to clean opinions in 2011-12 was <b>not achieved</b>. Instead, two (11%) of these auditees [Nkangala District Municipality and Mbombela Local Municipality] remained unqualified with material findings, while the remaining five (26%) regressed to qualified or disclaimed opinions.</li> </ul>
<b>Movement towards unqualified audit opinions</b>	<ul style="list-style-type: none"> <li>Dipaliseng Local Municipality, which was able to <b>improve</b> the quality of its financial statements and to address or avoid prior year qualification areas, received a financially unqualified opinion with material findings on both PDOs and non-compliance.</li> </ul>
<b>Unchanged qualified audit opinions for the past three years</b>	<ul style="list-style-type: none"> <li>Of the 12 auditees (63%) that were qualified or disclaimed, six (32%) [Albert Luthuli, Dr JS Moroka, Pixley Ka Seme, Thaba Chweu, Thembe Hani and Umjindi Local Municipalities] have <b>failed to obtain unqualified audit opinions for the past three years</b>. The most common recurring financial statement qualification areas related to property, plant and equipment; payables, accruals and borrowings; and the cash flow statement.</li> </ul>
<b>Best practices at district municipalities not implemented at local</b>	<ul style="list-style-type: none"> <li>Of the three district municipalities, one (33%) received a clean audit opinion and two (67%) received a financially unqualified opinion with material findings on both PDOs and non-compliance. The <b>good practices</b> at these district municipalities <b>had not been implemented</b> at the local municipalities. This is evidenced by the 12 local municipalities that received qualified and disclaimed audit opinions.</li> </ul>

Indicator	Key outcomes and trends
<i>municipalities</i>	
<b>Overall outcomes regarding PDOs and non-compliance</b>	<ul style="list-style-type: none"> <li>None of the auditees were able to improve their <b>overall outcomes regarding findings on PDOs and/or non-compliance</b> and move towards a clean audit opinion. Four auditees (21%) [Gert Sibande District Municipality as well as Emakhazeni, Umjindi and Victor Khanye Local Municipalities] regressed in this regard.</li> <li>Gert Sibande District Municipality and Victor Khanye Local Municipality had no material findings on PDOs or non-compliance in the previous year.</li> </ul>
<b>Progress towards avoiding material findings on PDOs and non-compliance</b>	<ul style="list-style-type: none"> <li>Nkangala District Municipality and Mbombela Local Municipality had <b>findings in one of our focus areas only</b>, namely PDOs and procurement, respectively. Full compliance with key laws and regulations is therefore within their reach.</li> </ul>
<b>Continued regression in outcomes relating to PDOs</b>	<ul style="list-style-type: none"> <li>Only Mbombela Local Municipality addressed the previous year PDO findings. This <b>improvement was overshadowed</b> by the four auditees (21%) [Nkangala District Municipality as well as Emakhazeni, Umjindi and Victor Khanye Local Municipalities] that were unable to maintain their status of no findings on PDOs from the previous year.</li> </ul>
<b>Continued regression in non-compliance with laws and regulations</b>	<ul style="list-style-type: none"> <li>Only Nkangala District Municipality addressed the previous year findings on non-compliance. This <b>improvement was overshadowed</b> by the two auditees (11%) [Gert Sibande District Municipality and Victor Khanye Local Municipality] that were unable to maintain their status of no findings on non-compliance from the previous year.</li> </ul>

Good

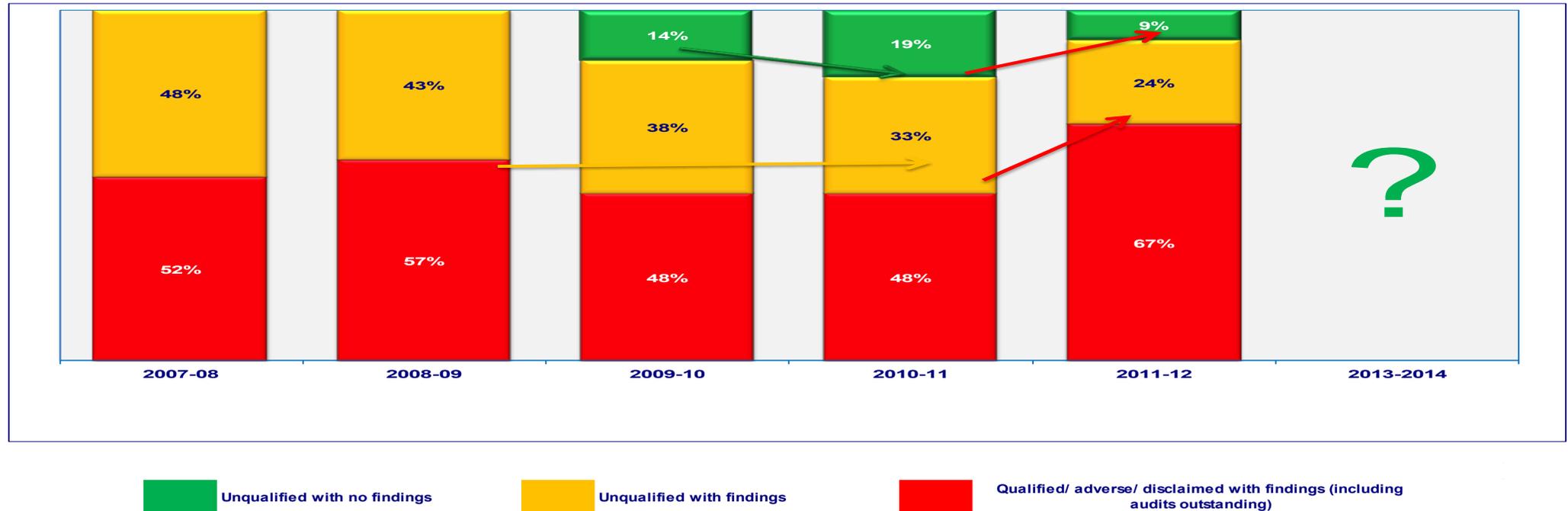
Concerned

Poor

### 2.1.2 Five-year progress towards clean audits

Producing unqualified financial statements is an important milestone towards clean audits. The following figure depicts the five-year progress of local government towards obtaining unqualified audit opinions with no material findings on PDOs or non-compliance (in other word, clean audits).

**Figure 3: Five-year progress towards clean audits**

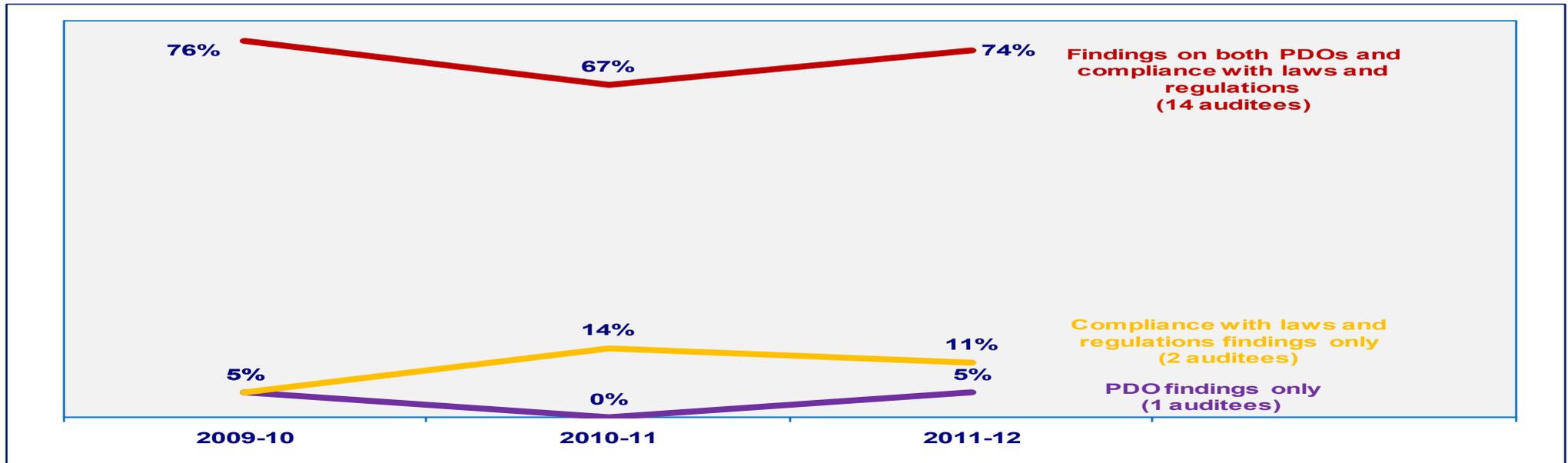


The 2009-10 to 2010-11 history of audit outcomes of local government showed marginal growth towards clean audits. These years reflected a conscious focus by the leadership on improving the outcomes by addressing the root causes identified in the 2008-09 audits. However, this encouraging trend was reversed in the 2011-12 financial year. The reality is that the practices that promote and sustain improved outcomes are not entrenched in the auditees' financial management practices. The regressed and stagnated outcomes can be attributed to a number of factors, involving both people and processes. Refer to section 3 for a detailed analysis of root causes and best practice recommendations regarding the financial statements.

### 2.1.3 Three-year progress towards useful and reliable reporting against predetermined objectives and compliance with laws and regulations

In order to obtain clean audit opinions, auditees should report annually on the achievement of their PDOs in a useful and reliable manner, and their audit reports should not contain material findings on non-compliance with laws and regulations. The following figure depicts the three-year progress of local government towards meeting these requirements.

**Figure 4: Three-year progress in addressing findings on predetermined objectives and non-compliance**



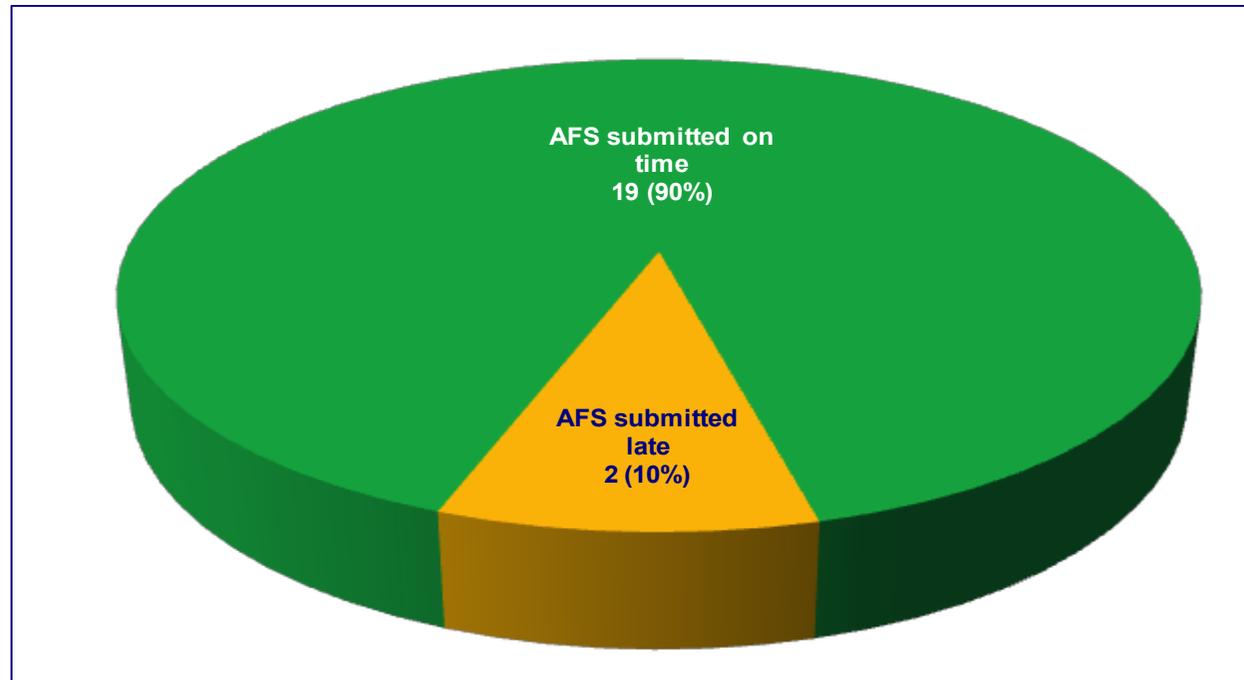
The above figure indicates that local government still has a long road ahead towards achieving clean administration. This is evidenced by the many auditees with findings on PDOs and non-compliance. Most auditees have been in this category for a number of years. The municipal and provincial leadership must focus on addressing these findings if the goal of clean administration by 2014 is to be achieved.

Auditees appear to be satisfied with modified audit outcomes and do not address matters that give rise to findings on PDOs and non-compliance. Compliance with laws and regulations and reporting on PDOs are not adequately monitored. The leadership is not taking ownership and responsibility for sound financial and performance management disciplines. Emphasis is placed on audit outcomes during the audit process, rather than on clean administration throughout the financial year. This has an impact on the sustainability of outcomes. Refer to sections 2.3 and 2.4 for a detailed analysis of findings on PDOs and non-compliance.

#### 2.1.4 Status and outcomes of audits not finalised by 31 March 2013

The timely completion of audits within the legislated timelines is primarily influenced by the date on which we receive the auditees' financial statements for auditing and the efficiency with which the audits are then completed. The figure below indicates that two auditees (10%) were unable to submit financial statements for auditing by 31 August 2012, as required by the Municipal Finance Management Act (MFMA).

**Figure 5: Timeliness of submission of annual financial statements for auditing**



Between 1 April 2013 and the date of this report, we finalised a further two audits, but their outcomes are not included in the analysis contained in this report. Table 4 below details these audit outcomes.

**Table 4: Outcomes of audits not finalised by 31 March 2013**

Auditee	2011-12 Anticipated audit opinion	2010-11 Audit opinion	Movement from 2010-11 audit opinion
Emalahleni local municipality	Disclaimer	Qualified	
Mkhondo local municipality	Qualified	Disclaimer	

 Improvement     
  Unchanged     
  Regression

## 2.2 Findings arising from the audit of financial statements

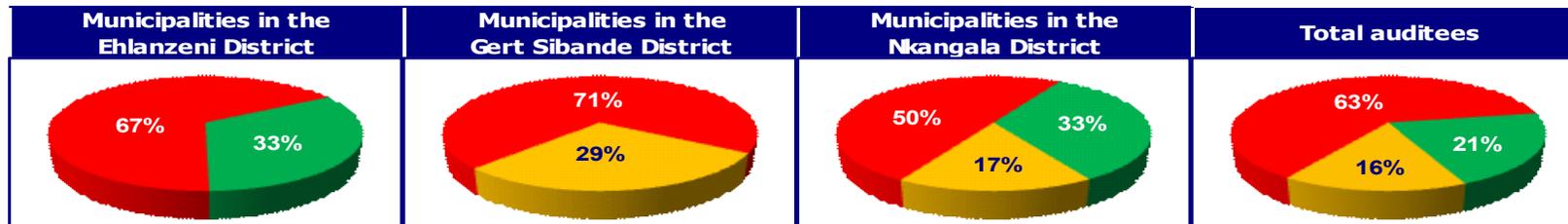
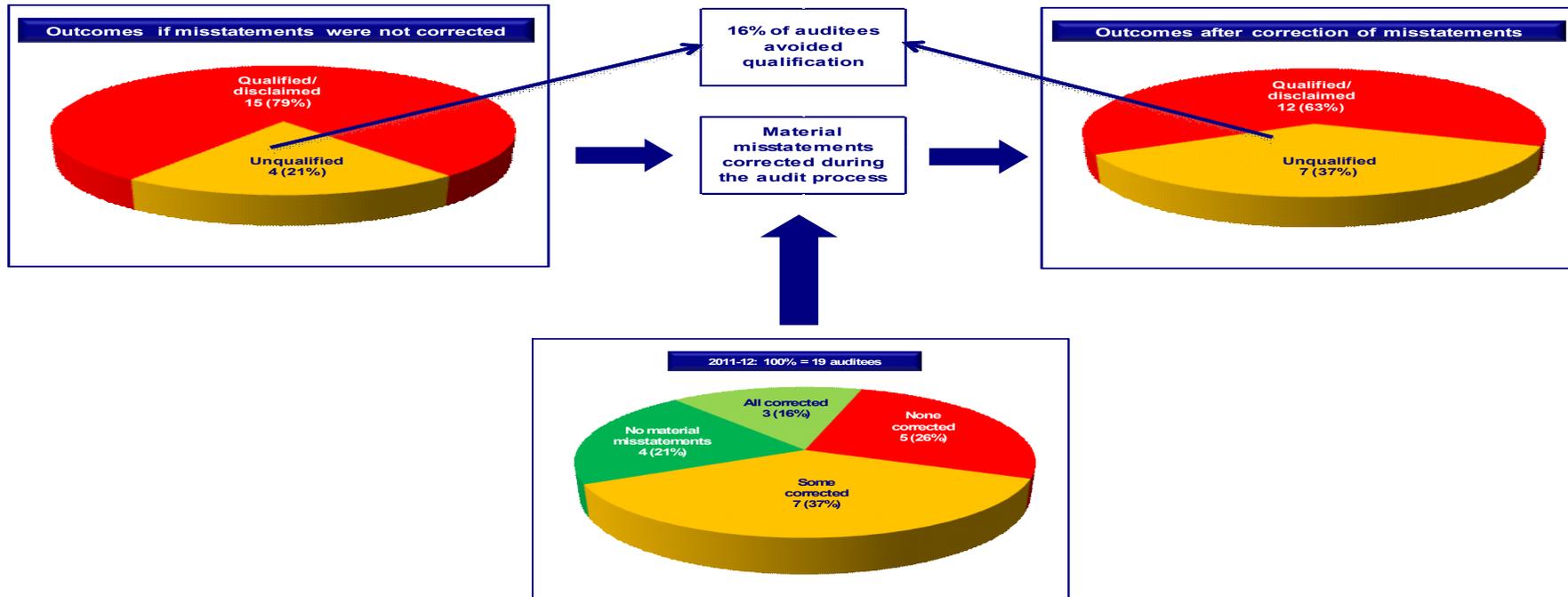
### 2.2.1 Material misstatements in financial statements

The purpose of the annual audit of the financial statements is to provide the users with an opinion on whether the financial statements fairly present, in all material respects, the financial position (statement of financial position) and results of an auditee's operations (statement of financial results) and cash flows for the reporting period in accordance with the applicable accounting framework and the requirements of the applicable legislation.

The audit provides the users with assurance on the degree to which the financial statements are reliable and credible on the basis that the audit procedures had not revealed any material errors or omissions.

Figure 6 analyses the material misstatements in the 2011-12 financial statements, which are then discussed in the paragraphs that follow.

Figure 6: Material misstatements in the financial statements



### ***The quality of financial statements submitted for auditing***

Most of the auditees submitted financial statements for auditing by the legislated deadline of 31 August 2012 but, as depicted previously, only four (21%) [2010-11: four (19%)] submitted financial statements with no material misstatements. Three auditees (16%) [2010-11: seven (33 %)] received a financially unqualified audit opinion only because they corrected all the misstatements we had identified during the audit.

The inability to produce credible and reliable financial statements is evident across the three districts, with only Ehlanzeni and Nkangala District Municipalities and Mbombela and Steve Tshwete Local Municipalities submitting annual financial statements without material misstatements. Although management has committed to improve the credibility of financial reporting by producing in-year financial statements, the continued reliance on the auditors to identify corrections to be made to the financial statements to obtain an unqualified audit opinion is not a sustainable practice. Furthermore, it places undue pressure on legislated deadlines and increases the cost of auditing.

### ***Uncorrected material misstatements in financial statements resulting in qualified or disclaimed audit opinions***

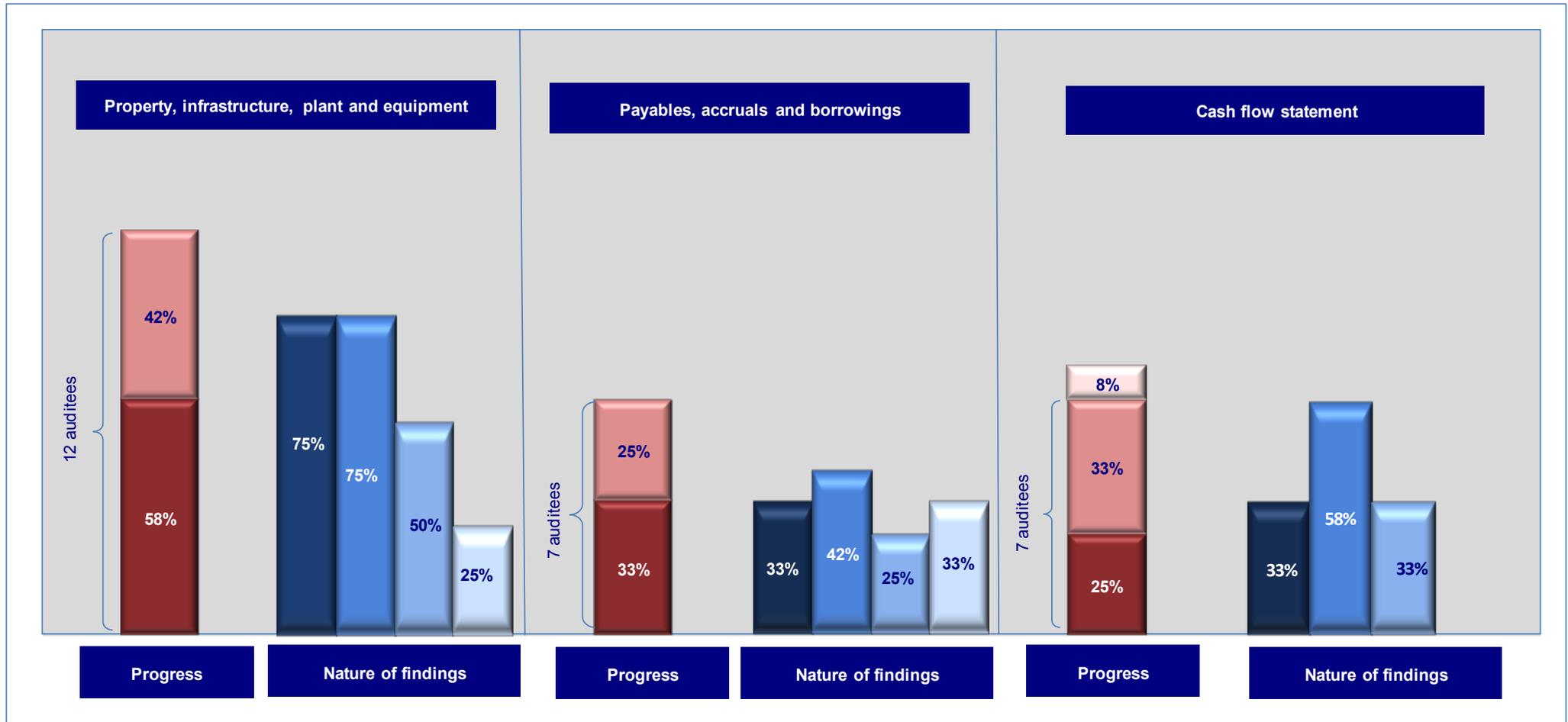
Twelve (63%) of the auditees failed to correct all the material misstatements identified by the audit process due to the unavailability of information or documentation required to determine the correct amounts to be reflected in the financial statements as well as a lack of capacity to effect the required changes. These auditees could therefore not avoid a qualified or disclaimed audit opinion.

The following section provides more detail on the areas in the financial statements containing misstatements.

### ***2.2.2 Financial statement qualification findings***

Figure 7 depicts the three most common qualification areas as well as the progress made by auditees in addressing prior year qualifications and the basis of the current year qualifications, while table 5 provides the reasons for the qualifications.

Figure 7: Progress in addressing, and nature of, the most common financial statement qualifications



Progress:

Prior year qualifications addressed

New qualifications

Repeat qualifications

Nature of qualification

Existence/Occurrence

Valuation/Accuracy

Completeness

Rights and obligations

Table 5: Common qualification areas

Qualification area	Basis for qualification	Reason for qualification
<b>Property, infrastructure, plant and equipment</b>	<b>Existence</b> of the disclosed assets	<ul style="list-style-type: none"> <li>Assets could not be identified or physically verified for existence</li> <li>Duplication of assets in the asset register</li> </ul>
	<b>Valuation</b> of the disclosed assets	<ul style="list-style-type: none"> <li>No, or incorrect, assessment of impairment</li> <li>No, or incorrect, assessment of useful lives</li> <li>No, or incorrect, assessment of residual values</li> <li>Incorrect depreciation</li> <li>Cost could not be determined</li> <li>Deemed cost or valuation was not supported by reliable information</li> </ul>
	<b>Completeness</b> of the disclosed assets	<ul style="list-style-type: none"> <li>Asset register did not exist or was incomplete</li> <li>Asset register not updated on a timely basis</li> <li>Asset register did not reconcile to the general ledger</li> </ul>
	<b>Rights</b> of the disclosed assets	<ul style="list-style-type: none"> <li>Assets not registered in the name of the municipality</li> <li>Supporting documents could not be provided</li> </ul>
<b>Payables, accruals and borrowings</b>	<b>Existence</b> of the disclosed liabilities	<ul style="list-style-type: none"> <li>No supporting documents for liabilities recorded</li> </ul>
	<b>Valuation</b> of the disclosed liabilities	<ul style="list-style-type: none"> <li>No supporting documents for liabilities recorded</li> <li>No creditors' reconciliations performed</li> </ul>
	<b>Completeness</b> of the disclosed liabilities	<ul style="list-style-type: none"> <li>Not all liabilities accounted for</li> <li>Suspense account not reconciled and cleared</li> </ul>
	<b>Obligation</b> pertaining to the disclosed liabilities	<ul style="list-style-type: none"> <li>No, or inadequate, supporting evidence</li> </ul>
<b>Cash flow statement</b>	<b>Occurrence</b> of the items disclosed	<ul style="list-style-type: none"> <li>We could not recalculate the amounts in the cash flow statement due to the misstatements contributing to the qualified opinion</li> </ul>
	<b>Accuracy</b> of the items disclosed	
	<b>Completeness</b> of the items disclosed	

The following table depicts auditees' progress, or lack thereof, in addressing their prior year qualification findings.

Table 6: Auditees' history of financial statement qualification areas

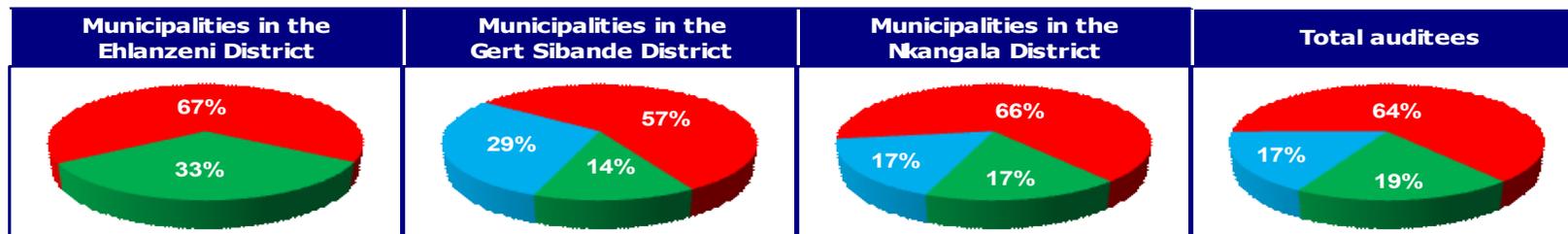
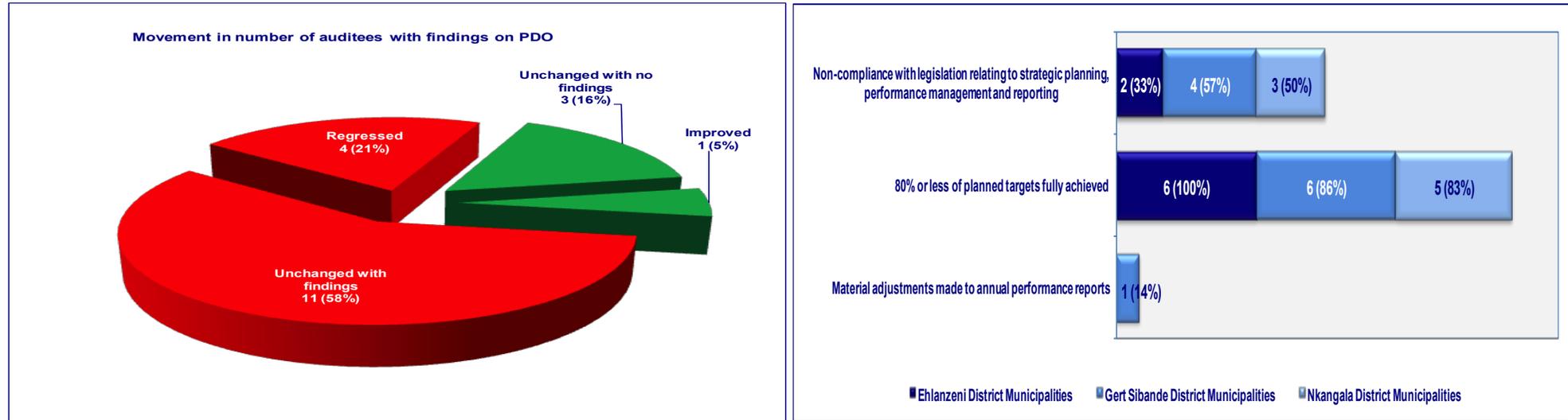
Auditee	Audit opinion 2011-12	Audit opinion 2010-11	Movement in addressing 2010-11 qualification areas						
			Non-current assets	Current assets	Liabilities	Other disclosure items	Revenue	Expenditure	Unauthorised, irregular as well as fruitless and wasteful expenditure
<b>Municipalities in the Ehlanzeni District</b>									
Bushbuckridge local municipality	Disclaimer	Financially unqualified with findings							
Nkomazi local municipality	Disclaimer	Financially unqualified with findings							
Thaba Chweu local municipality	Disclaimer	Disclaimer							
Umjindi local municipality	Qualified	Disclaimer							
<b>Municipalities in the Gert Sibande District</b>									
Albert Luthuli local municipality	Qualified	Disclaimer							
Dipaliseng local municipality	Financially unqualified with findings	Qualified							
Govan Mbeki local municipality	Qualified	Financially unqualified with findings							
Lekwa local municipality	Disclaimer	Disclaimer							
Msukaligwa local municipality	Disclaimer	Financially unqualified with findings							
Pixley Ka Seme local municipality	Qualified	Disclaimer							
<b>Municipalities in the Nkangala District</b>									
Dr. JS Moroka local municipality	Qualified	Disclaimer							
Emakhazeni local municipality	Qualified	Financially unqualified with findings							
Thembisile Hani local municipality	Qualified	Qualified							
<b>Repeat</b>			7	4	7	5	3	3	3
<b>New</b>			5	4	2	4	4	3	1
<b>Addressed</b>				3		3	3	3	

**2.3 Findings arising from the audit of reporting on predetermined objectives**

**2.3.1 Overall outcomes of the audit of reporting on predetermined objectives**

The Public Audit Act requires us to annually audit the reported information relating to the performance of the auditees against their PDOs. As depicted in figure 8, the overall audit outcomes showed a marginal improvement in the number of auditees that had no PDO findings. Table 7 presents notable findings in this regard.

**Figure 8: Findings on predetermined objectives**



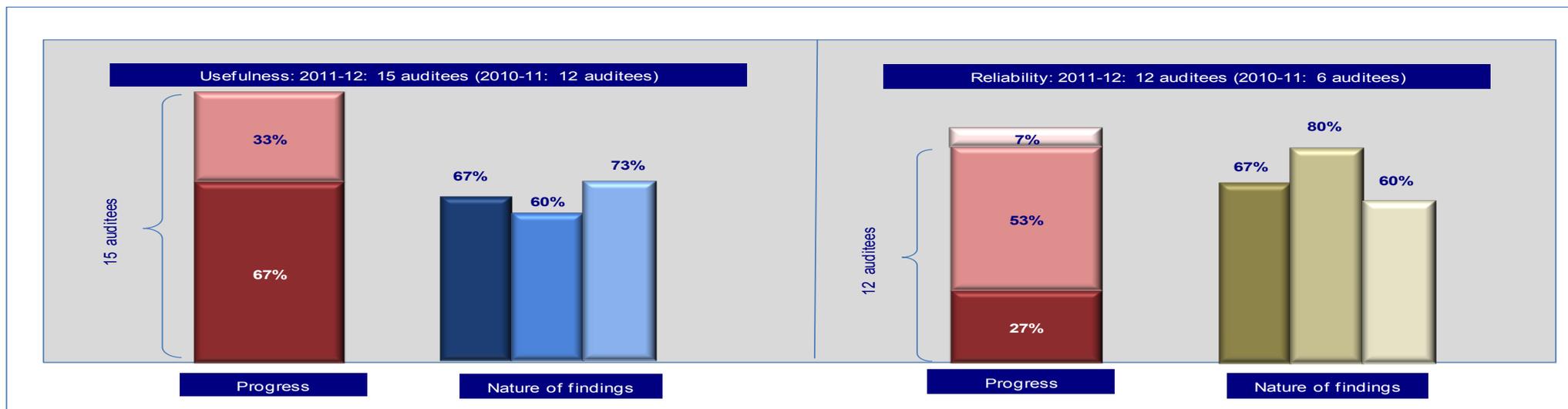
**Table 7: Notable findings on predetermined objectives**

Indicator	Key findings
<b>Poor</b>	<ul style="list-style-type: none"> <li>There was no clear improvement in the number of auditees without PDO findings. Although Mbombela Local Municipality improved to having no PDO findings, four auditees (21%) [Nkangala District Municipality as well as Emakhazeni, Umjindi and Victor Khanye Local Municipalities] were unable to maintain this status.</li> </ul>
<b>Poor</b>	<ul style="list-style-type: none"> <li>Thirteen auditees (68%) [2010-11: seven (33%)] had material non-compliance findings relating to PDOs. The most common of these findings related to strategic planning and performance management, performance reporting, internal audit and audit committees.</li> </ul>
<b>Poor</b>	<ul style="list-style-type: none"> <li>The audits of PDOs focused mainly on the usefulness and reliability of reported performance in the annual report and not on the achievement of actual targets. However, the audit reports highlighted cases where more than 20% of the planned targets had not been achieved. More than 89% of the auditees did not achieve 80% of their planned targets. This does not correlate with the financial resources allocated, as a number of the auditees had overspent their approved budgets using conditional grants, resulting in unauthorised expenditure. Refer to section 5.2.1 on budget and grant management for a detailed analysis of financial health.</li> </ul>
<b>Poor</b>	<ul style="list-style-type: none"> <li>A total of 13 auditees (68%) [2010-11: six (29%)] submitted annual performance reports that contained material misstatements in one or more areas. Pixley Ka Seme Local Municipality made material adjustments to their annual performance report but was unable to avoid findings on the reliability of the report because not all the misstatements identified as a result of the audit were corrected. Reliance on the auditors to identify corrections to be made to the annual performance reports is a practice that should not be encouraged.</li> </ul>

### 2.3.2 Findings on predetermined objectives

Figure 9 depicts auditees' progress, or lack thereof, in addressing prior year PDO findings and the nature of current year findings.

**Figure 9: Progress in addressing, and nature of, findings on predetermined objectives**



Prior year PDO findings addressed	New PDO findings	Repeat PDO findings
Presentation	Consistency	Measurability
Accuracy	Validity	Completeness

The **usefulness** of reported information is measured against the criteria of presentation, consistency, measurability and relevance. The information contained in the performance reports of 15 auditees (79%) [2010-11: 12 (57%)] was not useful.

Findings on **reliability** relate to whether the reported information on performance against PDOs could be traced back to the source data or documentation and whether the reported information was accurate, complete and valid when compared to the source data, evidence or documentation. The information contained in the performance reports of 12 auditees (63%) [2010-11: six (29%)] was not reliable.

The table below presents the most common types of findings.

**Table 8: Usefulness and reliability of reported information**

Category of PDO findings	Most common types of findings
<b>Reported information not useful</b>	<ul style="list-style-type: none"> <li>• The indicators or measures were not well defined to ensure that performance data could be collected consistently and was easy to understand and use.</li> <li>• The annual performance report was not presented in accordance with the requirements of the Municipal Systems Act.</li> <li>• The reported performance information was not consistent with planned objectives, indicators or measures, and targets.</li> <li>• Performance targets were not specific and measurable to ensure that the required performance could be measured.</li> </ul>
<b>Reported information not reliable</b>	<ul style="list-style-type: none"> <li>• Supporting information for reported performance information was not complete.</li> <li>• Reported performance information was not accurate when compared to supporting information.</li> <li>• Reported performance information was not valid when compared to supporting information.</li> </ul>

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

### 2.4.1 Overall outcomes of the audit of compliance with laws and regulations

The Public Audit Act requires us to audit compliance with laws and regulations applicable to financial matters, financial management and other related matters each year. The compliance audit was limited to the following focus areas: ■ material misstatements in the submitted annual financial statements ■ asset and liability management ■ audit committees ■ budget management ■ expenditure management ■ prevention of unauthorised, irregular as well as fruitless and wasteful expenditure ■ financial misconduct ■ internal audit ■ revenue management ■ strategic planning and performance management ■ transfer of funds and conditional grants ■ procurement and contract management, or supply chain management (SCM) ■ human resource (HR) management and compensation.

Annexure 1 lists all auditees where material non-compliance was reported in one or more of our compliance focus areas.

Some instances of non-compliance reported in this section can be linked to the following financial health aspects discussed in section 5: ■ budget and grant management ■ debtor management ■ creditor management ■ financial performance and position as well as cash management.

As depicted in figure 10 below, there was an overall increase in the number of auditees that had findings on non-compliance.

Figure 10: Movement in the number of auditees with findings on non-compliance and common areas of non-compliance

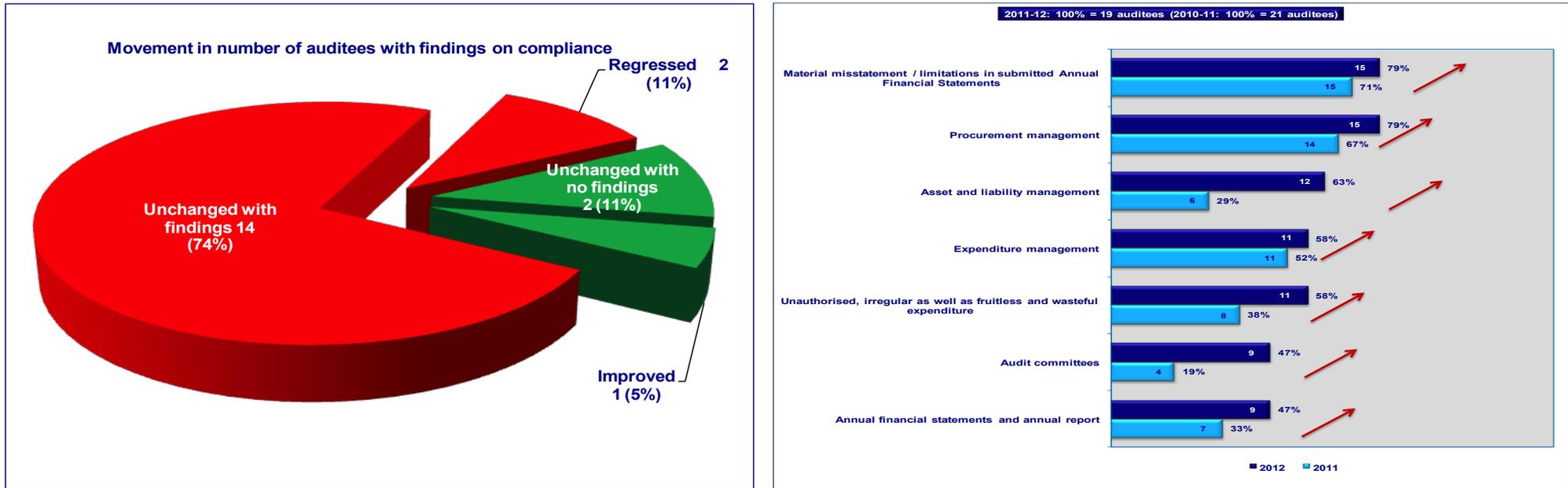


Table 9 presents notable outcomes and trends arising from the audits.

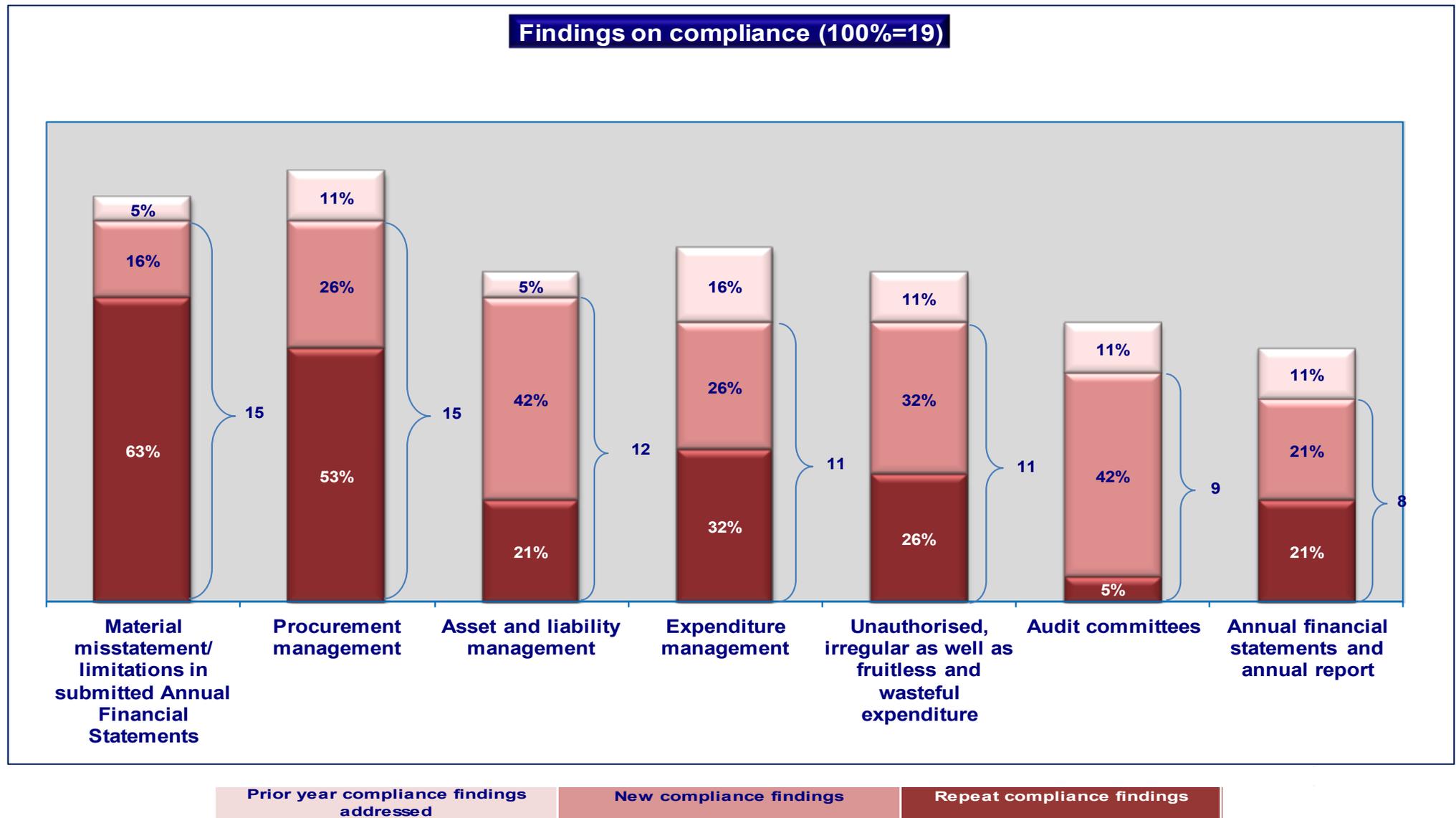
**Table 9: Key outcomes and trends regarding findings on non-compliance**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>Material non-compliance findings were reported at 16 auditees (85%). In most instances these were repeat findings.</li> </ul>
Good	<ul style="list-style-type: none"> <li>Ehlanzeni District Municipality and Steve Tshwete Local Municipality were able to sustain their status of having no non-compliance findings. Nkangala District Municipality was able to steer clear of material non-compliance findings in the current year.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>A high number of material non-compliance findings (85%) existed across all three districts. Findings ranged from 67% (municipalities in the Nkangala district) to 100% (municipalities in the Gert Sibande district).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Sixteen (84%) of the auditees had findings in one or more of the top three areas of non-compliance, namely material misstatements in the submitted financial statements; procurement and contract management; and asset and liability management.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Other findings on non-compliance showed further regression, with the most significant area being the prevention and detection of unauthorised, irregular as well as fruitless and wasteful expenditure.</li> </ul>

#### **2.4.2 Findings on non-compliance with laws and regulations**

Figure 11 shows the most common non-compliance findings as well as auditees' progress (or lack thereof) in addressing prior year findings on non-compliance.

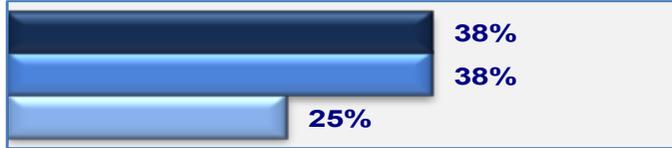
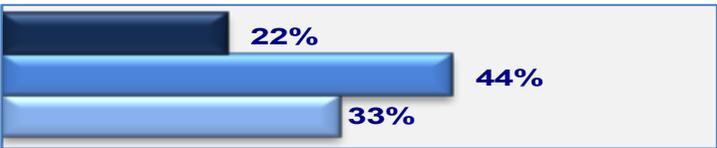
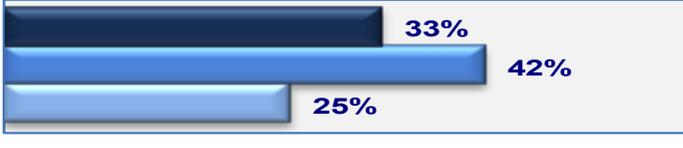
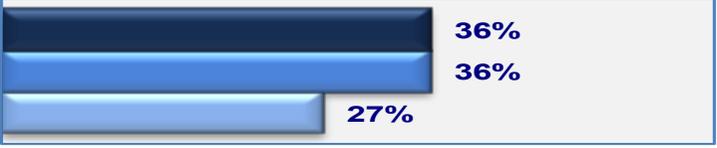
Figure 11: Common areas of findings on non-compliance with laws and regulations



Figures 10 and 11 show that there has been a lack of progress by auditees towards addressing previous year findings on non-compliance. Section 2.2.1 analyses the extent and impact of material misstatements or limitations in the annual financial statements submitted for auditing. Section 2.4.3 details

findings on procurement management, while section 2.4.4 looks at the extent and nature of unauthorised, irregular as well as fruitless and wasteful expenditure. Table 10 below details the nature of the most common findings in other areas of non-compliance per district.

**Table 10: Summarised findings on other areas of non-compliance**

Nature of other areas of non-compliance per district	
Annual financial statements and annual reports: 8 auditees (42%)	Audit committee: 9 auditees (47%)
 <p>A horizontal bar chart with three bars. The top bar is dark blue and labeled 38%. The middle bar is medium blue and labeled 38%. The bottom bar is light blue and labeled 25%. A large red arrow points downwards from the chart.</p>	 <p>A horizontal bar chart with three bars. The top bar is dark blue and labeled 22%. The middle bar is medium blue and labeled 44%. The bottom bar is light blue and labeled 33%. A large red arrow points downwards from the chart.</p>
<ul style="list-style-type: none"> <li>The annual performance reports did not contain a comparison of the municipality's performance and of each external service provider with development priorities, objectives and performance indicators [4 auditees (21%)]</li> <li>Annual reports were not made public immediately after being tabled [2 auditees (11%)]</li> <li>Oversight reports were not made public within seven days of adoption [2 auditees (11%)]</li> <li>Annual performance reports were not prepared with the integrated development or annual performance plan as basis [2 auditees (11%)]</li> </ul>	<ul style="list-style-type: none"> <li>Performance audit committees did not submit a report to the council regarding the performance management system at least twice during the financial year [4 auditees (21%)]</li> <li>Performance audit committees did not review the quarterly reports of internal auditors on their audit of the performance measurements at the municipality [4 auditees (21%)]</li> <li>A review of the adequacy, reliability and accuracy of financial reporting and information was not performed [3 auditees (16%)]</li> <li>A review of compliance with legal and regulatory provisions was not performed [3 auditees (16%)]</li> </ul>
Asset and liability management: 12 auditees (63%)	Expenditure management: 11 auditees (58%)
 <p>A horizontal bar chart with three bars. The top bar is dark blue and labeled 33%. The middle bar is medium blue and labeled 42%. The bottom bar is light blue and labeled 25%. A large red arrow points downwards from the chart.</p>	 <p>A horizontal bar chart with three bars. The top bar is dark blue and labeled 36%. The middle bar is medium blue and labeled 36%. The bottom bar is light blue and labeled 27%. A large red arrow points downwards from the chart.</p>
<ul style="list-style-type: none"> <li>Proper control systems were not implemented for safeguarding and maintaining assets [8 auditees (42%)]</li> <li>Lack of, or inadequate, management, accounting and information system for the management of assets [9 auditees (47%)]</li> </ul>	<ul style="list-style-type: none"> <li>Payments to creditors were not made within 30 days from receipt of an invoice [11 auditees (58%)]</li> <li>Ineffective system of internal control over expenditure [3 auditees (16%)]</li> </ul>

Ehlanzeni District Municipalities

Gert Sibande District Municipalities

Nkangala District Municipalities

Regression



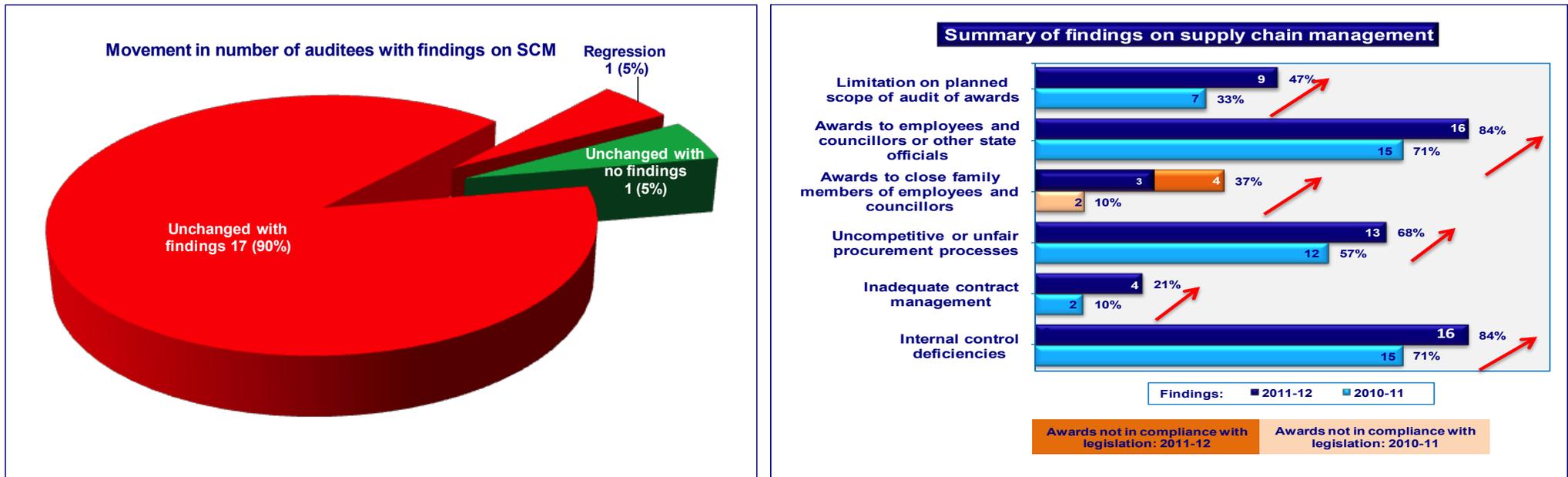
**2.4.3 Findings arising from the audit of supply chain management**

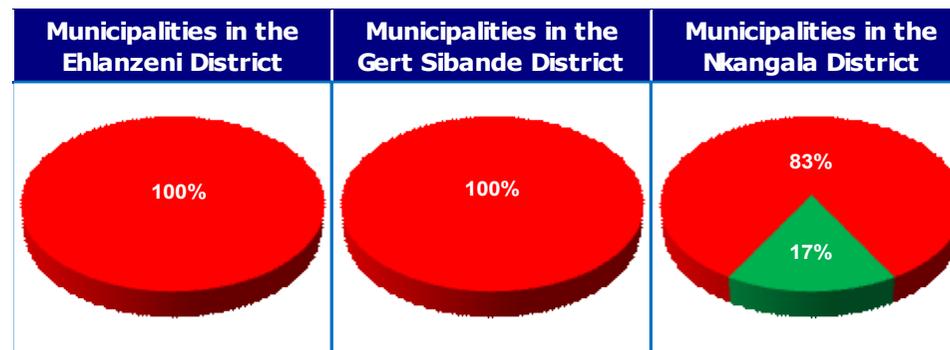
Our audits included an assessment of procurement processes, contract management and related controls. To ensure a fair, equitable, transparent, competitive and cost-effective SCM system, the processes and controls need to comply with legislation and must minimise the likelihood of fraud, corruption, favouritism as well as unfair and irregular practices. We performed the SCM assessment at all 19 auditees.

We reported findings arising from the audit in the management reports of 18 (95%) of the auditees, while the findings were material enough to be reported in the audit reports of 15 of these auditees (79%).

Figure 12 below presents the movement in the number of auditees with SCM findings, the prevalence of SCM findings across the three districts and a summary of SCM findings, with a comparison to the audit results of the 2010-11 financial year.

**Figure 12: Movement in the number of auditees with findings on supply chain management and common areas of supply chain management findings**





The table below provides key outcomes and trends, followed by a further analysis of the SCM findings.

**Table 11: Key outcomes and trends regarding supply chain management findings**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>At an overall level, there has been a regression in the number of auditees with findings on SCM.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>A high number of material SCM findings were reported in the audit reports of auditees in all three districts (79%). Findings ranged from 83% (municipalities in the Nkangala district) to 100% (municipalities in the Gert Sibande district).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>We could not audit awards to the value of R343,1 million [2010-11: R147,3 million] selected for auditing, due to the auditees not making the required information or documentation available. These limitations could have an impact on the extent of the identified irregularities and SCM weaknesses.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>There was a regression in all the SCM areas when compared to the previous year.</li> </ul>

### 2.4.3.1 Limitations on the planned scope of the audit of awards

Nine auditees (47%) could not provide sufficient appropriate audit evidence that awards had been made in accordance with the requirements of SCM legislation. We could not perform any alternative audit procedures to obtain reasonable assurance that the expenditure incurred in respect of these awards was not irregular. The main reason for these limitations was that supporting documentation was not made available for auditing purposes.

The following table depicts the auditees where limitations were experienced. Those auditees where limitations were also experienced in the previous year, are highlighted in red.

**Table 12: Limitations experienced on the planned scope of the audit of awards**

Auditee	Number of awards	Value of awards
Bushbuckridge local municipality	27	R 143,9 million
Dr. JS Moroka local municipality	28	R 68,8 million
Govan Mbeki local municipality	19	R 22,9 million
Lekwa local municipality	17	R 65,1 million
Mbombela local municipality	1	R 0,7 million
Msukaligwa local municipality	8	R 9,4 million
Nkomazi local municipality	40	R 31,2 million
Thembisile Hani local municipality	1	R 1 million
Umjindi local municipality	4	R 0,03 million
<b>Total</b>	<b>145</b>	<b>R 343,1 million</b>

### 2.4.3.2 Awards to employees and councillors or other state officials

SCM regulation 44 prohibits awards to persons (namely, employees and councillors), or entities owned or managed by them, if they are in the service of the auditee or in the service of any other state institution. Such expenditure is also considered irregular.

We identified such prohibited awards through our audits. We also performed tests to determine whether the legislated requirements with regard to declarations of interest had been met.

The table below shows the extent and nature of these awards and whether any non-compliance with legislation was identified, with an indication of the positions of the officials involved. Where prohibited awards were also identified in the previous year, the name of the auditee is highlighted in red.

**Table 13: Prohibited awards to employees and councillors or other state officials**

Auditee	Awards made to employees and councillors			Awards made to officials of other state institutions		Supplier did not declare interest		Supplier did not submit declaration of interest		Employee or councillor did not declare interest	
	Number of instances	Amount	Positions	Number of instances	Amount	Number of instances	Amount	Number of instances	Amount	Number of instances	Amount
Albert Luthuli local municipality	1	R 9k	Other employees	14	R 6,8 million	14	R 6,8 million			1	R 9k
Bushbuckridge local municipality	6	R 280k	Other employees	57	R 3 million	57	R 3 million			6	R 280k
Dipaliseng local municipality			Other employees	4	R 246k						
Dr. JS Moroka local municipality			Other employees	9	R3,8 million						
Ehlanzeni district municipality			Other employees	12	R1,3 million						
Emakhazeni local municipality	1	R 18k	Other employees	23	R 945k						
Gert Sibande district municipality			Other employees	42	R 537k						
Govan Mbeki local municipality	8	R 926k	Other employees								
Lekwa local municipality	2	R 209k	Other employees	77	R 343k						
Mbombela local municipality	4	R 225k	Councillors, Other employees	15	R 922k	4	R 225k	15	R 922k		
Msukaligwa local municipality			Other employees	4	R2,3 million						
Nkomazi local municipality	3	R 792k	Other employees	64	R5,1 million						
Steve Tshwete local municipality			Other employees	20	R 1,6 million			20	R 1,6 million		
Thaba Chweu local municipality			Other employees	4	R 65k	4	R 65k				
Thembisile Hani local municipality	1	R 50k	Other employees	20	R 6,6 million			21	R 6,65 million		
Victor Khanye local municipality	1	R 12k	Other employees	4	R 2 million						
<b>Total 2011-12</b>	<b>27</b>	<b>R 2,556 million</b>		<b>369</b>	<b>R 36,385 million</b>	<b>79</b>	<b>R 1,090 million</b>	<b>56</b>	<b>R 9,207 million</b>	<b>7</b>	<b>R 289k</b>
<b>Total 2010-11</b>	<b>38</b>	<b>R 11,032 million</b>		<b>208</b>	<b>R 15,173million</b>	<b>208</b>	<b>R 15,173 million</b>	<b>0</b>		<b>35</b>	<b>R 8,401 million</b>
											



Improvement



Regression

Awards to the value of R38,9 million identified at 17 auditees (90%) were made to suppliers in which officials or councillors of the auditee or officials of other state institutions had an interest. This marks a significant increase compared to the R11 million identified in the previous year at 15 auditees. The rand value of these awards increased by an alarming 254% across the three districts.

### 2.4.3.3 Awards to close family members of employees and councillors

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

We identified awards to close family members through our audits. We also performed tests to determine whether the financial statement disclosure was made and whether the legislated requirements with regard to declarations of interest had been met.

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

**Table 14: Awards to close family members**

Auditee	Awards made to close family members of persons in service of the auditee			No disclosure in financial statements	Official did not declare interest	Supplier did not declare interest
	Number of instances	Amount	Positions	Number of instances	Number of instances	Number of instances
Albert Luthuli local municipality	2	R 62k	Other employees		1	1
Bushbuckridge local municipality	1	R 6k	Other employees			
Dr. JS Moroka local municipality	1	R 6k	Other employees			1
Ehlanzeni district municipality	2	R1,2 million	Other employees			2
Mbombela local municipality	7	R1,6 million	Other employees			
Nkomazi district municipality	3	R 310k	Other employees			3
Steve Tshwete local municipality	1	R 108k	Other employees			
<b>Total 2011-12</b>	<b>17</b>	<b>R 2,092 million</b>		<b>-</b>	<b>1</b>	<b>7</b>
<b>Total 2010-11</b>	<b>7</b>	<b>R 3,469 million</b>		<b>2</b>	<b>2</b>	<b>5</b>
						

Awards to the value of R2,1 million identified at seven auditees were made to suppliers in which close family members of employees of the auditee had an interest. The decrease of R1,4 million compared to the previous year was overshadowed by the large increase in the number of auditees where this finding was raised.

#### 2.4.3.4 Uncompetitive or unfair procurement processes

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

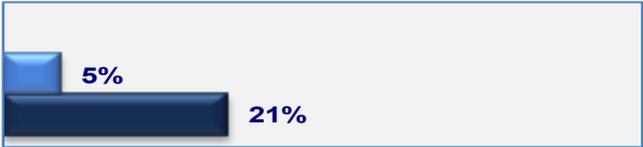
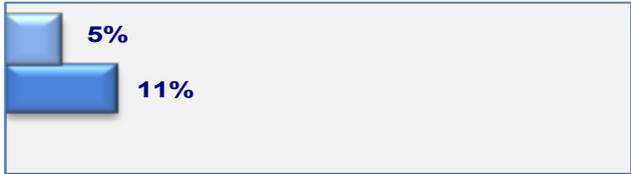
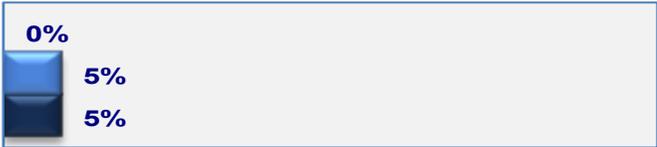
Our audits also focused on whether the procurement processes followed were fair and competitive in that they provided all suppliers equal opportunity to compete for public sector contracts and that the process did not favour some suppliers above others.

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

We tested the procurement processes of 775 contracts (with a value of R1,8 billion) and 1 167 quotations (with a value of R85,3 million). We did not test all awards made by auditees, but only those selected based on risk and a statistical sampling method. The following table summarises the most common findings on non-compliance with SCM legislation that resulted in uncompetitive or unfair procurement processes.

**Table 15: Summarised findings on uncompetitive or unfair procurement processes**

Summarised findings on uncompetitive or unfair procurement processes	
Three written quotations not invited: 6 auditees (32%)	Preference point system not used: 6 auditees (32%)
 <p>A bar chart with three horizontal bars. The top bar is blue and labeled '11%'. The middle bar is dark blue and labeled '16%'. The bottom bar is light blue and labeled '5%'. A large red arrow points downwards from the chart.</p>	 <p>A bar chart with three horizontal bars. The top bar is blue and labeled '5%'. The middle bar is dark blue and labeled '16%'. The bottom bar is light blue and labeled '11%'. A large red arrow points downwards from the chart.</p>
<ul style="list-style-type: none"> <li>A quotation process is prescribed for the procurement of goods and services valued at between R10 000 and R200 000. Three quotations were not in all instances obtained from prospective providers and the deviations were not approved by a properly delegated official or committee as required.</li> </ul>	<ul style="list-style-type: none"> <li>The preference point system was not applied in all procurement of goods and services above R30 000, as required by the Preferential Procurement Policy Framework Act.</li> </ul>
<p><b>Competitive bids not invited and no deviation approved: 5 auditees (26%)</b></p>	<p><b>Procurement without SARS tax clearance certificate: 3 auditees (16%)</b></p>

	
<ul style="list-style-type: none"> <li>A competitive bidding process should be followed for the procurement of goods and services above R200 000. Competitive bids were not always invited.</li> </ul>	<ul style="list-style-type: none"> <li>Awards were made to suppliers without proof from the South African Revenue Service that their tax matters were in order.</li> </ul>
<p><b>No declaration submitted by service provider: 2 auditees (10%)</b></p>	<p><b>Other findings: 6 auditees (32%)</b></p>
	
<ul style="list-style-type: none"> <li>Awards were made to suppliers that had not submitted a completed declaration of interest form.</li> </ul>	<ul style="list-style-type: none"> <li>Other findings included failure to declare past SCM practices; failure to submit a certificate of independent bid determination; and bids advertised for a shorter period than prescribed without the deviation being approved.</li> </ul>



### 2.4.3.5 Inadequate contract management

Shortcomings in the manner in which contracts are managed result in delays, wastage as well as fruitless and wasteful expenditure, which in turn has a direct impact on service delivery. The number of auditees at which these shortcomings were identified increased from the previous year, with the most noteworthy regressions at Dipaliseng and Govan Mbeki Local Municipalities.

Four auditees [Dipaliseng, Govan Mbeki, Lekwa and Umjindi Local Municipalities] had a finding in this category.

The table below summarises the most common findings on inadequate contract management.

**Table 16: Key findings on inadequate contract management**

Key findings: Inadequate contract management	Auditees	Percentage
Inadequate contract performance measures and monitoring	2	11%
Contracts amended or extended and reasons not tabled in the council	1	5%
Performance of contractors not monitored on a monthly basis	2	11%

### 2.4.3.6 Conclusion on supply chain management

A total of 98% (R244,2 million) of the irregular expenditure incurred by local government stemmed from expenditure incurred in contravention of SCM legislation. This can be attributed to the leadership not being fully aware of the SCM requirements and their specific oversight role. The leadership failed to pay adequate attention to SCM matters, resulting in procurement processes not being followed.

Compared to 2010-11, there has been a net regression in the SCM findings reported on. This can be attributed to a lack of leadership commitment to own action plans. The increase in awards made to employees, councillors, other state officials and their close family members in 2011-12 remains a concern. Also concerning is that there were no consequences for such transgressions at eight auditees (42%).

Despite the lack of movement in the number of auditees with findings on uncompetitive and unfair procurement processes, findings in this area remained widespread as evidenced by the increase in the extent of such findings. Findings in this area can be attributed to lack of sufficiently skilled and competent staff in the SCM units.

The provincial treasury facilitated training on SCM practices to municipalities, including the leadership. However, the impact of this initiative is not fully reflected in the audit outcomes, mainly due to municipalities not attending the training.

The following commitments are required from the leadership to address the significant SCM findings noted in this report:

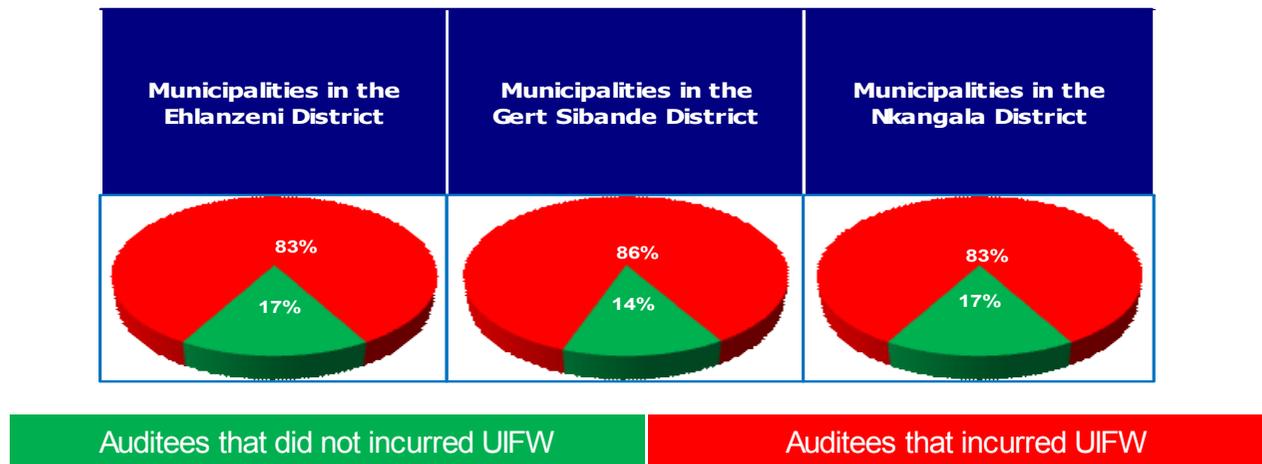
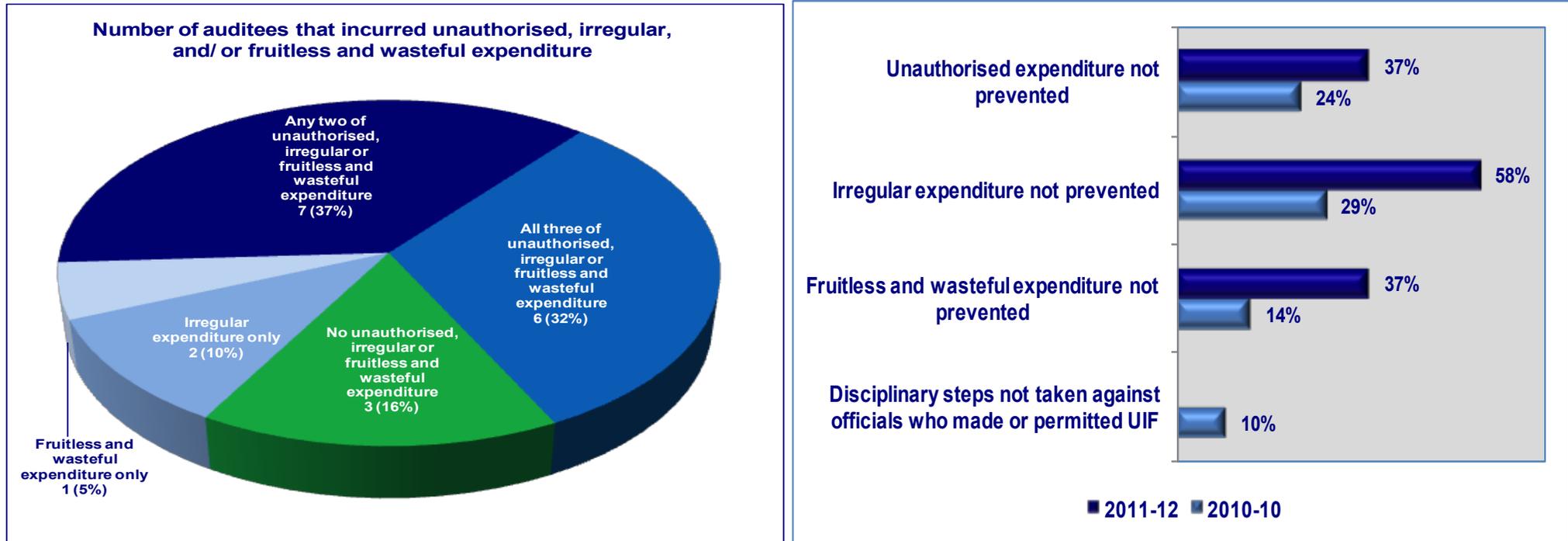
- Implement a document management system and conduct post-implementation reviews of the filing and retrieval of documentation.
- Improve processes to identify officials doing business with local government and ensure that all documentation required by law is completed.
- Implement guidance issued by the provincial treasury and the Department of Cooperative Governance and Traditional Affairs (CoGTA) on SCM regulations and put processes in place to deal with transgressions.
- Develop and implement an SCM compliance checklist to ensure that all legislative requirements are adhered to before approving awards.
- Develop policies and procedures that are aligned to SCM regulations.
- Develop mechanisms to monitor the implementation of the above recommendations.

#### ***2.4.4 Unauthorised, irregular as well as fruitless and wasteful expenditure incurred***

The MFMA requires accounting officers and accounting authorities to take effective and appropriate steps to ensure that unauthorised, irregular as well as fruitless and wasteful expenditure is prevented. Although there is an expectation that no such expenditure should be incurred, it is not always possible for an accounting officer to prevent it, even if all reasonable steps had been taken. In instances where it does occur, the MFMA makes it compulsory for auditees to disclose such expenditure in their annual financial statements. The MFMA further requires that all instances of unauthorised, irregular as well as fruitless and wasteful expenditure be investigated. If the investigation reveals that an official is liable for the expense, disciplinary steps should be taken and the expenditure should be recovered.

The extent of unauthorised, irregular as well as fruitless and wasteful expenditure and the pervasiveness of the related non-compliance with legislation applicable to such expenditure, as depicted in the following figure, indicate a breakdown in the auditees' internal control environment.

Figure 13: Unauthorised, irregular as well as fruitless and wasteful expenditure incurred



The table below summarises key outcomes and trends in this regard.

**Table 17: Key outcomes and trends regarding unauthorised, irregular as well as fruitless and wasteful expenditure**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>Sixteen (84%) of the auditees incurred one or more type of unauthorised, irregular or fruitless and wasteful expenditure.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Findings on non-compliance related to unauthorised, irregular as well as fruitless and wasteful expenditure remained in the top seven highest non-compliance findings across all auditees (as discussed in section 2.4.2).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The most common finding related to accounting officers failing to take effective steps to prevent irregular expenditure at 11 auditees (58%). This is a regression compared to the six auditees (29%) in the previous year.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Non-compliance findings on unauthorised, irregular as well as fruitless and wasteful expenditure were identified across all three districts.</li> </ul>

Section 3.3.5 provides further detail on the lack of consequences for transgressions, which include incurring unauthorised, irregular as well as fruitless and wasteful expenditure.

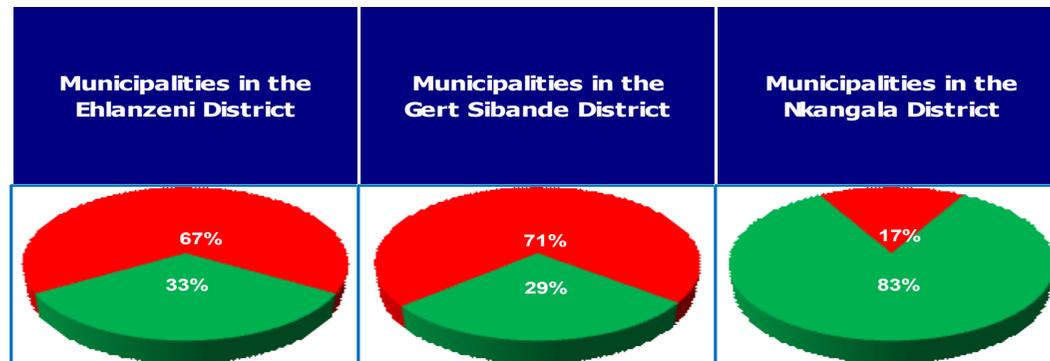
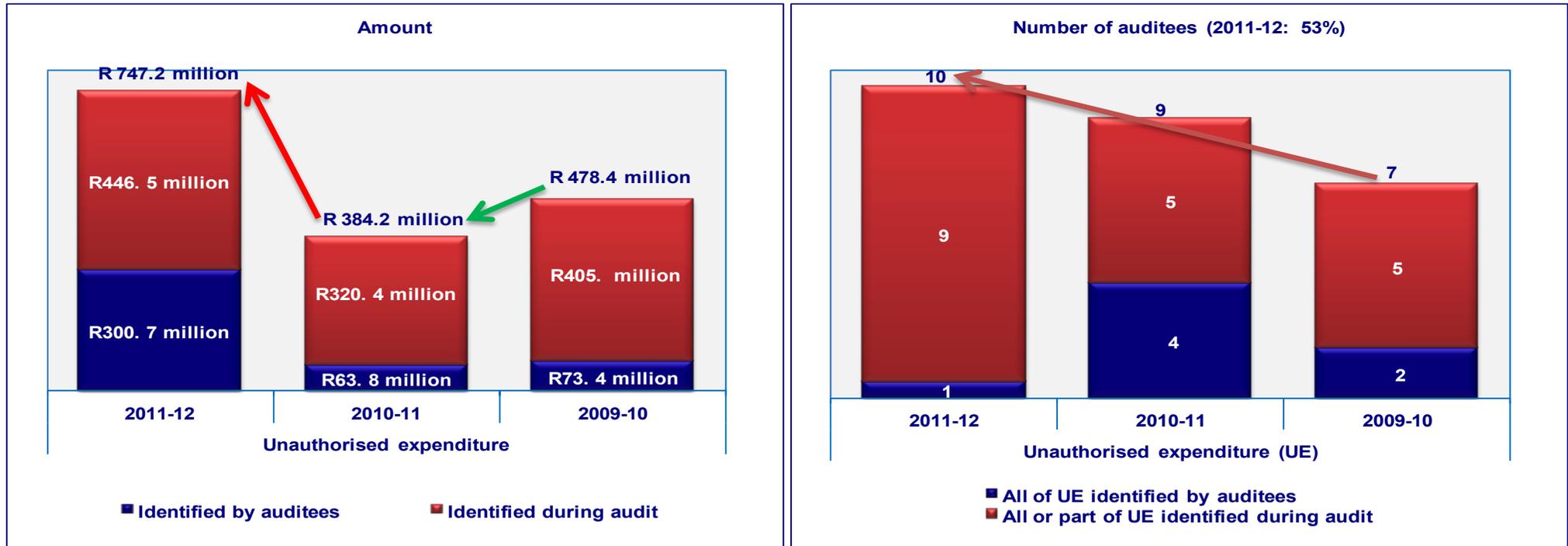
#### ***Nature of, and overall trends in, unauthorised expenditure***

Figure 14 reflects the three-year trend in unauthorised expenditure, the extent to which it was identified during the audit (and not by the auditees' internal control systems), and an analysis per district.

The unauthorised expenditure was incurred as a result of the overspending of votes or main divisions within votes as well as expenditure not spent in accordance with votes.

Unauthorised expenditure invariably means that money was not used for its intended purpose, which hampered the service delivery objectives set for the year.

Figure 14: Three-year trend in amount of unauthorised expenditure and number of auditees incurring unauthorised expenditure



Auditees that did not incur unauthorised expenditure (Green)

Auditees that incurred unauthorised expenditure (Red)

The table below summarises key outcomes and trends in this regard.

**Table 18: Key outcomes and trends regarding unauthorised expenditure**

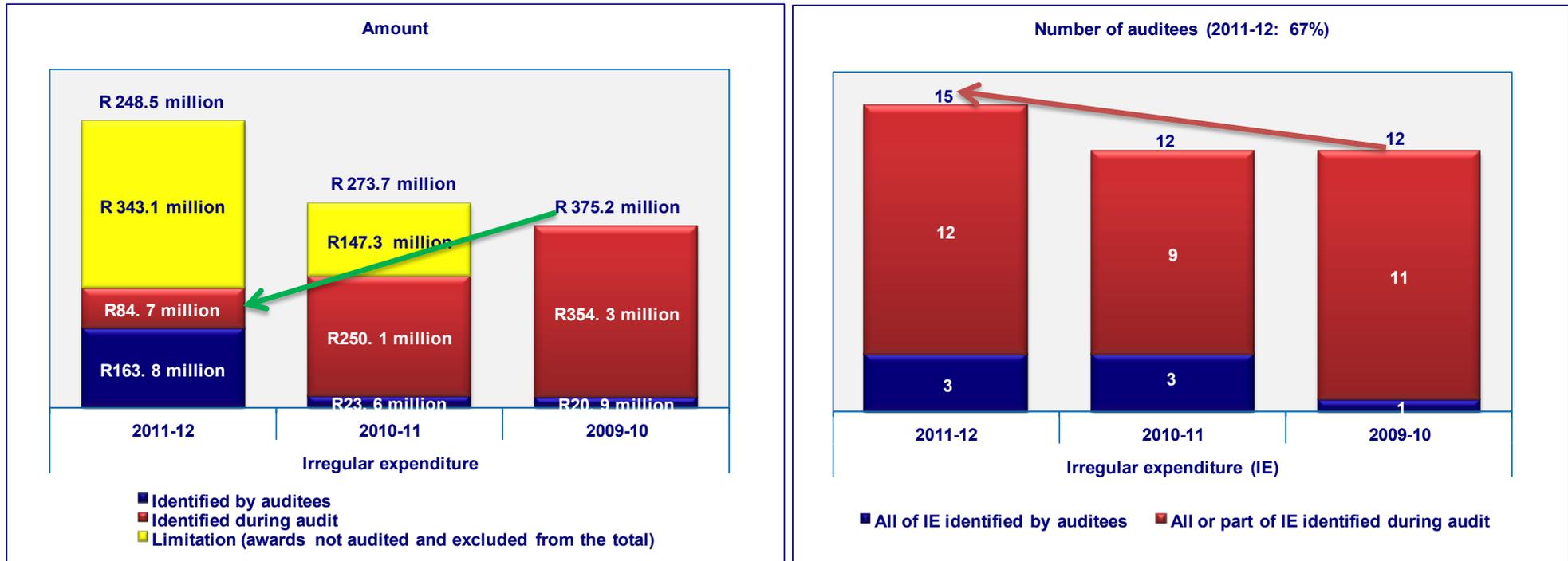
Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>The number of auditees that incurred unauthorised expenditure increased by 11% and the value of such expenditure by 95%.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>A major reason for the increase in unauthorised expenditure was the R363,5 million increase in overspending of votes or main divisions within votes, compared to the previous year.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Most of the unauthorised expenditure incurred was identified at municipalities in the Ehlanzeni and Gert Sibande districts.</li> </ul>
Concerned	<ul style="list-style-type: none"> <li>In total, 60% of the unauthorised expenditure was identified by the auditors; an 83% decrease compared to the previous year.</li> </ul>

***Nature of, and overall trends in, irregular expenditure***

Figure 15 reflects the three-year trend in irregular expenditure, the extent to which it was identified during the audit (and not by the auditees' internal control systems), and an analysis per district.

Irregular expenditure does not necessarily mean that money had been wasted or that fraud had been perpetrated. However, it is a measure of an auditee's ability to comply with laws and regulations relating to expenditure and procurement management.

Figure 15: Three-year trend in amount of irregular expenditure and number of auditees incurring irregular expenditure



Auditees that did not incur irregular expenditure (Green)

Auditees that incurred irregular expenditure (Red)

The table below reflects the nature of, and current year movement in, such expenditure.

**Table 19: Nature of, and current year movement in, irregular expenditure**

Nature	Number of auditees	Movement in number of auditees from 2010-11	Amount	Movement in amount from 2010-11
SCM related	14	27%	R 244 million	6%
Compensation of employees related	1	100%	R 365k	100%
Other non-compliance	2	100%	R 4 million	69%



**Improvement**



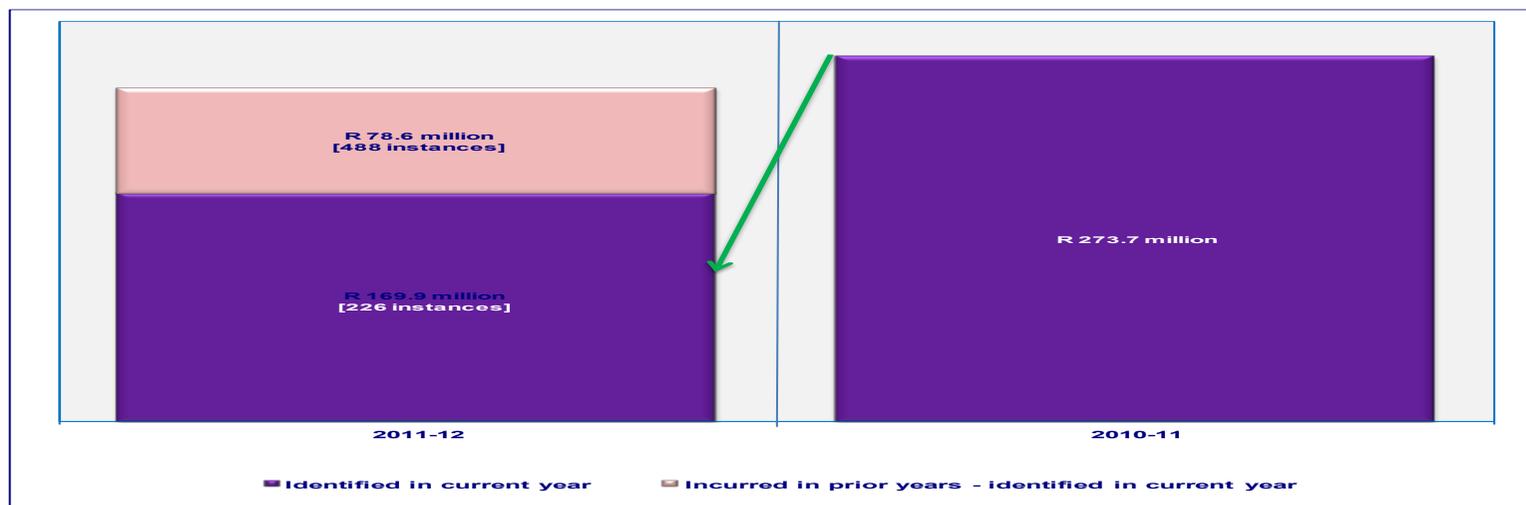
**Unchanged**



**Regression**

The following figure shows the extent of irregular expenditure disclosed in the current year which had resulted from non-compliance with legislation in prior years.

**Figure 16: Irregular expenditure incurred in prior years**



The table below summarises key outcomes and trends in this regard.

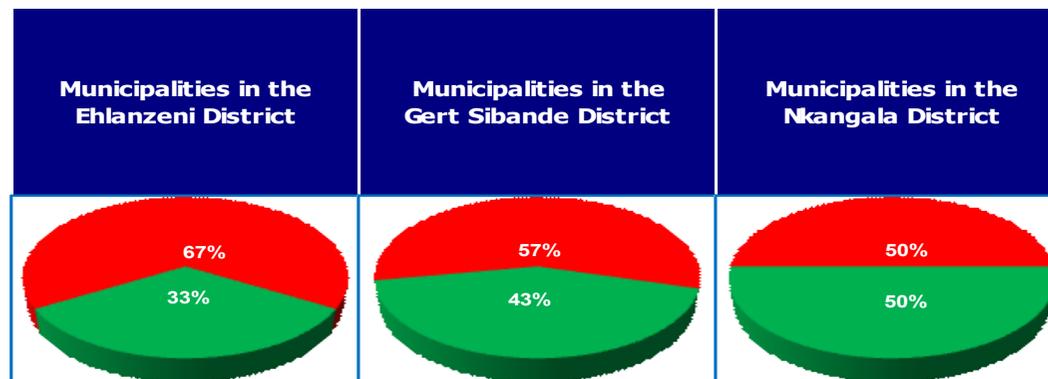
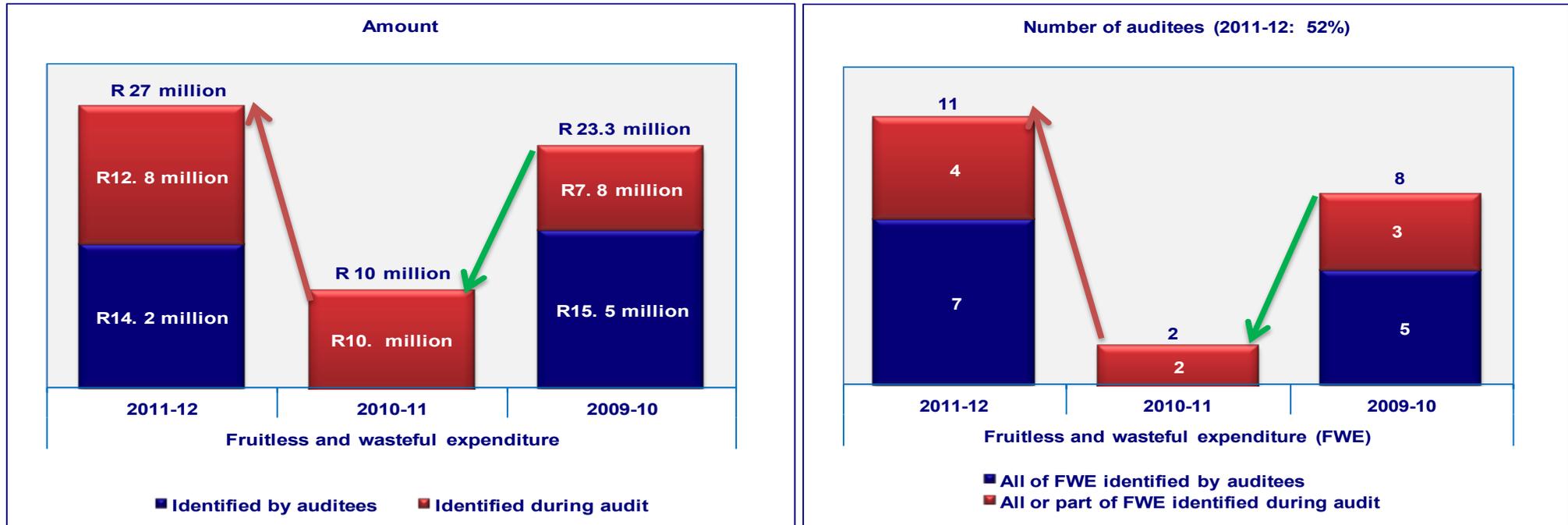
**Table 20: Key outcomes and trends regarding irregular expenditure**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>A significant portion (34%) of the irregular expenditure incurred by auditees was identified during the audit, indicating that the auditees' internal controls failed to detect these deviations.</li> </ul>
Concerned	<ul style="list-style-type: none"> <li>Irregular expenditure was identified across the three districts. However, municipalities in the Gert Sibande district recorded a significant increase of R66,1 million (191%) and municipalities in the Ehlanzeni district a significant reduction of R97,8 million (61%), compared to the previous year.</li> </ul>
Concerned	<ul style="list-style-type: none"> <li>A notable trend is that the number of auditees with irregular expenditure increased by three (25%), while the amount decreased by R25,2 million (10%).</li> </ul>

**Nature of, and overall trends in, fruitless and wasteful expenditure**

Figure 17 reflects the three-year trend in fruitless and wasteful expenditure, the extent to which it was identified during the audit (and not by the auditees' internal control systems), and an analysis per district.

**Figure 17: Three-year trend in amount of fruitless and wasteful expenditure and number of auditees incurring fruitless and wasteful expenditure**



Auditees that did not incur fruitless and wasteful expenditure

Auditees that incurred fruitless and wasteful expenditure

The table below depicts the overall movement in the number of auditees and the movement in the amount of fruitless and wasteful expenditure incurred by these auditees. The actual fruitless and wasteful expenditure related mostly to payments made and interest incurred on late payments.

**Table 21: Nature of, and current year movement in, fruitless and wasteful expenditure**

Nature	Number of auditees	Movement in number of auditees from 2010-11	Amount	Movement in amount from 2010-11
Incurring to prevent irregular/ loss/ further fruitless and wasteful expenditure	3	100%	R 9 million	100%
Actual fruitless and wasteful expenditure	8	300%	R 19 million	85%



Improvement



Unchanged



Regression

The table below summarises key outcomes and trends in this regard.

**Table 22: Key outcomes and trends regarding fruitless and wasteful expenditure**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>The number of auditees incurring fruitless and wasteful expenditure increased by nine (450%), while the value of such expenditure increased by R17 million (170%).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The most significant upward trend was at the municipalities in the Gert Sibande district, where the number of auditees increased by four (100%) and the value of such expenditure by R16,5 million (100%). This district accounted for 61% of the total fruitless and wasteful expenditure incurred.</li> </ul>

***Conclusion on unauthorised, irregular as well as fruitless and wasteful expenditure***

Unauthorised, irregular or fruitless and wasteful expenditure was incurred by 16 (84%) auditees. Our audits further revealed that the accounting officers of 11 auditees (58%) did not ensure that reasonable steps had been taken to prevent this type of expenditure. We reported this in the audit reports as material non-compliance.

The number of municipalities that incurred irregular expenditure increased, while the amount of this expenditure decreased compared to the previous year. Supporting documents for 145 awards [R343,1 million (2010-11: R147,3 million)] were not made available for audit purposes. This trend points to a culture where documents are deliberately misplaced to avoid accountability for non-compliance with laws and regulations.

The extent of this expenditure and the non-compliance by accounting officers indicate an environment where unauthorised, irregular as well as fruitless and wasteful expenditure has become the norm and not the exception. Reasonable steps are not taken to prevent such expenditure, while the occurrence thereof is also not detected by auditees but are most often identified through our audit process.

A lack of monitoring and enforcement of applicable legislation and policies, coupled with an inappropriate attitude towards the enforcement of consequences for those who deliberately or negligently disobey the applicable legislation, contributes to a situation where appropriate practices are not entrenched in the daily operations of local government. Such practices erode public confidence in auditees' ability to manage the resources allocated to them and require urgent attention. Very few, if any, consequences were evident in addressing these weaknesses and contraventions of basic SCM requirements and practices.

## SECTION 3: ROOT CAUSES OF AUDIT OUTCOMES

This section of the report details the root causes of audit outcomes and recommendations to address these root causes. Section 3.1 summarises the root causes, while these root causes and areas of risk are discussed further on as follows:

- Significant deficiencies in auditees' systems of internal control (section 3.2)
- HR management (section 3.3)
- Information technology (IT) management (section 3.4)
- The effectiveness of audit committees and internal audit units (section 3.5)

### 3.1 Summary of root causes of poor audit outcomes

Our audit process includes an assessment of the root causes of audit findings, based on identifying the internal controls that failed to prevent or detect the misstatement or non-compliance. We confirm the root causes with the auditee's management and report the root causes in the management report issued to the accounting officer and shared with the executive mayor. We also include the root causes of material findings reported in the audit reports as internal control deficiencies in the audit report, classified under the key drivers of leadership, financial and performance management, and governance. Section 3.2 provides more information on the specific drivers of internal control.

The two tables that follow summarise the most common root causes of the audit outcomes of local government, provide recommendations to address the root causes, and identify the role players responsible for addressing such root causes. We also reported most of these root causes and recommendations in the 2010-11 management, audit and general reports. We therefore provide our view on why the prior year root causes have not been addressed.

**Table 23: Prior year root causes not addressed and recommendations not implemented**

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations
			F	P	C	
1.	Slow response to the AGSA's message and not taking ownership of key controls (lack of willingness on the part of the political leadership)	15 (79%)	X	X	X	<p>The regression in the overall audit outcomes and the stagnation of outcomes at individual auditees are a direct result of the tone set from the top and the commitments made by municipal leaders (including mayors and councillors).</p> <p>Municipal councils, executive mayors and municipal managers did not take full ownership of the key control document and satisfy themselves that the identified areas of internal control weaknesses were receiving the required attention. Furthermore, councils and executive mayors did not ask for regular financial and performance reports and subject these reports to intense interrogation.</p>

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations										
			F	P	C											
						<p>The efforts of the provincial legislature and the portfolio committee on cooperative governance and traditional affairs were not coordinated to address local government oversight in provinces, which resulted in some matters being overlooked.</p> <p>Refer to the leadership section in table 26 for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>Address the root causes of findings raised by the AGSA.</li> <li>Implement commitments made by the mayor.</li> </ul> </td> <td>Municipal manager and chief financial officer</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Meet with the AGSA at least quarterly.</li> <li>Implement commitments made to the AGSA on a quarterly basis.</li> </ul> </td> <td>Mayor</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Oversee the implementation of controls to address root causes identified by the AGSA.</li> <li>Oversee the implementation of commitments to address weaknesses identified.</li> <li>Commit to regular interactions with the AGSA to measure the progress made in implementing controls.</li> </ul> </td> <td>Council, MPAC and audit committee</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Provide human and financial resources to assist in the implementation of the above commitments.</li> <li>Provide training to councils and municipal officials on service delivery and financial matters.</li> </ul> </td> <td>MEC for CoGTA and MEC for Finance</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>Address the root causes of findings raised by the AGSA.</li> <li>Implement commitments made by the mayor.</li> </ul>	Municipal manager and chief financial officer	<ul style="list-style-type: none"> <li>Meet with the AGSA at least quarterly.</li> <li>Implement commitments made to the AGSA on a quarterly basis.</li> </ul>	Mayor	<ul style="list-style-type: none"> <li>Oversee the implementation of controls to address root causes identified by the AGSA.</li> <li>Oversee the implementation of commitments to address weaknesses identified.</li> <li>Commit to regular interactions with the AGSA to measure the progress made in implementing controls.</li> </ul>	Council, MPAC and audit committee	<ul style="list-style-type: none"> <li>Provide human and financial resources to assist in the implementation of the above commitments.</li> <li>Provide training to councils and municipal officials on service delivery and financial matters.</li> </ul>	MEC for CoGTA and MEC for Finance
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<b>Reason why prior year root cause was not addressed</b>			At most municipalities, the leadership was available to meet with the AGSA each quarter to discuss the status of controls, but the leadership has not taken ownership of the control assessments. Although the trend has improved since the previous year, the leadership has to date failed to exercise the level of oversight committed to in response to the previous year's audit outcomes and during the quarterly visits.													
<b>Prior year recommendations not yet implemented</b>			<p>(a) Councils and executive mayors should periodically review the progress made by municipal managers in addressing external audit findings.</p> <p>(b) Councils and executive mayors should periodically look at the findings and ask the views of audit committees and internal audit units on internal control and risk management. They should further monitor the implementation of recommendations by the audit committee and internal audit unit with a view to remedial action.</p>													

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations				
			F	P	C					
						(c) Councils and executive mayors should take timeous action in instances of identified non-compliance with laws and regulations, or failure by management and staff to perform statutory duties.				
<b>Additional recommendations</b>						(a) The leadership (including executive mayors and councillors) and management should take primary ownership of action plans, which should include at least the following: <ul style="list-style-type: none"> <li>• Orientation, training and continuous development of councillors.</li> <li>• Once councillors have been given the required training and tools, they should be monitored to assess their ability to apply the training; in other words, councillors should be able to conduct oversight and be equipped to take clear and firm decisions.</li> <li>• There should be consequences for training not being provided to councillors, as well as for councillors not attending training.</li> <li>• The trained councillors should be responsible for appointing and monitoring key officials to run the municipality and professionalise local government.</li> </ul>				
2.	Lack of consequences for poor performance and transgressions	11 (57%)	X	X	X	<p>Inadequate performance management and a lack of consequences for transgressions are at the root of many of the failures in local government. When officials are not held accountable for their actions, a perception is created that poor performance and transgressions are accepted and tolerated. This is evidenced by the fact that modified opinions remain the norm.</p> <p>The leadership failed to fully implement mechanisms and procedures for managing poor performance and the misconduct of officials. This created the perception that the leadership (including mayors and councillors) was not committed to accountability.</p> <p>Refer to sections 3.3.4 (performance management) and 3.3.5 (consequences for transgressions) for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>• Ensure that there is a robust performance management system linked to the requirements of the integrated development plan and the service delivery and budget implementation plan.</li> <li>• Take oversight actions in respect of poor performance and transgressions.</li> </ul> </td> <td>Council, MPAC and audit committee</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>• Ensure that there is a robust performance management system linked to the requirements of the integrated development plan and the service delivery and budget implementation plan.</li> <li>• Take oversight actions in respect of poor performance and transgressions.</li> </ul>	Council, MPAC and audit committee
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No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations	
			F	P	C		
						<ul style="list-style-type: none"> <li>Ensure that a performance management system is in place and that the performance of the municipal manager and the chief financial officer is managed in accordance with the performance management system.</li> <li>Take appropriate actions relating to the performance of the municipal manager and the chief financial officer.</li> </ul>	Mayor
						<ul style="list-style-type: none"> <li>Implement the performance management system.</li> <li>Implement appropriate actions relating to poor performance and transgressions in respect of personnel reporting to them.</li> </ul>	Municipal manager and chief financial officer
						<ul style="list-style-type: none"> <li>Provide technical assistance relating to the development of appropriate performance management policies and systems.</li> <li>Assist in providing training to municipal officials and the council.</li> <li>Assist in sourcing funding for the implementation of these systems.</li> </ul>	Office of the Premier
						<ul style="list-style-type: none"> <li>Provide human and financial resources to assist in the implementation of the above actions.</li> </ul>	MEC for CoGTA and MEC for Finance
<b>Reason why prior year root cause was not addressed</b>			We identified a lack of discipline, no commitment to serve the public interest and non-adherence to the code of conduct for municipal officials as the primary reasons why this root cause had not been addressed. Furthermore, the controls and performance objectives of the municipalities did not filter through to the performance contracts of municipal officials in order to direct their daily operations.				
<b>Prior year recommendations not yet implemented</b>			<p>(a) The leadership should set the tone by implementing sound performance management processes, evaluating and monitoring performance, and consistently demonstrating that poor performance has consequences.</p> <p>(b) The disciplinary regulations for senior managers (effective from April 2011) should be implemented. These regulations provide mechanisms and procedures for managing the misconduct of municipal managers and senior managers.</p>				
<b>Additional recommendations</b>			(a) A coordinated and focused approach is needed to ensure that the many programmes, commitments and action plans of different stakeholders succeed. The implementation of the latest legislative reforms will also require a new level of collaboration, especially by the Department of Finance, CoGTA, districts and municipalities. Without these partnerships and the commitment of the auditees' political and administrative leaders, the situation will not improve.'				
3.	Key officials lacking minimum competencies and skills, and the	10 (53%)	X	X	X	<p><b>Key officials lacking competencies and skills</b></p> <p>The complex legislative requirements for local government and the reforms in financial and</p>	

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations				
			F	P	C					
	management of vacancies and acting positions					<p>performance management demand that key officials (municipal managers, chief financial officers and senior managers) have the required skills and experience to fulfil their responsibilities and exercise their functions and powers. The poor audit outcomes, many instances of non-compliance, failures in service delivery reporting and high demand for consultants and support from provincial government, indicate that these key officials did not have the required competencies and skills.</p> <p>The root cause of this is two-pronged: key officials were appointed who did not have the competencies, while current employees did not keep up with the changing local government environment through ongoing training and development.</p> <p>We previously recommended that the leadership should turn around the situation and address the gaps by providing training and development for appointed officials who lack academic qualifications and experience. This phasing-in period of persons currently in key positions was allowed in terms of the municipal regulations on minimum competency levels.</p> <p><b>Management of vacancies and acting positions</b></p> <p>The biggest challenge for local government is to attract and retain qualified and competent persons across all areas of administration. High vacancy levels and key positions being vacant were identified at eight of the municipalities in the province (47%) [2010-11: 13 (62%)].</p> <p>The vacancies at the level of municipal manager and senior management had a significant impact on the audit outcomes. Officials were directed to act in these positions until the vacancies were filled, but at four (21%) of the auditees, the acting periods were longer than the accepted benchmark of six months. When officials act in positions, they tend not to take on full responsibility for the functions and powers of the post, with a lower level of commitment to the deliverables, as a result of the temporary nature of the position.</p> <p>Refer to sections 3.3.1 (management of vacancies and acting positions) and 3.3.2 (competencies of key officials) for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>Ensure that there is a properly approved organisational structure that is responsive to the service delivery requirements of the</li> </ul> </td> <td>Council, MPAC and audit committee</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>Ensure that there is a properly approved organisational structure that is responsive to the service delivery requirements of the</li> </ul>	Council, MPAC and audit committee
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No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations	
			F	P	C		
						<p>municipality.</p> <ul style="list-style-type: none"> <li>Ensure that properly approved recruitment and retention policies and performance management policies are in place.</li> <li>Oversee the application of these policies.</li> </ul>	
						<ul style="list-style-type: none"> <li>Ensure that municipal managers and chief financial officers are appointed and that they have the required skills and competencies.</li> </ul>	Mayor
						<ul style="list-style-type: none"> <li>Ensure that the approved organisational structure is filled with competent staff.</li> <li>Ensure that the budget is sufficient to fund the required structure.</li> <li>Implement the recruitment and retention policies and performance management system.</li> </ul>	Municipal manager and chief financial officer
						<ul style="list-style-type: none"> <li>Provide technical assistance relating to the development of appropriate recruitment, retention and performance management policies.</li> <li>Assist in providing training to municipal officials and councils.</li> <li>Assist in sourcing funding for the approved organisational structures.</li> </ul>	Office of the Premier
						<ul style="list-style-type: none"> <li>Provide human and financial resources to assist in the implementation of the above policies and the funding of the approved organisational structures.</li> </ul>	MEC for CoGTA and MEC for Finance
<b>Reason why prior year root cause was not addressed</b>						Management members did not demonstrate a sufficient understanding of their management function. They did not satisfy themselves that processes had been implemented to ensure that key officials were adequately trained and that positions were timeously filled with skilled personnel.	
<b>Prior year recommendations not yet implemented</b>						(a)	The provision of dedicated resources for service delivery reporting, the implementation of the legislation on minimum competency levels, and the recent amendments to the Municipal Systems Act.
<b>Prior year recommendations not yet implemented</b>						(b)	Coordination and commitment by all political structures and government to ensure the success of the legislative reforms and interventions.
<b>Additional recommendations</b>						(a)	<p>More effective coordination between the Department of Finance, CoGTA, districts and municipalities should be established, with a focus on the following shortcomings:</p> <ul style="list-style-type: none"> <li>Guidance</li> <li>Financial management processes</li> <li>Training</li> <li>Filling of vacancies</li> </ul>

Audit outcomes affected

F = Financial

P = Predetermined objectives

C = Compliance

Table 24: Additional root causes identified and recommendations to address them

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations										
			F	P	C											
1.	Ineffective monitoring by audit committees and internal audit units (they do not positively influence audit outcomes)	15 (79%)	X	X	X	<p>The internal control monitoring mechanisms of audit committees and internal audit units did not function optimally, as many control weaknesses were only uncovered during the audit of the financial statements, PDOs and compliance.</p> <p>Refer to section 3.5 (audit committees and internal audit units) for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>Oversee the reports of the audit committee and internal audit unit.</li> <li>Make sufficient financial and human resources available to ensure that the governance structures are effective.</li> </ul> </td> <td>Council and mayor</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Ensure that the governance structures are supported and are capacitated to add value.</li> </ul> </td> <td>Municipal manager and chief financial officer</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Ensure that the reports of the internal audit unit and audit committee receive appropriate leadership attention.</li> <li>Oversee the IT risks and the strategies to reduce them.</li> </ul> </td> <td>MPAC and audit committee</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Facilitate appropriate training.</li> </ul> </td> <td>MEC for CoGTA and MEC for Finance</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>Oversee the reports of the audit committee and internal audit unit.</li> <li>Make sufficient financial and human resources available to ensure that the governance structures are effective.</li> </ul>	Council and mayor	<ul style="list-style-type: none"> <li>Ensure that the governance structures are supported and are capacitated to add value.</li> </ul>	Municipal manager and chief financial officer	<ul style="list-style-type: none"> <li>Ensure that the reports of the internal audit unit and audit committee receive appropriate leadership attention.</li> <li>Oversee the IT risks and the strategies to reduce them.</li> </ul>	MPAC and audit committee	<ul style="list-style-type: none"> <li>Facilitate appropriate training.</li> </ul>	MEC for CoGTA and MEC for Finance
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<ul style="list-style-type: none"> <li>Facilitate appropriate training.</li> </ul>	MEC for CoGTA and MEC for Finance															
<b>Recommendations</b>																
(a) Ongoing evaluation and monitoring should be performed to ensure that controls are in place and functioning.																
(b) Any deficiencies identified should be communicated to the relevant parties, while commitments to address these should be time bound and include specific responsibilities.																
(c) To improve audit outcomes, audit committees and internal audit units need to review financial statements before they are submitted for auditing. They should also ensure that measures have been implemented to correct the previous year's audit findings, and monitor the action plans to address audit findings.																
(d) Internal audit units and audit committees should focus in particular on confirming the																

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations								
			F	P	C									
						credibility of information and ratings in quarterly dashboard reports. Any lack of cooperation by the municipal manager and the management team should be escalated to the executive mayor and council.								
2.	A lack of basic financial discipline	15 (79%)	X			<p>Daily and monthly accounting and reconciling routines were absent at many auditees and it appears as if the leadership is accepting a qualified audit opinion on the financial statements as the norm.</p> <p>Refer to the financial and performance management section in table 26 for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>Ensure that all financial, service delivery and compliance reports presented to the council have been tested for credibility.</li> <li>Ensure that all reports prepared by the audit committee and MPAC relating to these documents are tabled in the council.</li> </ul> </td> <td>Mayor</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Ensure that all financial, service delivery and compliance reports presented to the council are checked for credibility by the MPAC and audit committee through the internal audit unit.</li> </ul> </td> <td>MPAC, audit committee and internal audit unit</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Implement systems and processes to ensure that credible monthly reports are produced within a reasonable period after the end of every month.</li> <li>Supervise the work of direct reports and create an environment where effective supervision takes place.</li> </ul> </td> <td>Municipal manager, chief financial officer and senior managers</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>Ensure that all financial, service delivery and compliance reports presented to the council have been tested for credibility.</li> <li>Ensure that all reports prepared by the audit committee and MPAC relating to these documents are tabled in the council.</li> </ul>	Mayor	<ul style="list-style-type: none"> <li>Ensure that all financial, service delivery and compliance reports presented to the council are checked for credibility by the MPAC and audit committee through the internal audit unit.</li> </ul>	MPAC, audit committee and internal audit unit	<ul style="list-style-type: none"> <li>Implement systems and processes to ensure that credible monthly reports are produced within a reasonable period after the end of every month.</li> <li>Supervise the work of direct reports and create an environment where effective supervision takes place.</li> </ul>	Municipal manager, chief financial officer and senior managers
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<b>Recommendations</b>			(a)	Municipal managers, chief financial officers, senior managers and internal audit units should insist on receiving monthly financial and performance statements. They should ensure that proper accounting records are kept, that all transactions are timeously processed throughout the financial year, that key reconciliations are periodically prepared, and that the accuracy of information is independently verified.										
			(b)	The leadership should demonstrate a willingness and determination to accept accountability for audit outcomes. They should establish standards of work that are understood by all staff and are monitored, while deviations should be timeously addressed.										
3.	A lack of commitment to own action plans	14 (74%)	X	X	X	The slow progress in addressing the previous year's audit findings on financial statements, PDOs and non-compliance with laws and regulations indicates that the leadership did not adequately monitor the progress of the effective implementation and follow-up of action plans to improve the audit outcomes.								

No.	Root cause	Number of auditees where the root cause was identified	Audit outcomes affected			Details of root causes and recommendations						
			F	P	C							
						<p>Refer to the leadership section in table 26 as well as table 36 (initiatives and commitments) for the context, reasons and impact relating to this problem.</p> <table border="1"> <thead> <tr> <th>Expectations of each role player</th> <th>Role players that should address the root cause</th> </tr> </thead> <tbody> <tr> <td> <ul style="list-style-type: none"> <li>Monitor that the assigned responsibilities are carried out effectively and consistently.</li> </ul> </td> <td>Mayor and council</td> </tr> <tr> <td> <ul style="list-style-type: none"> <li>Set action plans to specifically address external and internal audit findings. (Some action plans did not address the root causes of audit findings and therefore did not prevent repeat findings.)</li> </ul> </td> <td>Municipal manager and chief financial officer</td> </tr> </tbody> </table>	Expectations of each role player	Role players that should address the root cause	<ul style="list-style-type: none"> <li>Monitor that the assigned responsibilities are carried out effectively and consistently.</li> </ul>	Mayor and council	<ul style="list-style-type: none"> <li>Set action plans to specifically address external and internal audit findings. (Some action plans did not address the root causes of audit findings and therefore did not prevent repeat findings.)</li> </ul>	Municipal manager and chief financial officer
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<b>Recommendations</b>						<p>(a) Action plans should be reviewed to ensure that the commitments are SMART (specific, measurable, achievable, realistic and time bound).</p> <p>(b) Audit committees, MPACs and internal audit units should play an important role in monitoring the implementation of action plans.</p>						

Audit outcomes affected

F = Financial

P = Predetermined objectives

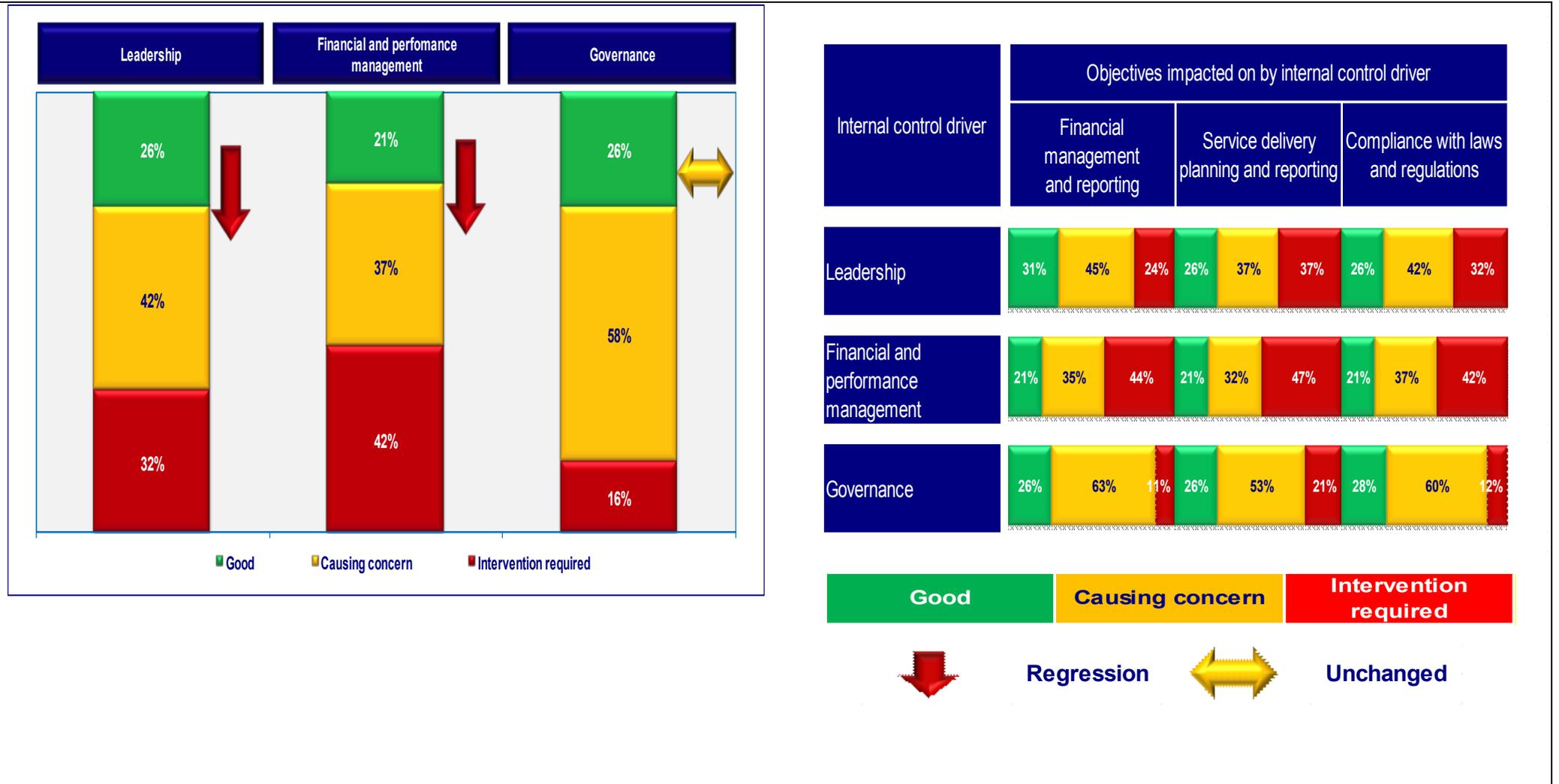
C = Compliance

### 3.2 Significant deficiencies in auditees' systems of internal control

A key responsibility of accounting officers or authorities and other officials is to implement and maintain effective and efficient systems of internal control. As part of our audits, we assess the auditee's system of internal control to determine its effectiveness in ensuring reliable financial and performance reporting and compliance with laws and regulations, which – in turn – will result in a clean audit. For purposes of focusing corrective action, we have categorised the principles of the different components of internal control, termed *drivers of internal control*, under leadership, financial and performance management, and governance.

Figure 18 reflects the overall assessment of these drivers at the time of the audit, based on significant deficiencies in internal control that resulted in corrected and uncorrected material misstatements in the financial statements and performance reports as well as findings on non-compliance with laws and regulations.

Figure 18: Overall assessment of drivers of internal control



The following table highlights broad areas of concern.

**Table 25: Assessment of drivers of internal control**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>There was an overall reduction in the number of auditees whose drivers were assessed as being 'good' at the conclusion of the 2010-11 audits.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>There was an overall increase in the number of auditees requiring intervention in controls related to financial and performance management.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The combined deficiencies in leadership, financial and performance management as well as governance had a negative impact on all three facets of the audit outcomes, namely financial statements, reporting against PDOs (service delivery reporting), and compliance with laws and regulations.</li> </ul>

The following table presents the status of the internal control elements underlying leadership, financial and performance management as well as governance at June 2012, and indicates any movements in the implementation thereof. Annexure 2 to this report provides the status of key controls per auditee.

**Table 26: Status of, and movement in, the internal control elements underlying leadership, financial and performance management as well as governance**

Driver no. 1: Leadership	Movement	Assessment of driver						
Provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the entity.		<table border="1"> <tbody> <tr> <td>2011-12</td> <td> 47%</td> <td> 53%</td> </tr> <tr> <td>2010-11</td> <td> 50%</td> <td> 45%  5%</td> </tr> </tbody> </table>	2011-12	 47%	 53%	2010-11	 50%	 45%  5%
2011-12	 47%	 53%						
2010-11	 50%	 45%  5%						

The improvement at some auditees and the regression or stagnation in the audit outcomes of others are a direct result of the tone set from the top and the commitments made by the municipal leadership, made up of mayors, councillors and municipal managers. Neither the administrative nor the political leadership adequately addressed the matters that prevented auditees from progressing towards clean audits. The weaknesses in leadership practices at most auditees included the following:

- Failure to implement formal codes of conduct and periodically communicate their existence and continued applicability to officials.
- Failure to monitor the performance of key officials regarding the maintenance of adequate systems of internal control that ensure credible monthly financial reporting, reliable reporting against PDOs, and compliance with laws and regulations.
- Failure to establish clear lines of accountability.
- Failure to take corrective or disciplinary action against key officials for misconduct.
- Failure to honour commitments made for interventions following the 2010-11 audit outcomes.
- The awarding of contracts to employees, close family members of employees and other state officials.

**Driver no. 1: Leadership****Movement****Assessment of driver**

Exercise oversight responsibility regarding financial and performance reporting and compliance with laws and regulations and related internal controls.

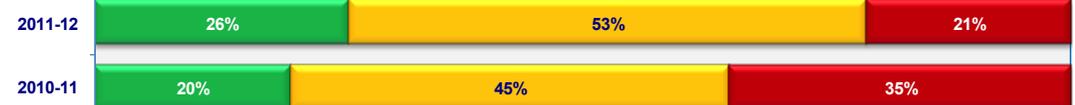


The leadership at some auditees, including executive mayors and councillors, did not make any progress to improve oversight and the leadership of those auditees whose outcomes had regressed did not effectively exercise oversight responsibility with regard to financial and performance reporting and compliance with applicable laws and regulations. Many councils, executive mayors and municipal managers did not take full ownership of the key control document and did not satisfy themselves that identified areas of internal control weaknesses were receiving the required level of attention.

Lapses in effective oversight included the following:

- The council did not periodically look at the findings and ask the views of audit committees and internal audit units on internal control and risk management, and did not monitor the implementation of their recommendations with a view to remedial action.
- Speakers did not insist on the credibility of the information submitted to council meetings.
- Councils did not take timeous action in instances of identified non-compliance with laws and regulations or failure by management and staff to perform statutory duties.
- Failure to exert a positive influence on the control environment.
- Failure to ensure that auditees appointed suitably qualified staff to perform essential duties relating to financial and performance reporting.
- Failure to periodically review progress made by management in addressing external audit findings.
- Failure to monitor controls.
- Failure to address the root causes of repeated qualifications of financial statements, findings on reporting against PDOs as well as findings on non-compliance with laws and regulations.
- Failure to insist on receiving credible monthly financial statements, the maintenance of proper accounting records, the periodic preparation of key reconciliations, and the independent verification of the accuracy of reported information.

Implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.



### Section 3.3 assesses findings arising from the audit of HR management.

Establish and communicate policies and procedures to enable and support an understanding and execution of internal control objectives, processes and responsibilities.

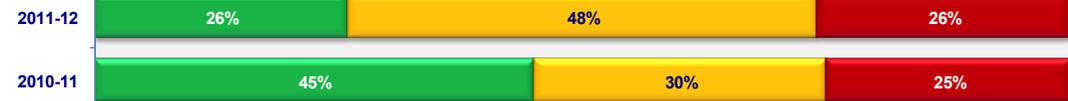


Policies and procedures to address areas of risk, to achieve desired internal control objectives and to guide the operations of auditees still required improvement at 12 auditees (63%). Matters that specifically need to be addressed include the following:

**Driver no. 1: Leadership****Movement****Assessment of driver**

- The effective implementation of documented policies and procedures.
- Policies specifically providing guidelines and directives for the collection, processing and validation of performance information.
- Policies and procedures dealing with compliance with laws and regulations.

Develop and monitor the implementation of action plans to address internal control deficiencies.



Specific action plans are required to address internal control deficiencies and improve audit outcomes. Matters requiring attention include the following:

- Some action plans did not address the root causes of audit findings and therefore did not prevent repeat findings. Action plans should specifically address external and internal audit findings.
- Staff members were not assigned responsibility to carry out these action plans.
- Monitoring was not adequate to ensure that the responsibilities assigned were carried out effectively and consistently.
- Some auditees' action plans were developed too late in the financial year to resolve matters by year-end.
- Action plans did not address all three facets of audit outcomes, namely qualifications, findings on PDO reporting as well as non-compliance with laws and regulations.
- Audit committees, MPACs and internal audit units should play an important monitoring role in this regard.

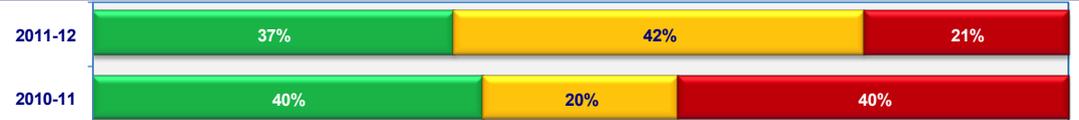
Develop and monitor the implementation of action plans to address internal control deficiencies in the IT environment. Establish an IT governance framework that supports and enables the business, delivers value and improves performance.



**Section 3.4 assesses IT controls.**

**Driver no. 2: Financial and performance management****Movement****Assessment of driver**

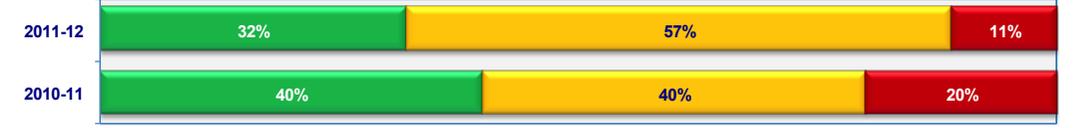
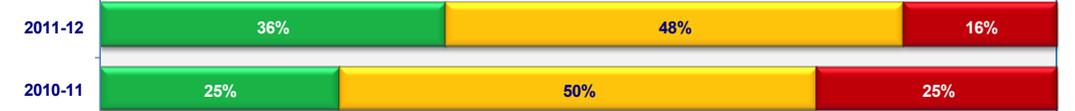
Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting.



Driver no. 2: Financial and performance management	Movement	Assessment of driver								
<p>Proper record keeping is an essential step towards achieving clean audit outcomes, as it ensures that the reported information can be substantiated and verified. It also empowers senior management to hold staff accountable for their actions. An adequate system of record keeping requires senior managers to establish adequately developed and communicated policies to ensure that staff align their actions with the auditee's objectives. A key objective of maintaining a formal and reliable system of record keeping is to have documentation readily available when requested.</p>										
<p>Most auditees' financial and performance systems have not yet reached the level of maturity where information is centrally available and evidence to support major decisions is readily available. The root causes of this include the following:</p>										
<ul style="list-style-type: none"> <li>• A lack of documented management policies.</li> <li>• Poor monitoring of policies by management where such policies did exist.</li> <li>• A lack of willingness by the leadership to implement the commitments made to specifically address the recurring instances of missing and incomplete supporting information.</li> <li>• A lack of document management to support the reported performance against PDOs.</li> </ul>										
<p>Implement controls over daily and monthly processing and reconciling of transactions.</p>		<table border="1"> <tr> <td data-bbox="1032 660 1133 687">2011-12</td> <td data-bbox="1133 660 1386 687" style="text-align: center;">26%</td> <td data-bbox="1386 660 1794 687" style="text-align: center;">42%</td> <td data-bbox="1794 660 2114 687" style="text-align: center;">32%</td> </tr> <tr> <td data-bbox="1032 727 1133 754">2010-11</td> <td data-bbox="1133 727 1386 754" style="text-align: center;">30%</td> <td data-bbox="1386 727 1794 754" style="text-align: center;">35%</td> <td data-bbox="1794 727 2114 754" style="text-align: center;">35%</td> </tr> </table>	2011-12	26%	42%	32%	2010-11	30%	35%	35%
2011-12	26%	42%	32%							
2010-11	30%	35%	35%							
<p>Auditees that sustained good audit outcomes effectively monitored daily and monthly processing and reconciling of transactions. Auditees that improved their reconciliation processes and reconstructed their fixed asset registers were able to resolve audit qualifications.</p>										
<p>Poor and deteriorating controls that had a negative impact on the audit outcomes included the following:</p>										
<ul style="list-style-type: none"> <li>• Key controls were not reviewed and monitored on a daily, weekly and monthly basis.</li> <li>• Assets were not verified at least on a quarterly basis to ensure that asset registers were reliable, which resulted in errors being detected only when an audit was performed.</li> <li>• Auditees did not ensure that the following controls were in place: <ul style="list-style-type: none"> <li>▪ Daily capturing of financial transactions, supervisory reviews of captured information, and independent monthly reconciliations of key accounts.</li> <li>▪ Collection of performance information at intervals that were appropriate for monitoring set service delivery targets and milestones and for validating recorded information.</li> <li>▪ Management of contracts and the commitments relating to such contracts.</li> <li>▪ Confirmation that legislative requirements and policies had been complied with before initiating transactions.</li> </ul> </li> </ul>										
<p>Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.</p>		<table border="1"> <tr> <td data-bbox="1032 1308 1133 1335">2011-12</td> <td data-bbox="1133 1308 1386 1335" style="text-align: center;">21%</td> <td data-bbox="1386 1308 1704 1335" style="text-align: center;">37%</td> <td data-bbox="1704 1308 2114 1335" style="text-align: center;">42%</td> </tr> <tr> <td data-bbox="1032 1375 1133 1402">2010-11</td> <td data-bbox="1133 1375 1386 1402" style="text-align: center;">24%</td> <td data-bbox="1386 1375 1704 1402" style="text-align: center;">41%</td> <td data-bbox="1704 1375 2114 1402" style="text-align: center;">35%</td> </tr> </table>	2011-12	21%	37%	42%	2010-11	24%	41%	35%
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2010-11	24%	41%	35%							

Driver no. 2: Financial and performance management	Movement	Assessment of driver								
<p>Only when the in-year preparation and independent review of financial statements and performance information become an established practice, will the quality of financial statements submitted for auditing significantly improve and findings resulting from material misstatements in financial statements and performance reports be eliminated.</p>										
<p>The following matters contributed to poor audit outcomes due to errors in, and the omission of, information. All of these could not be corrected during the audit process, resulting in qualifications or material PDO findings:</p>										
<ul style="list-style-type: none"> <li>• The practice of regular internal reporting was not fully established at most auditees to ensure self-monitoring, thereby reducing the likelihood of producing financial statements that attract qualifications when audited, or findings on the usefulness and reliability of performance information.</li> <li>• The leadership did not insist on receiving in-year financial and performance reports that were independently validated, as well as reports on compliance with legislative requirements.</li> <li>• Finance staff lacked an adequate understanding of the reporting framework, resulting in such staff members being unable to draft the required disclosure notes to the financial statements.</li> <li>• Auditees relied too much on consultants to assist in achieving an unqualified audit opinion.</li> </ul>										
<p>Review and monitor compliance with applicable laws and regulations.</p>		<table border="1"> <tr> <td data-bbox="1032 660 1128 724">2011-12</td> <td data-bbox="1128 660 1688 724">20%</td> <td data-bbox="1688 660 2114 724">37%</td> <td data-bbox="2114 660 2141 724">43%</td> </tr> <tr> <td data-bbox="1032 724 1128 788">2010-11</td> <td data-bbox="1128 724 1375 788">25%</td> <td data-bbox="1375 724 1767 788">40%</td> <td data-bbox="1767 724 2114 788">35%</td> </tr> </table>	2011-12	20%	37%	43%	2010-11	25%	40%	35%
2011-12	20%	37%	43%							
2010-11	25%	40%	35%							
<p>Management should perform regular monitoring to ensure that appropriate controls are in place to consistently comply with all applicable laws and regulations, as many auditees were unable to address or avoid material non-compliance findings. The leadership should focus on the regular monitoring of common areas of non-compliance and the effective implementation of checklists to ensure compliance before transactions are concluded and not after payments have been made.</p>										
<p>Findings on non-compliance with applicable laws and regulations were the result of matters that included the following:</p>										
<ul style="list-style-type: none"> <li>• Management and governance structures had not established their own processes to identify all existing legislation applicable to municipalities.</li> <li>• At some auditees, there was a deliberate disregard for laws and regulations.</li> <li>• Management failed to demonstrate any commitment to ensure compliance with relevant laws and regulations.</li> <li>• There were no significant consequences for officials who failed to comply with laws and regulations or for officials who failed to discharge their legislated duties.</li> <li>• While many auditees did have policies and procedures to monitor compliance with laws and regulations, monitoring should take place at more frequent intervals, such as on a monthly basis, by designated staff members to detect, or preferably prevent, non-compliance.</li> </ul>										
<p>Design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information, and to address application systems susceptible to compromised data integrity</p>		<table border="1"> <tr> <td data-bbox="1032 1294 1128 1358">2011-12</td> <td data-bbox="1128 1294 1442 1358">10%</td> <td data-bbox="1442 1294 1800 1358">21%</td> <td data-bbox="1800 1294 2141 1358">69%</td> </tr> <tr> <td data-bbox="1032 1358 1128 1422">2010-11</td> <td data-bbox="1128 1358 1218 1422">9%</td> <td data-bbox="1218 1358 1576 1422">25%</td> <td data-bbox="1576 1358 2114 1422">66%</td> </tr> </table>	2011-12	10%	21%	69%	2010-11	9%	25%	66%
2011-12	10%	21%	69%							
2010-11	9%	25%	66%							

Driver no. 2: Financial and performance management	Movement	Assessment of driver
(information systems).		
<b>Section 3.4 assesses IT controls.</b>		

Driver no. 3: Governance	Movement	Assessment of driver												
Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.		 <table border="1" data-bbox="1059 547 2134 675"> <thead> <tr> <th>Year</th> <th>Green (%)</th> <th>Yellow (%)</th> <th>Red (%)</th> </tr> </thead> <tbody> <tr> <td>2011-12</td> <td>32%</td> <td>57%</td> <td>11%</td> </tr> <tr> <td>2010-11</td> <td>40%</td> <td>40%</td> <td>20%</td> </tr> </tbody> </table>	Year	Green (%)	Yellow (%)	Red (%)	2011-12	32%	57%	11%	2010-11	40%	40%	20%
Year	Green (%)	Yellow (%)	Red (%)											
2011-12	32%	57%	11%											
2010-11	40%	40%	20%											
<p>Risk management is the practice of identifying, assessing and prioritising risks and developing risk management plans. These are essential elements in the review of the design and implementation of sound internal controls to achieve good governance and accountability in respect of financial reporting and reporting on achievements against PDOs (service delivery).</p> <p>Risk management activities that require attention from the leadership, management and governance structures of the municipalities included the following:</p> <ul data-bbox="91 914 2074 1090" style="list-style-type: none"> <li>• There was a lack of risk assessments and risk management strategies that sufficiently covered financial reporting, reporting on achievements against PDOs, and consistent compliance with applicable laws and regulations.</li> <li>• IT risk plans and fraud prevention plans were not adequately implemented.</li> <li>• Risk management strategies were developed but not appropriately implemented and monitored.</li> <li>• Auditees' risk assessment results did not inform the work plans of internal audit units and the agendas of audit committees.</li> </ul>														
Ensure that an adequately resourced and functioning internal audit unit is in place which identifies internal control deficiencies and recommends corrective action effectively.		 <table border="1" data-bbox="1059 1106 2134 1217"> <thead> <tr> <th>Year</th> <th>Green (%)</th> <th>Yellow (%)</th> <th>Red (%)</th> </tr> </thead> <tbody> <tr> <td>2011-12</td> <td>36%</td> <td>48%</td> <td>16%</td> </tr> <tr> <td>2010-11</td> <td>25%</td> <td>50%</td> <td>25%</td> </tr> </tbody> </table>	Year	Green (%)	Yellow (%)	Red (%)	2011-12	36%	48%	16%	2010-11	25%	50%	25%
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2011-12	36%	48%	16%											
2010-11	25%	50%	25%											
<b>Section 3.5 assesses the effectiveness of internal audit units.</b>														

Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and provides oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.



Section 3.5 assesses the effectiveness of audit committees.



Improvement



Regression



Unchanged

### 3.3 Human resource management

Effective HR management is a key driver of audit outcomes. In this context, HR management is effective if adequate and sufficiently skilled resources (employees) are in place and their performance and productivity are properly managed.

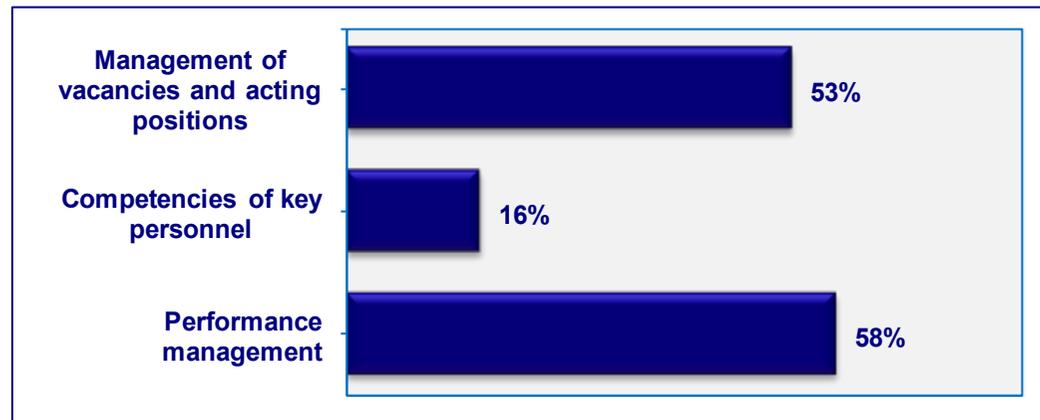
As detailed in section 3.1, vacancies in key positions, key officials lacking competencies, financial assistance provided by consultants and the lack of consequences for poor performance and transgressions were again identified as root causes of poor audit outcomes. These weaknesses point to ineffective HR management in local government. The high use of consultants is a symptom of the skills problem in local government. If consultants are used effectively, they can help to close the skills gap. However, it is an interim solution that can only contribute to better local government if skills are transferred. The appointment of consultants should therefore not be prioritised over the filling of vacancies.

For the past two years, our audits included an assessment of HR management, with specific focus on the following areas: ■ HR planning and organisation ■ management of vacancies ■ appointment processes ■ performance management ■ acting positions ■ management of leave, overtime and suspensions.

We reported findings arising from the assessment of HR management in the management reports of 73% of the auditees, while at 21% of these auditees the findings were material enough to be reported in the audit report.

The following figure depicts the three weakest areas of HR management at auditees, which should be improved to positively affect audit outcomes. Sections 3.3.1 to 3.3.5 provide further details on the findings.

**Figure 19: Summary of human resource management weaknesses**



Our audits of SCM, financial misconduct and unauthorised, irregular as well as fruitless and wasteful expenditure included procedures to determine whether there were consequences for transgressions by officials as required by legislation. Section 3.3.5 details the findings arising from these audits.

### 3.3.1 Management of vacancies and acting positions

The biggest challenge for local government is to attract and retain qualified and competent persons across all areas of administration. The table below presents key findings in this regard.

**Table 27: Key findings on the management of vacancies and acting positions**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>The <b>average overall vacancy rate</b> for municipalities at year-end was 14%. The highest vacancy rate was at Thembisile Hani Local Municipality (50%) and the lowest at Nkangala District Municipality (5%).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>At four auditees (21%), the <b>overall vacancy rate has increased</b> since 2010-11.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The <b>average vacancy rate at senior management level</b> for municipalities at year-end was 27%. The highest vacancy rate was at Lekwa Local Municipality (100%) and the lowest at Nkangala District Municipality (5%).</li> </ul>
Poor	<ul style="list-style-type: none"> <li>At four auditees (21%), the <b>senior management vacancy rate has increased</b> since 2010-11.</li> </ul>
Poor	<ul style="list-style-type: none"> <li><b>Senior management positions</b> at six auditees (32%) <b>were vacant for more than 12 months</b>. However, at one (5%) of these auditees, the positions <b>were not advertised within six months of becoming vacant</b>.</li> <li>Officials are directed to act in these positions until the vacancies are filled, but at four (21%) of the auditees the <b>acting periods</b> were longer than the accepted benchmark of six months.</li> </ul>
Poor	<ul style="list-style-type: none"> <li><b>Municipal manager positions</b> were vacant at six auditees (32%). At two (11%) of these auditees, the position had been vacant for more than 12 months. At one (5%) of these auditees, the position <b>was not advertised within six months of becoming vacant</b>.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The position of <b>chief financial officer</b> was vacant at four auditees (21%). At two (11%) of these auditees, the position had been vacant for more than 12 months. All these positions <b>were advertised within six months of becoming vacant</b>.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>The position of the <b>head of the SCM unit</b> was vacant at six auditees (32%). At three (16%) of these auditees, the position had been vacant for more than 12 months. At three (16%) of these auditees, the positions <b>were not advertised within six months of becoming vacant</b>.</li> </ul>

The **reasons** for the continuing vacancies in local government are as follows:

- Attracting and retaining qualified and competent persons across all areas of administration remained a challenge.
- The poor image of local government made municipalities less attractive to skilled professionals as a potential employer.
- The remoteness and poor working conditions, especially relating to rural municipalities, were obstacles to attracting the professionals needed to turn local government around.

The **impact** of the vacancies is as follows:

- Vacancies in key positions and instability in leadership positions affect the pace of sustainable audit improvements. When people act in a position, they

Indicator	Key findings
	<p>tend not to take on the full responsibility, functions and powers of the post, with a lower commitment to the deliverables as a result of the temporary nature of the position. This also leads to ineffective performance management, which was evident at all the auditees with vacancies in key positions. This means that officials who performed poorly were not dealt with decisively.</p>
	<p>The following are <b>recommended</b> to address weaknesses in the management of vacancies and acting positions:</p> <ul style="list-style-type: none"> <li>• Clearly formulated interventions and commitments should be developed and implemented to manage vacancies in local government. The right leadership tone, together with the support of the Office of the Premier, CoGTA and the Department of Finance, will improve the filling of vacancies which – in turn – will strengthen the control environment and yield the required results.</li> <li>• Continuous training and orientation of councillors will give them the necessary technical knowledge and equip them to appoint skilled and competent staff.</li> </ul>

### 3.3.2 Competencies of key officials

The complexities in local government, the challenges experienced and the high expectations of the public demand that key personnel at municipalities have the skills, experience and capacity to fulfil their responsibilities and exercise their functions and powers. The reforms in financial and performance management have also resulted in a higher level of competency required from municipal managers, chief financial officers, senior managers, SCM officials and other financial officials than in the past.

However, poor audit outcomes, failures in service delivery, a high demand for consultants and dependence on support from national and provincial governments point to an environment where the persons appointed to these posts do not have the required competencies.

The root cause of this is two-pronged: people that do not have the required competencies are appointed in key positions, and current employees do not keep up with the changing local government environment through ongoing training and development.

However, the implementation of the municipal regulations on minimum competency levels and the amendments to the Municipal Systems Act provide an opportunity to improve the situation. The regulations define the minimum competency levels of accounting officers, chief financial officers, senior managers, SCM officials and other financial officials, taking into account the differences in size and scope of the municipalities. It provides for a phasing-in period for staff currently in those positions to obtain the minimum competency level through academic studies, experience and addressing any gaps in competencies through training and development. The phasing-in period ended on 1 January 2013 and, as per the regulations, the affected positions may not continue to be filled by persons who do not meet the minimum competency levels. This will thus influence the continued employment of these officials.

The National Treasury gave municipalities the opportunity to apply by September 2012 for an 18-month extension (until 1 July 2014) to enforce the regulations as a special merit case, based on the particular circumstances of the municipality.

The amendments to the Municipal Systems Act (effective from July 2011) declare the appointment of a municipal manager without the minimum competency levels as invalid. It also provides for a defined appointment process for municipal managers, which includes monitoring and intervention by the MEC for local government in the province.

The table below presents the key findings from the audits.

**Table 28: Key findings on the competencies of key officials**

Indicator	Key findings
Good	<ul style="list-style-type: none"> <li>By 30 June 2012 (six months from the effective date of the regulations), all of the appointed <b>municipal managers</b> in the province had <b>met the minimum competency levels</b> defined in the regulations.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Four (21%) of the <b>chief financial officers</b> appointed in the province by 30 June 2012 <b>did not yet meet the minimum competency levels</b> defined in the regulations. Four (21%) of these chief financial officers did not have the required <b>qualification</b>. Two (11%) did not meet any of the prescribed <b>competency requirements</b>, and two (21%) only met some of the requirements.</li> </ul>
Concern	<ul style="list-style-type: none"> <li>By 30 June 2012, two (11%) of the <b>heads of SCM units</b> appointed in the province <b>did not yet meet the minimum competency levels</b> defined in the regulations. Two (11%) of them did not have the required <b>qualification</b>. One (5%) did not meet any of the prescribed <b>competency requirements</b>, and one (5%) only met some of the requirements.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>By 11 January 2013, 52% of the municipalities had applied to be considered as <b>special merit cases</b>.</li> </ul>

The **reasons** for the inadequate competencies of key officials and the poor progress towards obtaining the minimum competency levels are as follows:

- There was a lack of dedicated resources for financial and service delivery reporting, while the implementation of the legislation on minimum competency levels and the recent amendments to the Municipal Systems Act did not receive the required intervention and attention.
- There was a lack of coordination and commitment from all the political structures and government to ensure the success of these legislative reforms.

The **impact** of the inadequate competencies is as follows:

- The overall regression in the audit outcomes, failures in service delivery, high demand for consultants and continuous support from provincial government point to an environment where the persons appointed in positions do not have the required competencies.
- Municipalities have not used the phased-in strategy allowed by the municipal regulations on minimum competency levels and the Municipal Systems Act to strengthen the competencies of their key officials.
- The lack of competencies and skills of persons in key positions affects the pace of sustainable audit improvements.

The following are **recommended** to address the weaknesses:

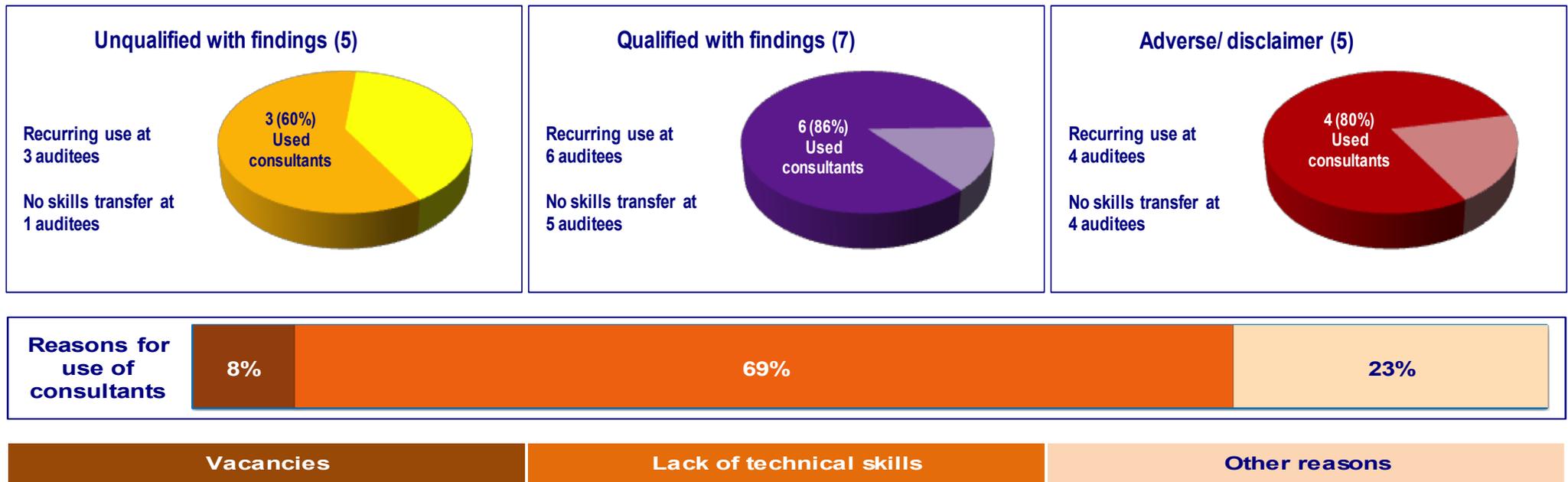
- Clearly formulated interventions and commitments should be developed** and implemented to strengthen the competencies of key personnel in local government.
- The right leadership tone, together with the support of the Office of the Premier, CoGTA and the Department of Finance, will address the lack of competencies of personnel and – in turn – strengthen the control environment and yield the required results.

### 3.3.3 Financial reporting assistance provided by consultants

As in previous financial years, auditees continued to use consultants to assist them with accounting-related services and the preparation of year-end financial statements. Thirteen auditees (69%) were assisted by consultants, compared to 15 (79%) in 2010-11. Based on the available information, the cost of consultants to auditees is estimated as having exceeded R45,1 million (2010-11: R22,9 million) for the 2011-12 financial year, which is an average in excess of R3,7 million per auditee. This excludes amounts spent by the treasuries and CoGTA on consultants assigned to assist municipalities.

The following figure depicts the most common reasons why consultants were used and the extent of use by auditees categorised per audit outcome, with an indication of whether consultant were also used previously and whether skills were transferred. Not all improvements in audit outcomes (or a lack of improvement) can be directly attributed to the use of consultants, as the contracted scope of work varies from one auditee to the next. None of the auditees that received clean audit outcomes had engaged consultants to provide financial reporting assistance.

Figure 20: The use of consultants



As can be seen above, a lack of technical skills was identified at 69% of the municipalities as a significant factor contributing to the appointment of consultants. Vacancies existed in the finance sections of only eight of the auditees that enlisted the assistance of consultants. This indicates that although staffing is seemingly adequate in terms of the filling of vacant posts, finance staff are not adequately skilled and do not have enough experience to perform the duties for which they have been appointed, especially in relation to the compilation of financial statements that comply with the Standards of Generally Recognised Accounting Practice.

The reported extent of skills transfer from consultants to municipal staff was noted as a concern at 10 (77%) of the municipalities that had engaged consultants. Consultants were appointed at nine auditees (47%) where vacancies existed, indicating that the appointment of consultants was prioritised over the filling of vacancies. The consultants were unable to ensure that any of these auditees progressed towards financially unqualified audit opinions. The impact of assistance provided by consultants, given the relatively small reduction in the material misstatements in the financial statements submitted for audit purposes, the low rate of skills transfer and the lack of management involvement and monitoring, raises further concerns regarding the sustainability of improved audit outcomes.

We are also concerned about the ability of auditees to obtain financially unqualified audit opinions in the future if they are not assisted by consultants. Auditees should have a strategy to ensure that skills are transferred to municipal staff. Contracts with consultants should include specific clauses on the transfer of skills and should not be limited to assistance in correcting financial statements. Management should be more actively involved during the financial reporting process and should monitor the transfer of skills from consultants to staff.

### 3.3.4 Performance management

The inadequate performance management of municipal managers, senior management and other officials was identified in 2010-11 to be at the root of many of the failures of local government. The controls and performance objectives of the municipalities did not filter through to the performance contracts of municipal officials in order to direct their daily operations.

In 2011-12, we further identified a lack of discipline, an absence of commitment to serve the public interest and non-adherence to the code of conduct for municipal officials as root causes by national, provincial and oversight role players, which were echoed in the experiences of the public at some municipalities. In order to improve the performance and productivity of municipal officials, the leadership should set the tone by implementing sound performance management processes, evaluating and monitoring performance, and consistently demonstrating that poor performance has consequences.

The table below presents key findings arising from an assessment of performance management processes.

**Table 29: Key findings on performance management**

Indicator	Key findings
Poor	<ul style="list-style-type: none"> <li>One (5%) of the <b>municipal managers</b> appointed in the province <b>did not have a signed performance agreement</b> for 2011-12.</li> <li>Of those with performance agreements, three (16%) had not been signed by the mayor, while three (16%) did not meet the requirements of the Municipal Systems Act.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>At two auditees (11%), 20% or more of the <b>senior managers did not have signed performance agreements</b> for 2011-12.</li> </ul>

Indicator	Key findings
	<ul style="list-style-type: none"> <li>The performance agreements of senior managers had not all been signed by the municipal manager at two auditees (11%), while at two auditees (11%) not all performance agreements met the requirements of the Municipal Systems Act.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>Appropriate <b>performance management systems had not been established</b> at six auditees (32%) to monitor, measure and evaluate the performance of officials other than the municipal manager and senior management.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>At eight auditees (42%), no <b>performance evaluation</b> was performed for <b>municipal managers</b>.</li> <li>A <b>performance bonus</b> was paid to five municipal managers (26%) in 2011-12 without a performance evaluation having been performed and approved by the council.</li> </ul>
Poor	<ul style="list-style-type: none"> <li><b>Performance evaluations</b> were not performed for all <b>senior managers</b> at six auditees (31%).</li> <li>At five auditees (26%), <b>performance bonuses</b> were paid to senior managers in 2011-12 without a performance evaluation having been performed and approved by the council.</li> </ul>

The **reasons** for the weaknesses in the performance management systems are as follows:

- The controls and performance objectives of the municipalities did not filter through to the performance contracts of municipal officials in order to direct their daily operations.
- There was a lack of discipline, an absence of commitment to serve the public interest, and non-adherence to the code of conduct for municipal officials.

The **impact** of poor performance management is as follows:

- When officials are not held accountable for their actions, a perception could be created that these actions are acceptable and tolerated. This could make even those officials who are giving their best under trying circumstances feel hopeless.
- The inadequate performance management of accounting officers and employees and a lack of consequences for poor performance are at the root of many of the failures of local government, and were identified at most of the municipalities.

The following is **recommended** to address the weaknesses:

- In order to improve the performance and productivity of municipal officials, the leadership should set the tone by implementing sound performance management processes, evaluating and monitoring performance, and consistently demonstrating that poor performance has consequences.

### **3.3.5 Consequences for transgressions**

In terms of the MFMA, financial misconduct is committed by a municipal manager, senior manager or other official if he or she deliberately or negligently:

- fails to comply with a duty imposed by a provision of the MFMA or fails to perform a delegated duty
- incurs or permits, or instructs another official of the municipality to incur, an unauthorised, irregular or fruitless and wasteful expenditure

- provides incorrect or misleading information in any document which, in terms of a requirement of the MFMA, must be submitted to the mayor or the council of the municipality, the auditor-general, the National Treasury or other organ of state, or must be made public
- contravenes a provision of the MFMA (municipal manager only).

The MFMA and the disciplinary regulations for senior managers prescribe how such financial misconduct should be dealt with through an investigative and disciplinary process, with sanctions if found guilty and criminal proceedings if applicable.

The SCM regulations further provide the steps to be taken if improper conduct is identified in SCM processes, while the MFMA prescribes the steps to be taken to investigate and deal with unauthorised, irregular or fruitless and wasteful expenditure.

The findings in this report relating to a failure to meet legislated obligations and responsibilities, instances of non-compliance with legislation, indicators of improper conduct in SCM as well as the occurrence of unauthorised, irregular or fruitless and wasteful expenditure, require an appropriate response in accordance with the mentioned legislation. Such a response should clearly demonstrate that there are consequences for transgressions by officials in local government.

The table below presents key findings arising from the audits of the steps taken to address transgressions.

**Table 30: Key findings on consequences for transgressions**

Indicator	Key findings
Concerned	<ul style="list-style-type: none"> <li>• Eight auditees (42%) recorded <b>allegations of financial misconduct</b>. Financial misconduct allegations were not investigated at two municipalities (11%). These allegations of misconduct related to possible fraud reported in the previous year.</li> </ul>
Poor	<ul style="list-style-type: none"> <li>• Seven auditees (37%) did not take the necessary steps to recover <b>unauthorised, irregular or fruitless and wasteful expenditure</b>, or did not approve or certify such expenditure as irrecoverable. These auditees are Bushbuckridge, Dipaliseng, Lekwa, Mbombela, Nkomazi, Pixley Ka Seme and Umjindi Local Municipalities.</li> </ul>

The **reasons** for the lack of consequences for transgressions by local government officials are as follows:

- Lapses in effective oversight.
- The council not taking timeous action in instances of identified non-compliance with laws and regulations, or failure by management and staff to perform statutory duties.
- Failure to exert a positive influence on the control environment.

The **impact** of the lack of consequences is as follows:

- Deliberate disregard for laws and regulations.
- Management failing to demonstrate any commitment to ensure compliance with the relevant laws and regulations.

Indicator	Key findings
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The following are **recommended** to address the weaknesses:

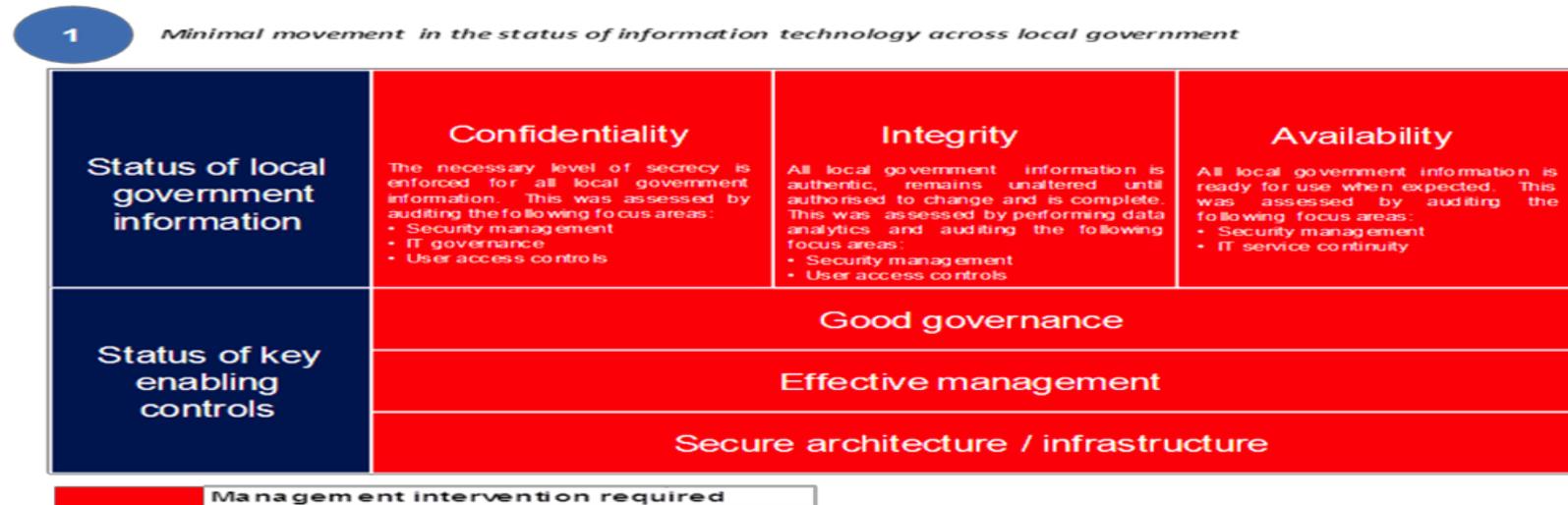
- The leadership should monitor compliance with laws and regulations. Such monitoring should take place at more frequent intervals, such as on a monthly basis, by designated staff members to detect, or preferably prevent, non-compliance.
- The leadership and management should confirm that legislative requirements and policies have been complied with before initiating transactions.
- More investigations into misconduct should be performed and disciplinary processes implemented where necessary.

### 3.4 Information technology management

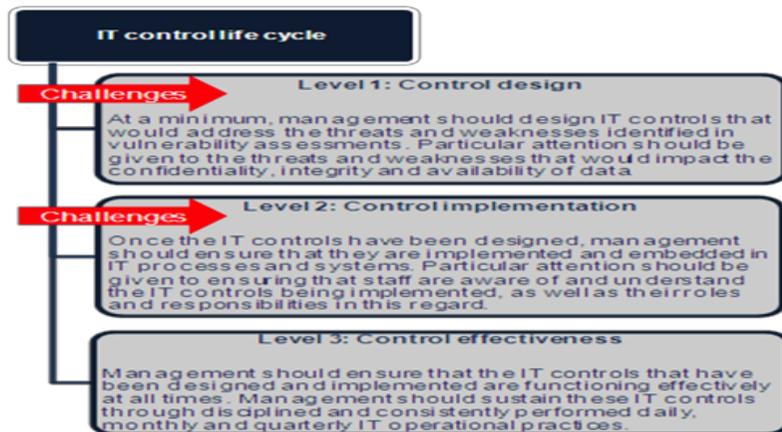
#### 3.4.1 Information technology management as a key driver of audit outcomes

As can be seen in figure 21 below, there has been minimal movement in the status of IT controls at auditees in the province.

Figure 21: Status of information technology across local government



**2 The majority of auditees have challenges with the design of controls and have not even begun to deal with implementation and sustained effectiveness**



**3 Drivers of IT control weaknesses – many cannot be addressed from within IT**



**3.4.2 Summary of the overall audit outcomes**

We assessed IT controls in four key focus areas at three district municipalities and 15 local municipalities in the province. The focus areas were IT governance, security management, user access management, and IT service continuity. We conducted detailed general control audits at the high-capacity municipalities (Nkangala and Ehlanzeni District Municipalities as well as Steve Tshwete, Govan Mbeki and Mbombela Local Municipalities), while we

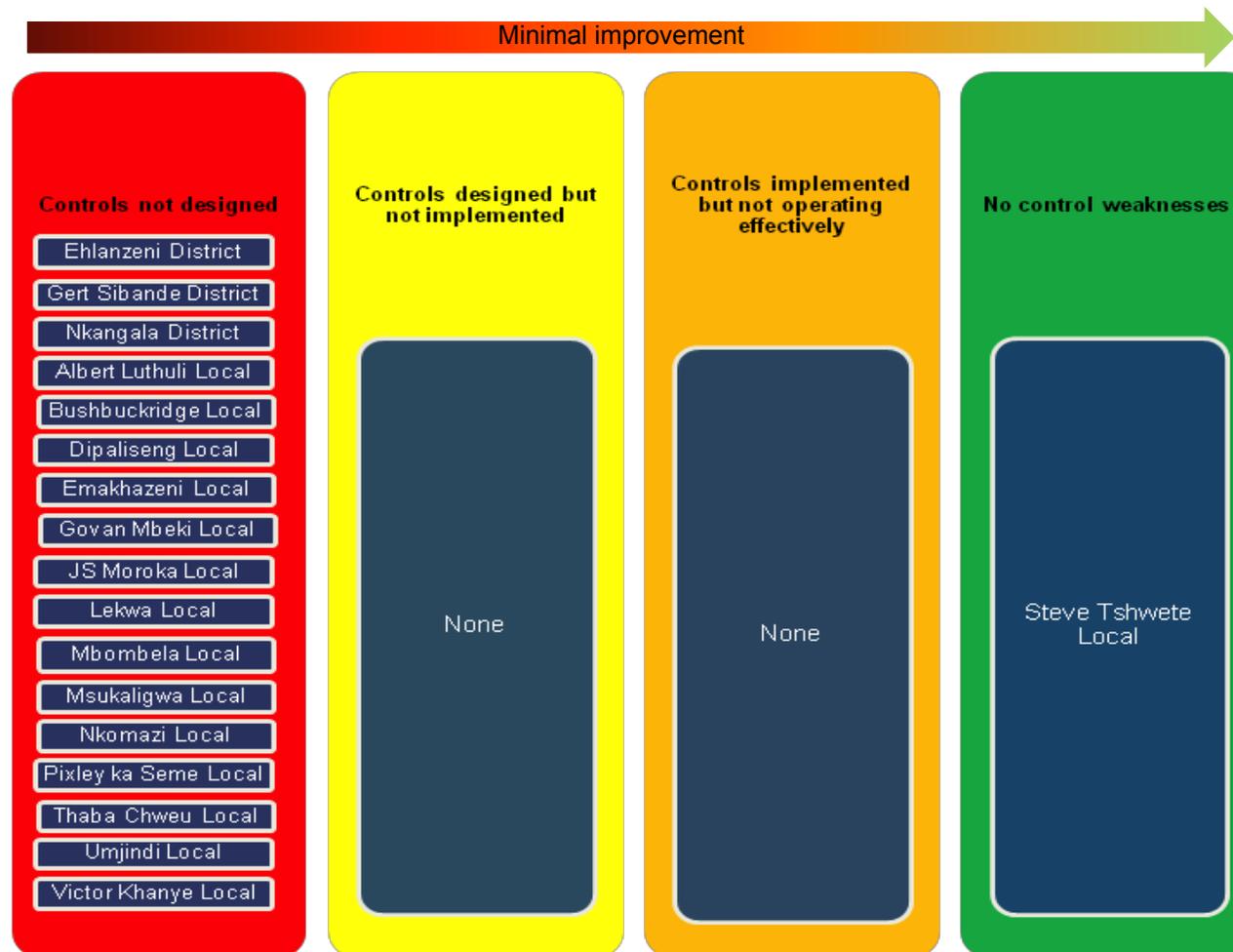
assessed internal controls by means of questionnaires at the medium- and low-capacity municipalities. This process was followed to determine the readiness of the municipalities for a detailed IT audit.

An analysis of the audit outcomes indicates that most municipalities experienced challenges with the design of IT controls. Adequate progress had not been made in addressing previous findings, as risks remained in all of the focus areas, even though some corrective measures had been instituted. The lack of adequate progress could be attributed to inadequate oversight by those charged with governance, a lack of consequences for not resolving audit findings, and a lack of consistent monitoring by internal audit units and audit committees of the progress made in implementing management commitments.

### ***3.4.3 Information technology governance***

IT governance is the responsibility of executive and IT management. It is an integral part of organisational governance, and consists of the leadership, organisational structures and processes ensuring that the auditee's IT resources sustain its strategies and objectives. IT governance allows the auditee to manage IT risks and derive value from IT investments, and supports the achievement of business objectives dependent on IT systems. We evaluated the controls at the municipalities in terms of their status in relation to the IT control life cycle, namely design, implementation, and operating effectiveness. Figure 22 depicts the outcomes in this regard.

**Figure 22: Information technology governance audit outcomes**



At Nkangala District Municipality, the developed IT governance framework was only approved after year-end. It also lacked key aspects, such as roles and responsibilities, risk management and baseline standards. At Ehlanzeni District Municipality as well as Govan Mbeki and Mbombela Local Municipalities, IT governance frameworks had not yet been developed and approved. IT risk assessments were also not conducted and IT risk registers had not been established to ensure that IT risks would be managed appropriately. Moreover, IT strategic plans had not been developed to ensure that the objectives of the IT sections would be aligned to the municipalities' business objectives. It was therefore impossible to confirm that IT risks were appropriately managed, that value was derived from IT investments, or that the IT function supported the achievement of business objectives at these municipalities.

At most municipalities, service level agreements with service providers for outsourced services did not exist or had not been formally signed off. Adherence to service level agreements was therefore also not effectively monitored. The responsibility for IT security had also not been formally assigned to specific

persons. Information assets might therefore not be adequately protected, as the responsibility for the design and implementation of information security measures was not clearly defined.

#### **Root causes**

- At many municipalities, reliance was placed on IT service providers but municipal staff did not consistently monitor their performance, as vendors were not proactively managed and their work was not adequately checked.
- There was a lack of appropriately skilled staff at municipalities to design and implement IT governance controls, which was made worse by vacant posts not being filled.

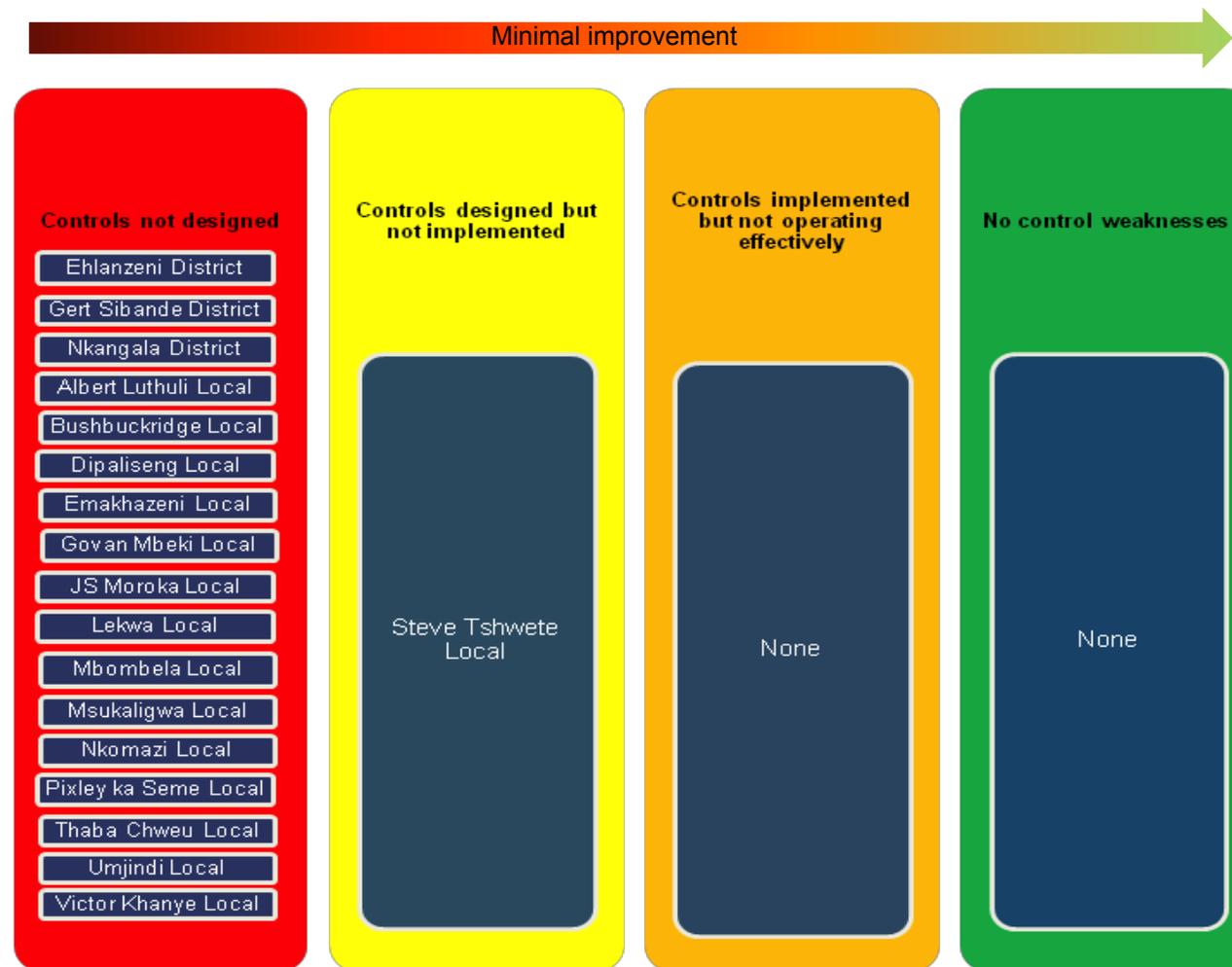
#### **Good practices**

- At Steve Tshwete Local Municipality, adequate IT governance processes had been designed and implemented, and these processes were operating effectively. The effective operation of IT governance processes at this municipality can be attributed to the leadership demonstrated by municipal management in ensuring that an IT governance framework was adopted and implemented, service level agreements were in place, IT risks were managed, and an IT steering committee was established.

#### **3.4.4 Security management**

Security controls are measures designed by management to prevent and detect the risk of unauthorised access to the IT infrastructure supporting the financial and performance application systems. This responsibility normally resides with the IT section. We evaluated the controls at the municipalities in terms of their status in relation to the IT control life cycle, namely design, implementation, and operating effectiveness. Figure 23 depicts the outcomes in this regard.

Figure 23: Security management audit outcomes



At Steve Tshwete Local Municipality, the approved policies had not been adequately implemented, as the password parameter settings on the systems were not in line with the IT security policies, due to infrastructure changes that had to be effected to accommodate certain settings.

At Nkangala District Municipality, an IT security policy had been developed and approved, but it did not define aspects such as the responsibility for IT security, actions to be taken in the event of a security incident, and monitoring activities.

At most municipalities, information security policies had not been formally approved and in some instances key controls had been omitted. Security parameter settings for passwords were also not always appropriately set on the municipalities' systems.

IT security policies that are inadequate or do not exist at all could lead to external parties gaining unauthorised access to financial information without detection, which could compromise the confidentiality, integrity and availability of data.

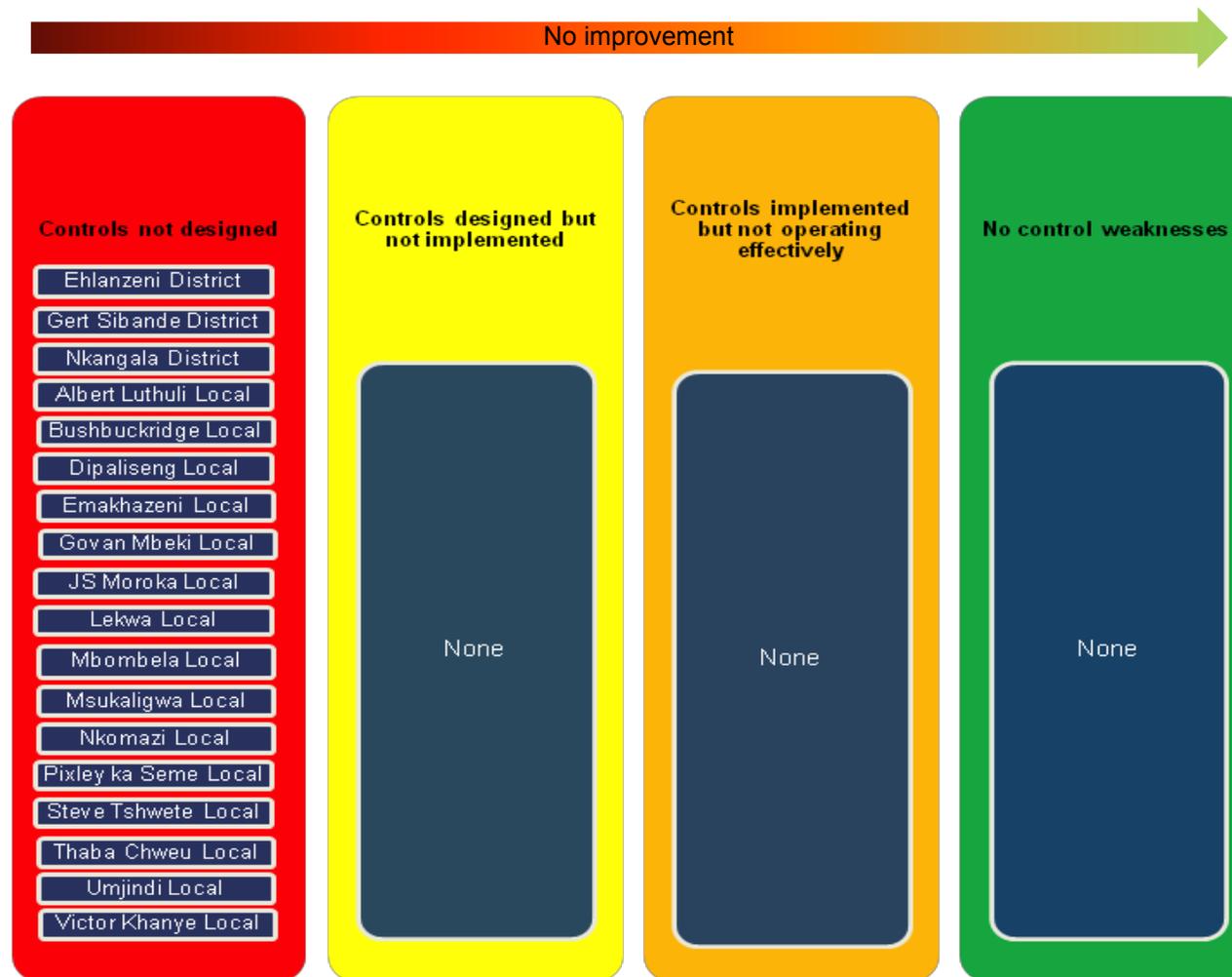
#### **Root causes**

- There was a lack of appropriately skilled staff to design and implement IT security controls, such as IT security policies and procedures, which was made worse by vacant posts not being filled.

#### **3.4.5 User access management**

User access controls are measures designed by management to prevent and detect the risk of unauthorised access as well as the creation of, or amendment to, financial and performance information stored in the application systems. We evaluated the controls at the municipalities in terms of their status in relation to the IT control life cycle, namely design, implementation, and operating effectiveness. Figure 24 depicts the outcomes in this regard..

Figure 24: User access audit outcomes



At Nkangala and Ehlanzeni District Municipalities and Steve Tshwete Local Municipality, user account management policies and procedures had been developed and approved, but lacked aspects such as the monitoring and review of access and logon violations, users' access rights, and the activities of system controllers.

At most other municipalities, formal user account management policies and standards had not been adequately designed. As a result, users were created on systems or their access rights were amended without adequate supporting documentation. The lack of formal user account management policies and standards also resulted in the appropriateness of users' access rights not being periodically monitored and reviewed to ensure that such rights were still in line

with the users' actual job responsibilities. System controllers' user access maintenance activities were, moreover, not monitored and reviewed to ensure that they were supported by valid and authorised access request documentation.

The lack of adequate and formally approved and implemented user account management policies and procedures could lead to unauthorised access and the creation of, and amendments to, financial and performance transactions. Financial information might therefore be at risk of being compromised by fraudulent activities.

#### **Root causes**

- There was a lack of adequately skilled staff to design and implement user access management controls, specifically regarding the monitoring and review of users' access rights and system controllers' activities, which was made worse by vacant posts not being filled.

#### ***3.4.6 Information technology service continuity***

IT service continuity controls are measures designed by management to ensure the availability of financial and performance information in the event of data loss or a disaster. This responsibility is normally shared between the IT section and the business. We evaluated the controls at the municipalities in terms of their status in relation to the IT control life cycle, namely design, implementation, and operating effectiveness. Figure 25 depicts the outcomes in this regard.

Figure 25: Information technology service continuity



At the high-capacity municipalities, business continuity plans had not been developed to ensure that all critical business processes supported by IT systems would be identified and included in a disaster recovery plan, which could be used to recover IT systems to a normal operating state in the event of a disaster.

At most municipalities, there was a lack of adequately designed and formally approved backup procedures, while backups were not monitored and reviewed, periodically tested by means of restores, or kept at secure off-site storage facilities.

These weaknesses could lead to municipalities not being able to restore their financial and performance data when a disaster occurs, for instance in the event of a natural disaster or civil unrest.

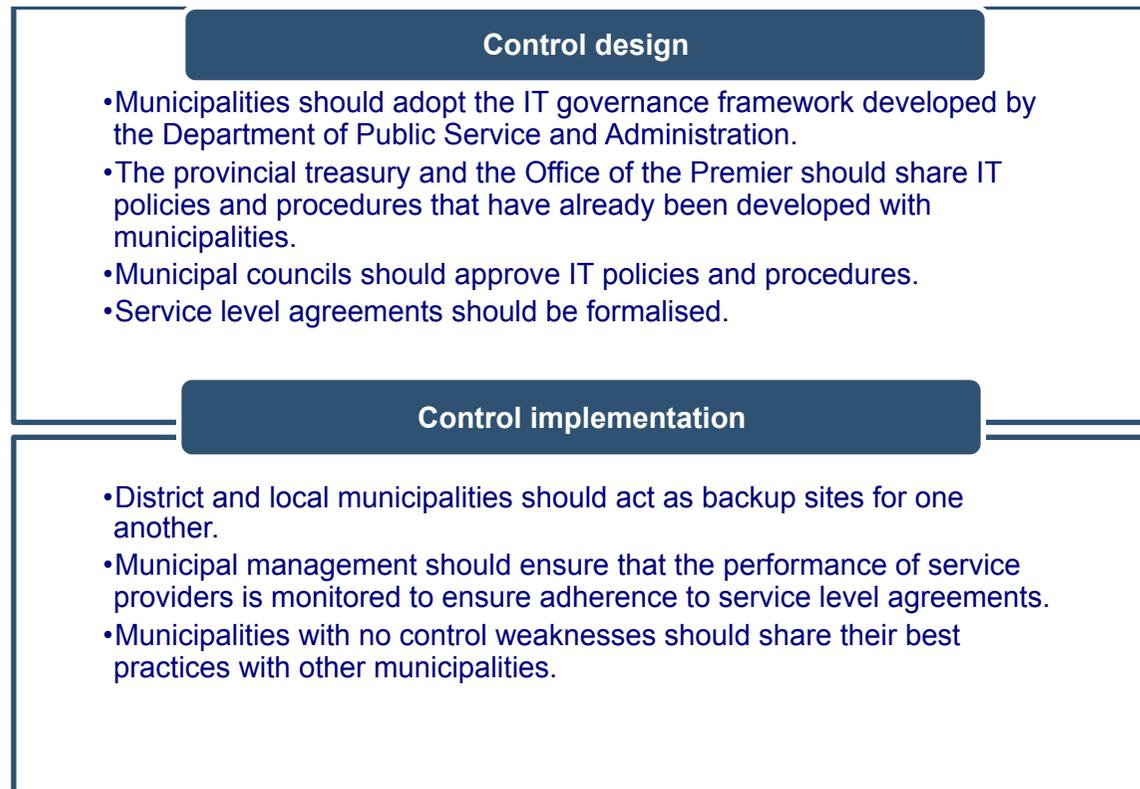
## Root causes

- There was a lack of appropriately skilled staff to design and implement disaster recovery plans, which was made worse by vacant posts not being filled.

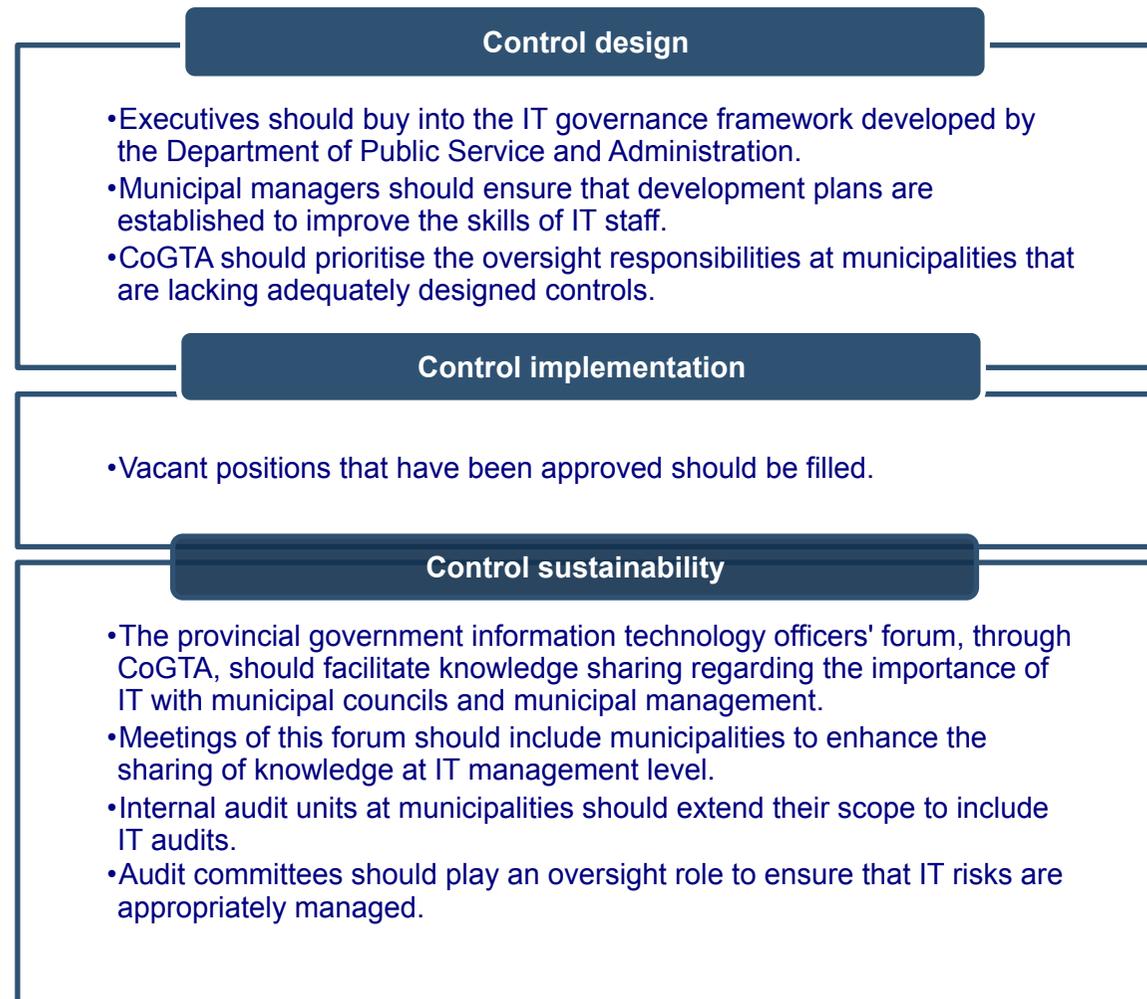
### 3.4.7 Quick wins and recommendations

Figure 26 highlights the areas where quick wins can be achieved, while figure 27 lists some recommendations that can be implemented over time.

**Figure 26: Quick wins – controls to be designed and implemented immediately**



**Figure 27: Recommendations – controls to be designed, implemented and sustained over time**

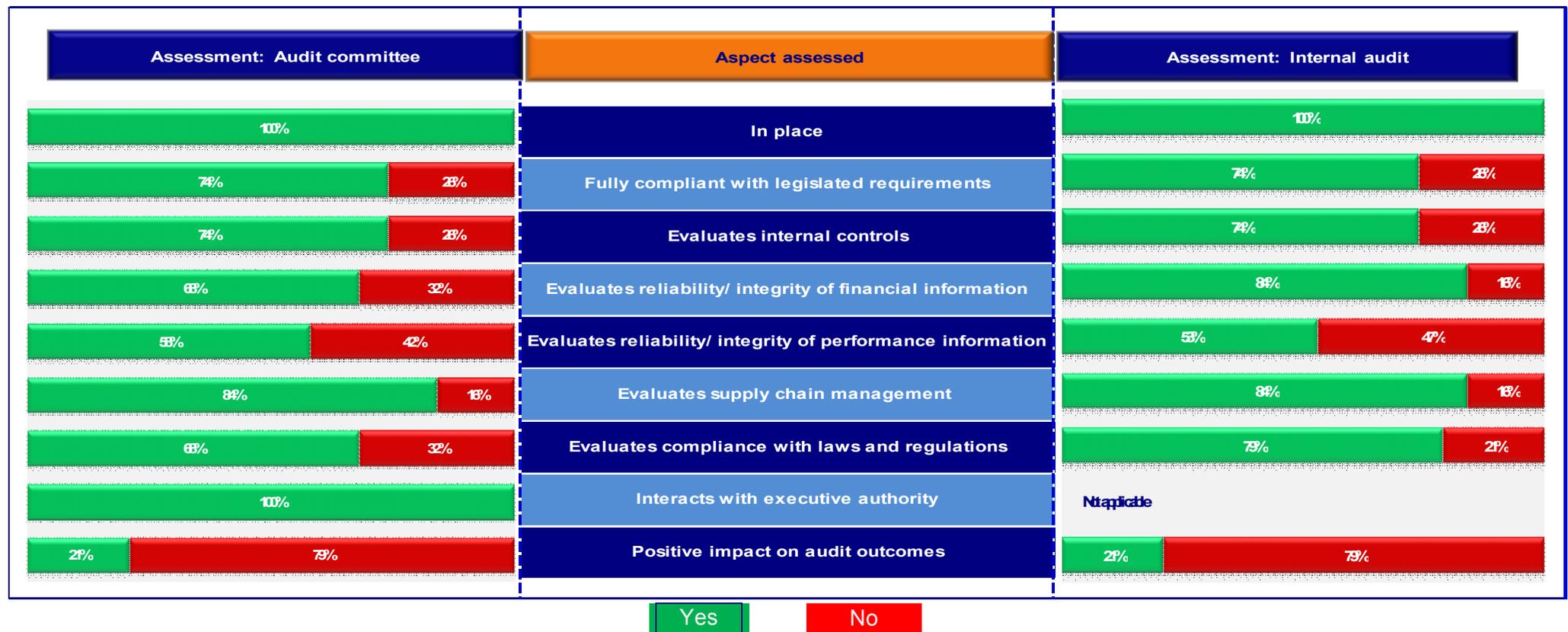


### 3.5 Audit committees and internal audit units

Effective governance is a key driver of internal control, which – in turn – has an impact on audit outcomes. Risk management and effective audit committees and internal audit functions are key elements of this driver of internal control. In terms of the MFMA, all auditees must establish an audit committee and internal audit unit. Audit committees serve as independent governance structures whose function it is to play an oversight role regarding the systems of internal control, compliance with legislation, risk management and all other matters of governance. In executing its duties, the audit committee assists the accounting officer in the effective execution of his or her responsibilities, with the ultimate aim of ensuring that the auditee achieves its objectives. Internal audit units form an integral part in providing assurance on governance, risk management and internal control.

The figure below reflects the results of our assessment of the effectiveness of audit committees and internal audit units.

**Figure 28: Assessed effectiveness of audit committees and internal audit units**



The table below provides information on the key findings arising from the assessment.

**Table 31: Assessment of the effectiveness of audit committees and internal audit units**

Governance structure aspect	Key findings and recommendations
Audit committees and internal audit units in place	<ul style="list-style-type: none"> <li>As required by the MFMA, all the auditees had established audit committees and internal audit units. These governance structures were not in place for the entire financial year at one auditee.</li> </ul>
Audit committees and internal audit units fully compliant with legislation	<ul style="list-style-type: none"> <li>Audit committees and internal audit units that are compliant with legislation is an important component of effective governance, risk management and internal control at the municipalities where they are appointed. The following findings on audit committees relate to non-compliance with the MFMA: <ul style="list-style-type: none"> <li>No review of performance management systems.</li> <li>No review of the effectiveness of internal control systems.</li> <li>No review of the effectiveness of the internal audit function.</li> <li>No review of the adequacy, reliability and accuracy of financial reporting and information.</li> <li>Not correctly constituted.</li> <li>No review of the risk areas of the auditee's operations to be covered in the scope of internal and external audits.</li> </ul> </li> <li>A significant number of internal audits units (26%) did not comply with all the requirements of the MFMA. These non-compliance findings included the following: <ul style="list-style-type: none"> <li>No, or inadequate, evaluation, advice or reporting on internal controls, accounting, risk and loss control.</li> <li>No reporting to the audit committee on compliance with legislation.</li> <li>Performance measurements not audited on a continuous basis.</li> <li>Quarterly reports, detailing performance against the annual internal audit plan, not submitted to the audit committee.</li> <li>No three-year strategic internal audit plan.</li> </ul> </li> </ul>
Audit committees and internal audit units evaluate internal control	<ul style="list-style-type: none"> <li>As depicted in figure 28, not all audit committees evaluated internal controls.</li> <li>The general regression in the implementation of the drivers of internal control serves as a signal to audit committees and internal audit units that they should broaden their scope of independent reviews to include all aspects of financial and performance management. They should also discharge their responsibilities in line with the recommendations of King III to ensure that an improved control environment is established and sustained.</li> <li>Audit committees and internal audit units should implement an effective and consistent method of following up actions taken to address audit findings relating to internal control weaknesses.</li> </ul>

Governance structure aspect	Key findings and recommendations
	<ul style="list-style-type: none"> <li>Assurances given by internal audit units on the adequacy of auditees' systems of internal control should be supported by assessments undertaken in accordance with the International Standards on Internal Auditing.</li> </ul>
Audit committees and internal audit units evaluate the reliability of performance information	<ul style="list-style-type: none"> <li>The lack of attention given by audit committees and internal audit units to auditees' performance information is a contributor to the lack of progress made by auditees during the year under review in addressing prior year PDO findings. The material misstatements in, and material adjustments to, the performance information submitted for auditing indicate that audit committees and internal audit units should conduct a more robust assessment of the controls relied on by management to produce reliable performance information.</li> </ul>
Audit committees and internal audit units evaluate SCM and compliance with laws and regulations	<ul style="list-style-type: none"> <li><b>An encouraging number of audit committees and internal audit units paid attention to SCM risks and other risks of non-compliance (including unauthorised, irregular as well as fruitless and wasteful expenditure). However, the general increase in external audit findings on non-compliance indicates the need for more focused attention on implementing audit recommendations.</b></li> </ul>
Audit committees interact with executive authority	<ul style="list-style-type: none"> <li>All the audit committees had regular interactions with their executive authorities. <b>However, the general increase in external audit findings on PDOs and non-compliance indicates the need for more focused attention on implementing audit recommendations</b></li> <li>Frequent, candid interactions between audit committees and their executive authorities provide a basis for progress towards clean audit outcomes, especially as executive authorities are in a position to objectively assess the merits of audit committee recommendations and have the authority and power to address obstacles that audit committees may encounter in executing their mandate to promote sound governance, risk management and control.</li> </ul>
Audit committees and internal audit units have a positive impact on audit outcomes	<ul style="list-style-type: none"> <li>Audit committees that focus on all three audit aspects, namely financial reporting, reporting against PDOs, and compliance with laws and regulations, have a positive impact on audit outcomes, especially at auditees whose management seriously considers their recommendations for the improvement of risk management, governance and internal control.</li> <li>We recognise that the impact may not immediately translate into auditees' progression to clean audits or even improvement from qualified to financially unqualified financial statements. However, we have assessed that audit committees and internal audit units had an impact on audit outcomes at those auditees whose financial statement qualification findings had been reduced or who had fewer findings on PDOs and non-compliance, compared to the previous financial year.</li> <li>Further steps that should be taken by audit committees and internal audit units to improve audit outcomes include the following:</li> </ul>

Governance structure aspect	Key findings and recommendations
	<ul style="list-style-type: none"> <li>▪ Perform an adequate risk assessment to ensure that the audit plan covers the most significant areas.</li> <li>▪ Arrange a joint planning session with external audit to improve cooperation and coordination throughout the audit process.</li> <li>▪ Ensure that management has implemented measures to address the internal and external audit findings.</li> <li>▪ Perform regular reviews of key internal controls, especially those related to daily financial and performance management, and ensure compliance with laws and regulations.</li> <li>▪ Review monthly and quarterly financial and performance reports during the financial year and, in particular, those submitted for auditing at year-end.</li> <li>▪ Ensure that internal audits are conducted in compliance with the International Standards on Internal Auditing.</li> <li>▪ Ensure that the internal audit plan is completed.</li> <li>▪ Ensure that all actions take into account independence and objectivity to achieve sustainable, improved audit outcomes.</li> <li>▪ Escalate the lack of management cooperation to executive mayors and councillors.</li> </ul>

## SECTION 4: INITIATIVES AND IMPACT OF KEY ROLE PLAYERS ON AUDIT OUTCOMES

This section of the report provides an overview of the impact of the key role players in local government on the audit outcomes. Section 4.1 includes an assessment of these assurance providers. Section 4.2 looks at the levels of oversight by MPACs, while section 4.3 focuses on the interactions with mayors. Section 4.4 discusses the commitments made by key role players, the status thereof and the impact on audit outcomes. Lastly, section 4.5 outlines our ongoing initiatives to encourage clean administration.

### 4.1 Assurance providers in local government

The processes and enforcement of accountability for the actions, performance, financial management and compliance with legislation of all involved in local government serve as a cornerstone of democratic governance in South Africa. The annual reports serve as a mechanism whereby the mayors and their municipal managers report on the financial position of the auditee, its performance against PDOs, and overall governance. One of the most important oversight functions of councils is considering auditees' annual reports. For the council to perform its oversight function, assurance is needed that the information in the annual report is credible. To this end, the annual report also includes our audit report, which provides assurance on the credibility of the financial statements, annual performance report and the auditee's compliance with laws and regulations.

In addition to the AGSA, other role players in local government also contribute to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented at auditees.

The role players discussed in this section are (1) those directly involved with the management of the auditee (management/leadership assurance); (2) those that perform an oversight/governance function, either as an internal governance function or an external monitoring function (internal independent assurance and oversight); and (3) the independent assurance providers that provide an objective assessment of the auditee's reporting (external independent assurance and oversight).

We assessed the level of assurance provided by the role players based on the status of internal controls of auditees and the impact of the different role players on the controls. In the current environment, characterised by inadequate internal controls, material misstatements in financial and performance information and widespread non-compliance with legislation, all role players are expected to provide an extensive level of assurance.

Figure 29 depicts the outcome of the assessment of these role players in the province.

Figure 29: Level of assurance provided by role players

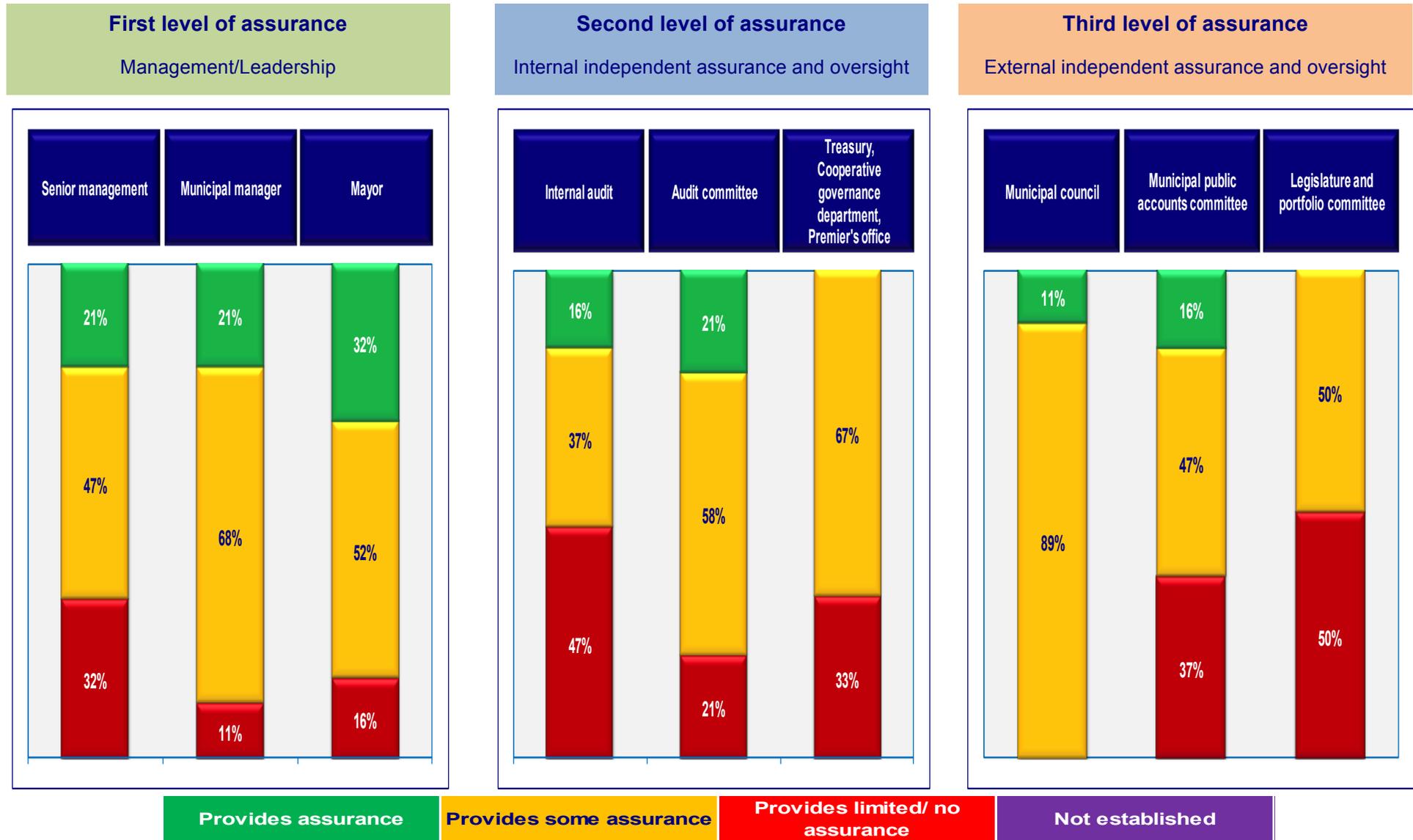


Table 32 reflects the assessment per auditee and provincial role player, while table 33 further details the level of assurance provided.

**Table 32: Level of assurance provided by role players that form part of the auditee**

Auditee	Senior management	Accounting officer or authority	Mayor	Audit committee	Internal audit unit	Municipal council	MPAC
<b><i>Ehlanzeni District Municipality and local municipalities in the district</i></b>							
Bushbuckridge Local Municipality							
Ehlanzeni District Municipality							
Mbombela Local Municipality							
Nkomazi Local Municipality							
Thaba Chweu Local Municipality							
Umjindi Local Municipality							
<b><i>Gert Sibande District Municipality and local municipalities in the district</i></b>							
Albert Luthuli Local Municipality							
Dipaliseng Local Municipality							
Gert Sibande District Municipality							
Govan Mbeki Local Municipality							
Lekwa Local Municipality							
Msukaligwa Local Municipality							
Pixley Ka Seme Local Municipality							
<b><i>Nkangala District Municipality and local municipalities in the district</i></b>							
Dr JS Moroka Local Municipality							
Emakhazeni Local Municipality							
Nkangala District Municipality							
Steve Tshwete Local Municipality							
Thembisile Hani Local Municipality							

Provides assurance

Provides some assurance

Provides limited/ no assurance

Not established

**Table 33: Comments on the level of assurance provided by role players that form part of the auditee**

Role player	Comment
<b>Senior management</b>	<ul style="list-style-type: none"> <li>Senior management, which includes the chief financial officer, chief information officer and head of the SCM unit, is responsible for implementing the detailed financial and performance management controls. Our assessment demonstrates that they had failed to do so adequately. This unsatisfactory level of assurance is a symptom of the vacancies and inadequate performance management at this level, as reported in section 3.3.</li> </ul>
<b>Accounting officer</b>	<ul style="list-style-type: none"> <li>We assessed the level of assurance provided by accounting officers only marginally higher than that of senior managers, and their impact on creating an effective control environment was not evident at many auditees. In general, there has been a regression in the status of the drivers of internal control for which accounting officers are responsible, as their leadership, planning, risk management, oversight and monitoring did not result in sustainable practices that translated into improved audit outcomes, as reported in table 26 dealing with the status of the internal control assessment underlying leadership.</li> </ul>
<b>Mayor</b>	<ul style="list-style-type: none"> <li>The regression in the overall audit outcomes and the stagnation of outcomes at individual auditees are a direct result of the tone set and the commitments made by mayors. Their ineffective leadership can be seen in the inadequate monitoring of the performance, quality of work and outputs of key officials as well as the late, or lack of, action in instances of poor performance, as reported in section 4.3.</li> <li>Many mayors made themselves available to meet us each quarter to discuss the status of controls, but failed to take ownership of the control assessments. This can be seen in the negative trend in key control assessments compared to the previous year, as mayors failed to exercise the level of oversight committed to in response to the previous year's audit outcomes.</li> </ul>
<b>Audit committee</b>	<ul style="list-style-type: none"> <li>We assessed audit committees as a more effective governance structure than internal audit units, based on their level of compliance with the applicable legislated requirements. Although assessed at a slightly higher level than internal audit units, they did not ensure that internal audit units functioned at the required level. This aspect must improve significantly at most auditees to fully meet the extensive level of assurance expected from them. As reported in section 3.5, neither of these governance structures had any discernible impact on the audit outcomes of more than a third of the auditees.</li> </ul>
<b>Internal audit unit</b>	<ul style="list-style-type: none"> <li>Although internal audit units were in place, they did not provide sufficient assurance in the areas they are required by legislation to audit and report on. These areas correspond to our assurance mandate. This means that their inability to function at the required level, together with the inadequate assurance provided by senior management and the accounting officers, placed undue pressure on our audit teams</li> </ul>

Role player	Comment
	and consequently on the audit fees. Refer to section 3.5 for a detailed assessment of the effectiveness of internal audit units.
<b>Municipal council</b>	<ul style="list-style-type: none"> <li>• Councils did not demonstrate a sufficient understanding of their oversight functions and did not satisfy themselves that processes had been implemented to ensure that reported information was credible and reliable.</li> <li>• Councillors did not take full ownership of the key control document and satisfied themselves that identified areas of internal control weaknesses were receiving the required level of attention. Furthermore, councils did not call for regular financial and performance reports and did not subject them to intense interrogation.</li> <li>• Councils did not periodically review the progress of municipal management in addressing external audit findings.</li> <li>• Councils did not periodically look at the findings and ask the views of audit committees and internal audit units on internal control and risk management. They also did not monitor the implementation of recommendations by the audit committee and internal audit units with a view to remedial action.</li> <li>• Councils did not take timeous action in instances of identified weaknesses or failure by management and staff to perform statutory duties.</li> <li>• Refer to table 26 dealing with the status of the internal control assessment underlying leadership for more information in this regard.</li> </ul>
<b>MPAC</b>	<ul style="list-style-type: none"> <li>• MPACs have not had the desired impact on audit outcomes and clean administration in local government due to their late establishment. They have, however, gained momentum after the 2010-11 audits. MPACs have a very long way to go before they will achieve their intended oversight effectiveness and have a positive impact on audit outcomes. The leadership and oversight structures are encouraged to support the work of these committees.</li> <li>• Refer to section 4.2 for more detail on the oversight provided by MPACs.</li> </ul>

As reflected in the audit outcomes presented in this report, the activities and interventions of role players have had a limited impact. Our assessment of 'no significant identified impact' does not imply that role players did not make any effort, but rather illustrates that the impact on the audit outcomes is not yet evident.

Provincial role players have a number of initiatives and interventions aimed at improving audit outcomes, some of which directly target the focus areas discussed in this report. These include the following:

- Establishing a premier's coordinating forum to look at ways to address auditees' financial management issues.
- Facilitating the establishment and training of MPACs.
- Facilitating training for municipal officials on SCM.
- Assisting with the training and further development of audit committees and internal audit units.
- Supporting municipalities to develop fraud prevention plans and monitoring the implementation of these plans.

At the end of the previous MFMA cycle, the key role players in the province made commitments to improve the audit outcomes of municipalities. The provincial political leadership, which included the premier, the MEC for Finance and the MEC for CoGTA, made a commitment to focus on *Operation clean audit* and to drive resources through the provincial executive committee meetings, which saw the MECs for CoGTA and Finance enhancing the quarterly MuniMEC meetings where actions, progress and feedback were discussed.

Table 34 below gives a more detailed analysis of what each provincial role player contributed to the attainment of sustainable audit outcomes.

**Table 34: Level of assurance provided by role players at the level of coordinating or monitoring institutions**

Auditee	Coordinating or monitoring institutions and provincial oversight	Comment
Provincial treasury		<ul style="list-style-type: none"> <li>• The provincial treasury undertook to establish a dedicated unit to assist identified municipalities on site with financial management requirements. The leadership undertook to meet quarterly with the AGSA to track progress on commitments and discuss pertinent issues. This unit did not have the expected impact, as representatives from the provincial treasury and CoGTA were often not available for the discussions.</li> <li>• The municipal finance division within the provincial treasury did not have much impact on the 2011-12 audit outcomes. The provincial treasury managed a number of interventions, most of which focused on budgetary control, monitoring of monthly reports, and principles of</li> </ul>

Auditee	Coordinating or monitoring institutions and provincial oversight	Comment
		<p>financial management. Due to capacity constraints within the provincial treasury, municipalities that desperately needed assistance did not get the necessary help to improve their financial management. As a result, the provincial treasury, under the guidance of the MEC for Finance, has reassessed its roles and responsibilities in terms of local government and has given commitments which, if implemented and monitored correctly, could have a positive impact on the drive towards clean administration within the local government sphere.</p>
Office of the Premier		<ul style="list-style-type: none"> <li>• The premier instituted two platforms to strengthen the drive towards improving the audit outcomes of municipalities. The first of these was the establishment of the premier's coordinating forum, which meets quarterly and is attended by the premier, CoGTA and the provincial treasury as well as all the executive mayors, municipal managers and chief financial officers in the province. This forum is aimed at addressing the financial management issues highlighted at municipalities in previous audit reports and recommending appropriate actions. The second platform established by the premier is the provincial executive committee outreach, in terms of which five municipalities (Emakhazeni, Thaba Chweu, Dr JS Moroka, Umjindi and Nkomazi Local Municipalities) were visited and assisted in addressing their financial management challenges.</li> <li>• The premier also embarked on a process with the provincial legislature that will see a change to SCM legislation relating to instances of state employees conducting private business with the state. However, this process is still underway and has not yet had an impact on the audit outcomes and reported non-compliance findings.</li> </ul>
CoGTA		<ul style="list-style-type: none"> <li>• Very late in the 2011-12 financial year, the MEC for CoGTA implemented a strategy that focused on improving audit outcomes within the province. The key element of this strategy was to capacitate CoGTA to set up multidisciplinary teams that would</li> </ul>

Auditee	Coordinating or monitoring institutions and provincial oversight	Comment
		<p>provide hands-on support in eight areas, ranging from financial management, oversight and HR to environmental issues. The mandate of these teams was to transfer skills and raise awareness of the need for creating an environment of accountability, thereby ensuring compliance with laws and regulations.</p> <ul style="list-style-type: none"> <li>• During the year, the department had limited involvement with the municipalities to assist in getting the basics right. However, the department faced a number of challenges in executing this mandate, including the following: <ul style="list-style-type: none"> <li>▪ Many municipalities either did not have the appropriate resources to enable the transfer of skills or had vacancies within critical areas. As a result, the department's teams had to perform operational work and municipalities did not enjoy the full benefit of skills being transferred. The assistance provided will therefore not have a sustainable impact on the audit outcomes.</li> <li>▪ The lack of risk management often resulted in crises at municipalities. As a result, the department was forced to second members of the task teams to the municipalities to perform managerial duties and ensure continuance in respect of service delivery.</li> <li>▪ The political and administrative leadership's will to improve audit outcomes was not evident at some municipalities and the assistance provided did therefore not bear fruit.</li> </ul> </li> </ul>
Portfolio committee on cooperative governance and traditional affairs		<ul style="list-style-type: none"> <li>• The portfolio committee on cooperative governance and traditional affairs did not have any impact on the audit outcomes of the province. With regard to progress made with the <i>Operation clean audit</i> programme run by CoGTA, we noted no direct interventions from the committee that would have had an impact on the audit outcomes</li> </ul>

Auditee	Coordinating or monitoring institutions and provincial oversight	Comment
		other than the fact that CoGTA's activities were subject to oversight.
Provincial legislature		<ul style="list-style-type: none"> <li>The speaker of the provincial legislature established a speakers' forum, which includes all the speakers from the municipalities within the province. The primary focus of this forum is to ensure better oversight at the municipalities. The speakers' forum has not yet had any visible impact; however, coupled with the new commitments from the speaker, it is envisioned that progress will be made going forward in moving to improved, sustainable audit outcomes.</li> </ul>

Provides assurance

Provides some assurance

Provides limited/ no assurance

Not established

### Conclusion on the level of assurance provided by role players

At an overall level, the key role players in local government are providing minimal assurance. Significant strides will have to be made if the required level of assurance is to be provided for credible decision-making. The foundation for setting up processes to provide assurance is made up of skills, competence, ethics, embedded systems of control and an understanding of the roles and responsibilities of all role players, together with a strictly enforced performance management system.

The assurance provided by senior management, accounting officers, internal audit units, audit committees, mayors and municipal councils is directly linked to the implementation of controls. Internal controls that are properly designed and implemented as intended will assist in ensuring compliance with laws and regulations as well as credible performance reports and financial statements. Similarly, the quality and the credibility of information supplied to coordinating role players (namely, the Office of the Premier, CoGTA and the provincial treasury) have an impact on the assurance provided by them. Currently, the quality of information is not at the required level, which influences the effectiveness of these oversight bodies. It is thus very important that all role players take ownership of the implementation and monitoring of key controls to ensure that all information produced for oversight and decision-making is accurate and reliable, thereby enhancing credibility and accountability.

## 4.2 Oversight by municipal public accounts committees

MPACs were established at municipalities in the province in 2011. When operating as intended, the MPAC will be one of the most critical role players in municipal oversight and governance and should have a positive impact on audit outcomes. In short, the primary functions of the MPAC include the following:

- Consider and evaluate the content of the annual report and make recommendations to the council when adopting an oversight report on the annual report.
- Review information relating to past recommendations made in the annual report. This relates to current in-year reports, including the quarterly, mid-year and annual reports.
- Examine the financial statements and audit reports of the municipality and municipal entities and consider improvements against previous statements and reports.
- Evaluate the extent to which the audit committee and the auditor-general's recommendations have been implemented.
- Promote good governance, transparency and accountability in the use of municipal resources.

By the end of the 2011-12 financial year, all municipalities had implemented MPACs.

As shown in section 4.1, MPACs have not yet provided the level of assurance required to contribute to the credibility and reliability of financial and performance reports, compliance with legislation and effective internal control.

The **root causes** of the ineffective functioning of MPAC are as follows:

- MPACs have not had the desired impact on audit outcomes and clean administration in local government due to their late establishment. They have, however, gained momentum after the 2011-12 audits. MPACs have a very long way to go before they will achieve their intended oversight effectiveness and have a positive impact on audit outcomes. The provincial leadership and oversight structures are encouraged to support the establishment and work of these committees.
- There was a lack of skills and coordinated effort among MPAC members.

The **recommended way forward** to strengthen the operation and functioning of MPACs is as follows:

- MPAC hearings should be prioritised to ensure that monitoring and review contribute to the reporting timelines of municipalities and that audit committees are quickly responded to.
- For the committee to be truly effective, resolutions should not only deal with purely financial management but also with PDO reporting and compliance.
- The role players within the municipality should submit quarterly reports to the MPAC on the implementation of its resolutions.
- A closer relationship with the portfolio committees is required to ensure the coordination and monitoring of resolutions.
- New MPAC members should attend a thorough induction session where all the concepts contained in the audit report are explained.
- All MPAC members should be trained on a continuous basis so that this oversight structure can ensure accountability within local government and remain relevant.

### 4.3 Interactions with mayors

In response to the 2010-11 audit outcomes, mayors committed an hour of their time every 90 days to meet with our senior management members. At these interactions, the status of the key controls and commitments are discussed, and identified risks are shared. Our leadership interacts at least once every four months with the political and administrative leadership at municipal level. These interactions are used to share insights relating to risks and controls to create a deeper understanding of the audit outcomes and messages. Interactions are also extended to provincial legislative oversight to share insights and enable improved oversight of local government. Although the engagements were well received, they had a limited impact on the audit outcomes of most of the auditees.

The table below shows the number of interactions with the mayors and the assessed impact of these interactions.

**Table 35: Interactions with mayors**

Auditee	Total number of interactions	Evaluation of impact
<i>Ehlanzeni District Municipality and local municipalities in the district</i>		
Bushbuckridge Local Municipality	3	
Ehlanzeni District Municipality	3	
Mbombela Local Municipality	3	
Nkomazi Local Municipality	3	
Thaba Chweu Local Municipality	3	
Umjindi Local Municipality	3	
<i>Gert Sibande District Municipality and local municipalities in the district</i>		
Albert Luthuli Local Municipality	2	
Dipaliseng Local Municipality	3	
Gert Sibande District Municipality	2	
Govan Mbeki Local Municipality	3	
Lekwa Local Municipality	3	
Msukaligwa Local Municipality	3	
Pixley Ka Seme Local Municipality	3	
<i>Nkangala District Municipality and local municipalities in the district</i>		
Dr JS Moroka Local Municipality	3	
Emakhazeni Local Municipality	3	
Nkangala District Municipality	3	
Steve Tshwete Local Municipality	3	
Thembisile Hani Local Municipality	3	
Victor Khanye Local Municipality	3	

Significant impact – improvement in audit outcome

Significant impact – sustained clean audit

Some impact – improvement in key controls

Minimal impact – improvement expected only in next financial year

No impact

The regression in the overall audit outcomes and the stagnation of outcomes at individual auditees are a direct result of the tone set from the top and commitments made by the municipal leadership, including the mayors.

Many mayors made themselves available to meet us to discuss the status of controls and some have taken ownership of the control assessments. The interactions with mayors have not had a positive impact on the audit outcomes, due to the following:

- Mayors failing to exercise the level of oversight committed to in response to the previous year's audit outcomes.
- The challenges faced by the municipalities are too big and the mayors become unresponsive.
- Instability and political interference.

A number of the mayors have not taken full ownership of the key control document and satisfied themselves that identified areas of internal control weaknesses were receiving the required level of attention.

#### 4.4 Initiatives and commitments of key role players to improve audit outcomes

The table that follows outlines the key initiatives of the provincial leadership and oversight to improve audit outcomes as well as further commitments on actions to be taken. The commitments include those made in response to the previous year's audit outcomes and new commitments obtained through in-year interactions and engagements between January 2013 and the date of this report. An assessment of the impact of the initiatives and commitments is also provided.

**Table 36: Initiatives and commitments of key role players in response to audit outcomes**

Key role players	Outline of initiatives and commitments	Focus area targeted by initiatives and commitments	Progress made with implementing initiatives and commitments	Impact of initiatives and commitments on audit outcomes
Office of the Premier	<b>Prior year initiatives and commitments</b>			
	Add suppliers linked to officials to the prohibited suppliers' database.	SCM	Not implemented	No impact
	Issue an instruction, prohibiting officials from entering into contracts with municipalities.	SCM	In progress	No impact
	Take steps against officials that transgressed SCM regulations.	SCM	Not implemented	No impact
	Establish the premier's coordinating forum. This forum is attended by the premier, CoGTA and the provincial treasury as well as all the executive mayors, municipal managers and chief financial officers in the province. This forum is aimed at addressing financial management issues highlighted in audit reports and recommending appropriate actions.	Quality of AFS, SCM, PDOs	In progress	No impact

Key role players	Outline of initiatives and commitments	Focus area targeted by initiatives and commitments	Progress made with implementing initiatives and commitments	Impact of initiatives and commitments on audit outcomes
	Establish the provincial executive committee outreach where specific municipalities are visited and assisted in addressing their financial management challenges.	Quality of AFS, SCM, PDOs	In progress	No impact
	<b>New initiatives and commitments</b>			
	Review the quality, implementation and monitoring of the municipalities' action plans, especially at those municipalities that continue to receive disclaimed, adverse and qualified audit opinions.	Quality of AFS, SCM, PDOs	New	Not yet able to assess
	Continuous compliance monitoring through the use of a simplified compliance checklist that covers all the critical regulatory requirements.	SCM, PDOs, HR management	New	Not yet able to assess
<b>Provincial treasury and MEC for Finance</b>	<b>Prior year initiatives and commitments</b>			
	Facilitate training sessions and workshops on Generally Recognised Accounting Practice.	Quality of AFS	Complete	Limited impact
	Develop guidance for internal audit units on how to audit interim and annual financial statements to enable them to identify and report weaknesses.	Quality of AFS	Complete	Limited impact
	Develop an internal audit manual and an audit committee checklist to assist these governance structures in performing their required responsibilities effectively.	Quality of AFS, SCM, PDOs	Complete	Limited impact
	Develop an evaluation checklist to monitor the effectiveness of internal audit units and audit committees through quarterly assessments.	Quality of AFS, SCM, PDOs	In progress	Limited impact
	Facilitate training sessions and workshops on SCM practices.	SCM	In progress	No impact
	Develop and implement an SCM compliance checklist as a control measure for the municipalities.	SCM	Complete	Limited impact
	Develop a database of policies and procedures available for the municipalities.	SCM	Complete	Limited impact
	Establish a dedicated unit to assist municipalities on site with financial management requirements.	Quality of AFS, SCM, PDOs	In progress	No impact
	<b>New initiatives and commitments</b>			

Key role players	Outline of initiatives and commitments	Focus area targeted by initiatives and commitments	Progress made with implementing initiatives and commitments	Impact of initiatives and commitments on audit outcomes
	Standardise an IT system for local government and implement adequate IT policies and procedures. Follow up on progress made in addressing IT findings in conjunction with its internal audit function.	IT management	New	Not yet able to assess
	Improve the availability of quality supporting documentation to support financial statements and management information (guidelines and monitoring).	Quality of AFS, SCM, PDOs	New	Not yet able to assess
	Perform a readiness assessment to determine what municipalities should do to manage, and assist them with the implementation of, performance management systems.	Quality of AFS, SCM, PDOs	New	Not yet able to assess
	Monitor trends in financial and performance management through the use of quarterly dashboard assessments as a proactive approach that will highlight areas that require intervention early on to prevent regressions.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess
	Attend monthly chief financial officers' forums, monitor the provincial clean audit strategy against milestones, and host monthly operation clean audit meetings.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess
CoGTA and MEC for CoGTA	<b>Prior year initiatives and commitments</b>			
	Monitor the progress of officials made available to assist with <i>Operation clean audit</i> .	Quality of AFS, SCM, PDOs, HR management	In progress	No impact
	Implement the remedial action plan developed to address shortcomings identified during the GAP analysis.	Quality of AFS	In progress	No impact
	Review the progress of the rapid response unit in assisting municipalities to address challenges relating to financial reporting.	Quality of AFS	In progress	No impact
	<b>New initiatives and commitments</b>			
Perform a readiness assessment to determine what municipalities should do to manage, and assist them with the implementation of, performance management systems.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess	

Key role players	Outline of initiatives and commitments	Focus area targeted by initiatives and commitments	Progress made with implementing initiatives and commitments	Impact of initiatives and commitments on audit outcomes
	Conduct a skills audit with regard to incumbents of key positions.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess
	Strengthen capacity to implement the operation clean audit strategy at all leadership levels, monitor the strategy against milestones, and report on the activities of operation clean audit committees each quarter.	Quality of AFS, SCM, PDO, HR management	New	Not yet able to assess
<b>Portfolio committee on cooperative governance and traditional affairs</b>	<b>Prior year initiatives and commitments</b>			
	Intensify the monitoring of support given to the municipalities.	Quality of AFS, SCM, PDOs, HR management	In progress	No impact
	Analyse and visit all municipalities with adverse, disclaimed and qualified audit opinions and monitor progress made with resolutions taken.		In progress	No impact
	<b>New initiatives and commitments</b>			
Establish a joint oversight committee to monitor the oversight role of councils. Councils will provide oversight reports on a timely basis. Oversight visits to be conducted at municipalities.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess	
<b>Speaker and provincial legislature</b>	<b>Prior year initiatives and commitments</b>			
	Represented on the municipal finance group committee that meets quarterly with the leadership of individual municipalities on matters raised in the management and audit reports.	Quality of AFS, SCM, PDOs, HR management	In progress	Limited impact
	The municipal finance group committee will assist municipalities to develop commitments that are SMART (in other words, specific, measurable, achievable, relevant, and time bound) and follow up the implementation thereof.		In progress	Limited impact
	<b>New initiatives and commitments</b>			
The speaker will convene quarterly meetings with the provincial oversight group, consisting of the chairpersons of local government-related oversight committees, to	Quality of AFS, SCM,	New	Not yet able to assess	

Key role players	Outline of initiatives and commitments	Focus area targeted by initiatives and commitments	Progress made with implementing initiatives and commitments	Impact of initiatives and commitments on audit outcomes
	monitor areas that hinder the achievement of results.	PDOs, HR management		
	Develop an induction training and continuous further development programme to empower councillors to fulfil their responsibilities.	Quality of AFS, SCM, PDOs, HR management	New	Not yet able to assess

#### 4.5 Initiatives of the AGSA to encourage clean audits

Over the past two years, we have embarked on many initiatives to enhance accountability and influence the process towards improving audit outcomes and achieving clean administration. The main initiative was to further strengthen our relationship with the political and administrative leadership to deepen their understanding of accountability, the audit process and governance mechanisms, thereby paving the way towards improving public confidence. This initiative included the increased visibility of our senior leadership and continuous interactions to highlight possible challenges, audit findings and transversal risks.

Table 37 summarises some of the key initiatives we have undertaken to promote public sector accountability and to encourage the process of improving audit outcomes and attaining clean audits.

**Table 37: Key initiatives of the AGSA**

Nature	Outline of AGSA initiatives
Interactions with the political and administrative leadership	<ul style="list-style-type: none"> <li>Our leadership interacts at least once every three months with the political and administrative leadership at municipal level. These interactions are used to share insights relating to risks and controls to create a deeper understanding of the audit outcomes and messages. Interactions are also extended to provincial legislative oversight to share insights and enable improved oversight of local government.</li> </ul>
Stakeholder interactions and audit outcome roadshows	<ul style="list-style-type: none"> <li>During January to March 2013, our provincial leaders engaged with the provincial leadership, municipalities and councils on the audit outcomes, the root causes of audit outcomes, and the recommended way forward to improve audit outcomes. This gave the leadership and oversight the opportunity to assess the root causes of the qualifications and findings.</li> </ul>

Quarterly interactions on status of key controls	<ul style="list-style-type: none"> <li>• We have sensitised auditees to the importance of implementing and maintaining key controls around financial and performance management as well as compliance with laws and regulations. We assess the key controls on a quarterly basis and share their status with the mayor, council and municipal managers as part of the quarterly interactions.</li> <li>• During the key control visits, we secure commitments on improvements and we then monitor these commitments. We have conveyed the message that the leadership should now take ownership of the key controls and monitor them on a continuous basis.</li> </ul>
Promoting an understanding of PDO requirements	<ul style="list-style-type: none"> <li>• We have had many interactions with auditees in respect of requirements relating to the reporting of performance information. We also extended the awareness sessions to oversight and the provincial leadership.</li> </ul>
Involvement in forums and meetings related to local government financial affairs	<ul style="list-style-type: none"> <li>• We regularly participate in a number of forums and committees to raise pertinent issues that may affect audit outcomes and to enable the forums to execute their oversight role. These include the following: <ul style="list-style-type: none"> <li>▪ Provincial coordinating committee overseeing the implementation of <i>Operation clean audit</i></li> <li>▪ Speakers' forums</li> <li>▪ Internal audit forums</li> </ul> </li> </ul>
Collaboration with the provincial treasury	<ul style="list-style-type: none"> <li>• We meet regularly with the provincial treasury to highlight and address any emerging transversal matters that could affect the audit outcomes.</li> </ul>
Quality of financial statements	<ul style="list-style-type: none"> <li>• During recent interactions, we identified the need for enhanced communication with the leadership on matters identified during the quarterly visits and audit process that have an impact on the quality of the financial statements. The following communication tools are used to inform the leadership in advance of matters that will have an impact on the audit opinion: <ul style="list-style-type: none"> <li>▪ Lapses letters are used to inform the leadership of instances where reliable supporting information is not available to validate classes of transactions, account balances or disclosure notes presented in the financial statements, or where no progress has been made to implement commitments.</li> <li>▪ Early warning letters are used to alert the leadership well in advance to possible material misstatements identified during the audit process and the impact thereof on the audit opinion.</li> </ul> </li> <li>• The relevance and impact of the concerns relayed in these communication tools are further enhanced by a detailed analysis of root causes and best practices.</li> </ul>

## SECTION 5: FINANCIAL HEALTH OF LOCAL GOVERNMENT

We performed a high-level analysis of municipalities' financial health during our audits. Section 5.1 assesses the ability of municipalities to continue as going concerns, while section 5.2 looks at the financial health indicators of municipalities.

### 5.1 Going concern

Under the going concern assumption, an auditee is viewed as continuing to operate for the foreseeable future. As the going concern assumption is a fundamental principle in the preparation of the financial statements, management is required to assess the municipality's ability to continue as a going concern and make relevant disclosures in the financial statements. As part of the audit process, we also perform procedures to assess whether there are any events or conditions that may cast significant doubt on the auditee's ability to continue as a going concern.

Based on our assessments, none of the auditees were required to disclose in their financial statements that a material uncertainty existed with regard to their ability to continue as a going concern.

### 5.2 Financial health indicators

Management is responsible for the sound and sustainable management of the affairs of the municipality to which they are appointed and for implementing an efficient, effective and transparent financial management system for this purpose, as regulated by legislation. Our annual audits now include a high-level analysis of municipalities' financial management indicators to provide management with an overview of selected aspects of municipalities' current financial management and enable timely remedial action where the municipality's operations and service delivery may be at risk.

This analysis is presented under the following headings:

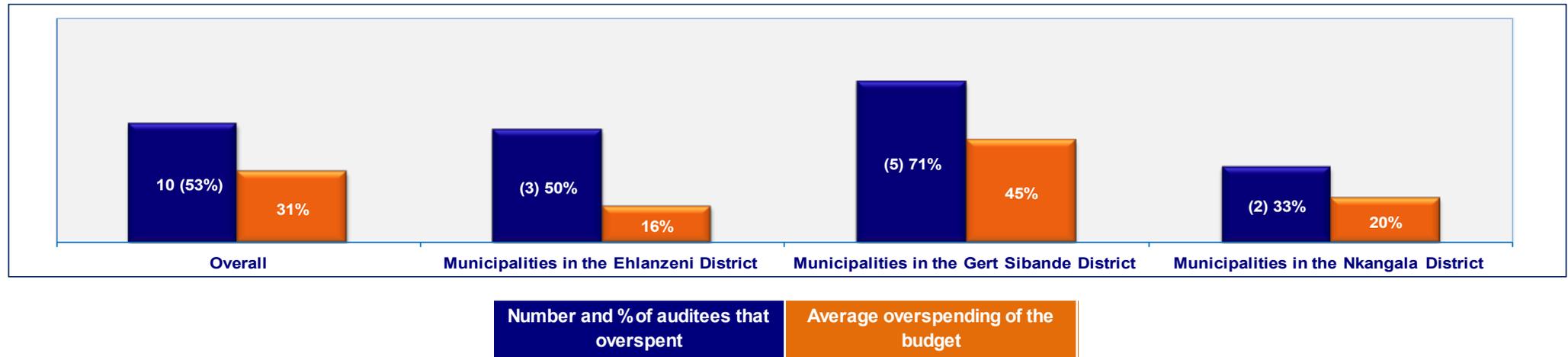
- Budget and grant management (section 5.2.1)
- Debtor management (section 5.2.2)
- Creditor management (section 5.2.3)
- Financial performance and position as well as cash management (section 5.2.4)

We also give concluding comments in section 5.2.5.

### 5.2.1 Budget and grant management

The figure below presents the number and percentage of municipalities overall and per district that overspent their final operational budgets (in other words, after adjustments to their original budget). It further shows the average percentage by which the budget was overspent by the municipalities that had overspent.

**Figure 30: Overspending of the operational budget**



As can be seen in figure 30, overspending on operational budgets was not restricted to a particular district but was widespread throughout the province. It is concerning that despite district and local municipalities having made adjustments to their budgets, they still overspent their final operational budgets. This indicates that the quality of the budgeting and the management of revenue and expenditure against the budget were poor.

#### Possible reasons and impact

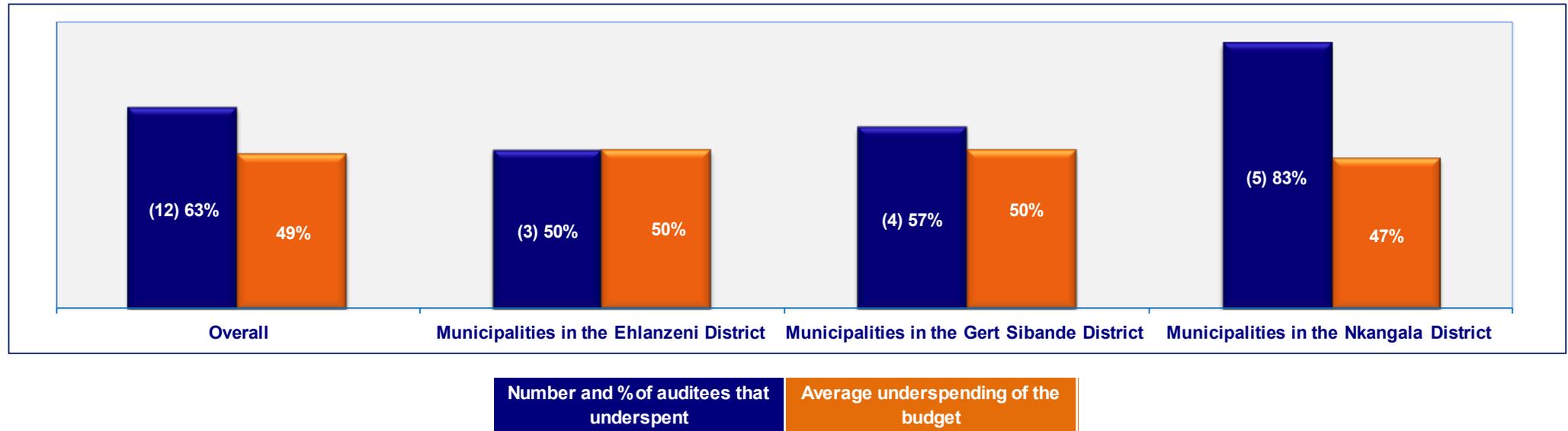
The overspending of the operational budget can be attributed to the following:

- The approved budget was not spent on its intended purposes, as evidenced by the unauthorised expenditure incurred and reported.
- Weaknesses within expenditure management; for example, expenditure was incurred without obtaining the required approvals.
- The budget was inconsistent with the priorities and objectives set in terms of the integrated development plan or the strategic plan.
- Unforeseen or unavoidable expenditure was not approved in terms of the adjustment budget.
- Unforeseen or unavoidable expenditure exceeded the prescribed limit.

The overspending had a direct impact on the municipalities' cash flow and credit management. Consequently, contractors and suppliers were not paid timeously, which in turn resulted in goods and services not being delivered. Refer to figures 35 and 36 for an assessment of the municipality's creditor-payment periods and intervals.

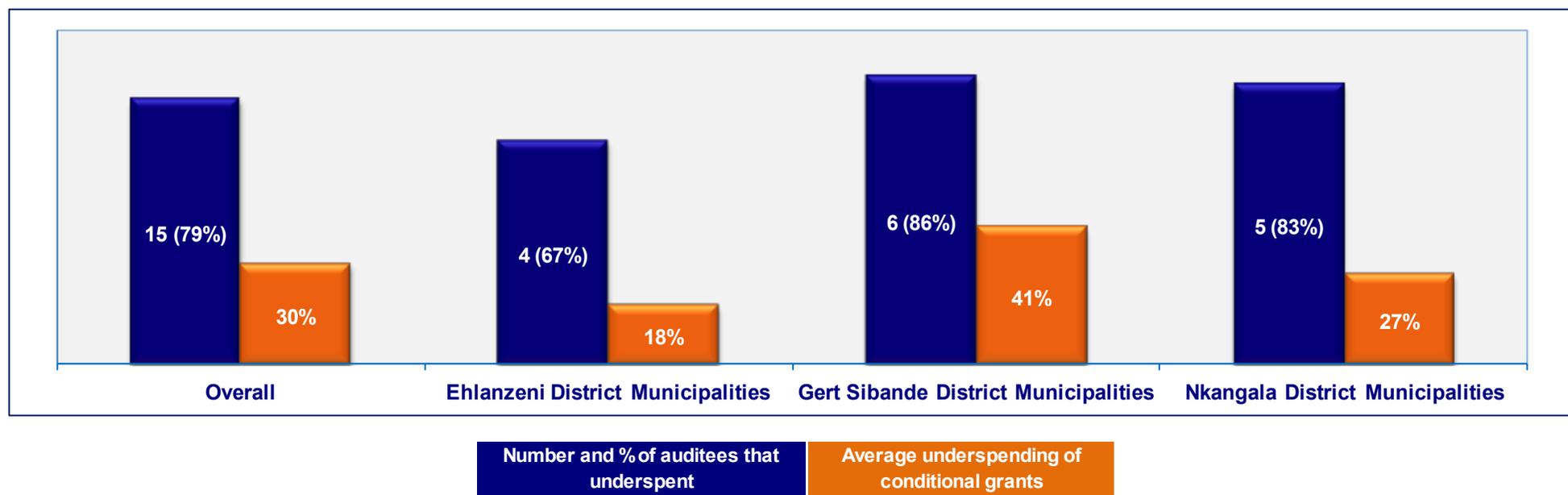
The figure below presents the number and percentage of municipalities overall and per district that underspent their final capital budgets. It further shows the average percentage by which the budgets were underspent by the municipalities that had underspent.

**Figure 31: Underspending of the capital budget**



The figure below presents the underspending on conditional grants per district, reflecting both the number and percentage of auditees that underspent. It further shows the average percentage by which the budgets were underspent by the municipalities that had underspent.

Figure 32: Underspending of conditional grants



As depicted in figures 31 and 32, underspending on the capital budget and conditional grants was not restricted to a particular district but was widespread throughout the province. Municipalities receive conditional grants to achieve specific objectives, mostly related to service delivery. It is concerning that, as is the case with the underspending of capital budgets, the underspending of specific-purpose conditional grants had a negative impact on municipalities' service delivery objectives.

### Possible reasons and impact

The underspending of the capital budget and conditional grants can be attributed to the following:

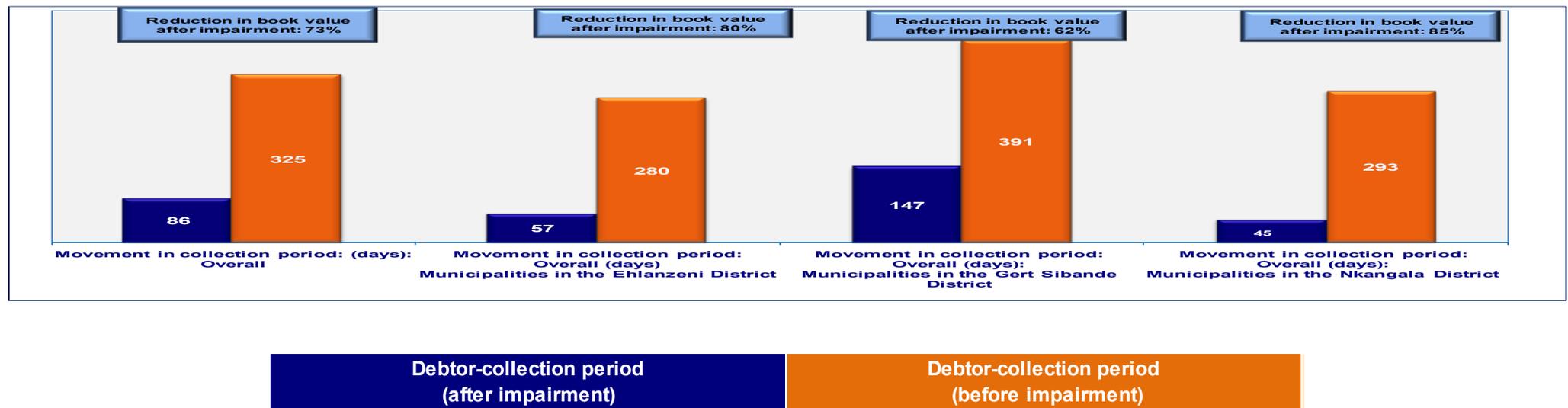
- Poor planning and ineffective SCM processes, resulting in delays in appointing service providers.
- Lack of action to address delayed projects.
- A lack of capacity to deliver on capital projects; for example, **a shortage of suitably skilled engineers and technicians to implement capital projects.**
- Inadequate monitoring and oversight of key projects.
- Allocations utilised for purposes other than those stipulated in their respective schedules or in the gazetted **Division of Revenue Act** framework.
- Inadequate level of reporting and the information reported not being credible.
- **Inadequate monitoring as per the requirements of the Division of Revenue Act and the MFMA.**

Conditional grants and capital budgets are intended to enhance specific service delivery objectives. As mentioned above, the significant underspending of these budgets indicates that these municipalities did not achieve their service delivery objectives. Furthermore, the unauthorised expenditure analysed in section 2.4.4 was due to the operational budgets being funded from the capital budgets and conditional grants.

## 5.2.2 Debtor management

The following figure indicates the average period in days that it took municipalities to collect outstanding consumer debts, both before and after impairment (write-off) for uncollectable debt. The figure also shows the extent, in percentage terms, to which debts were written off (impaired).

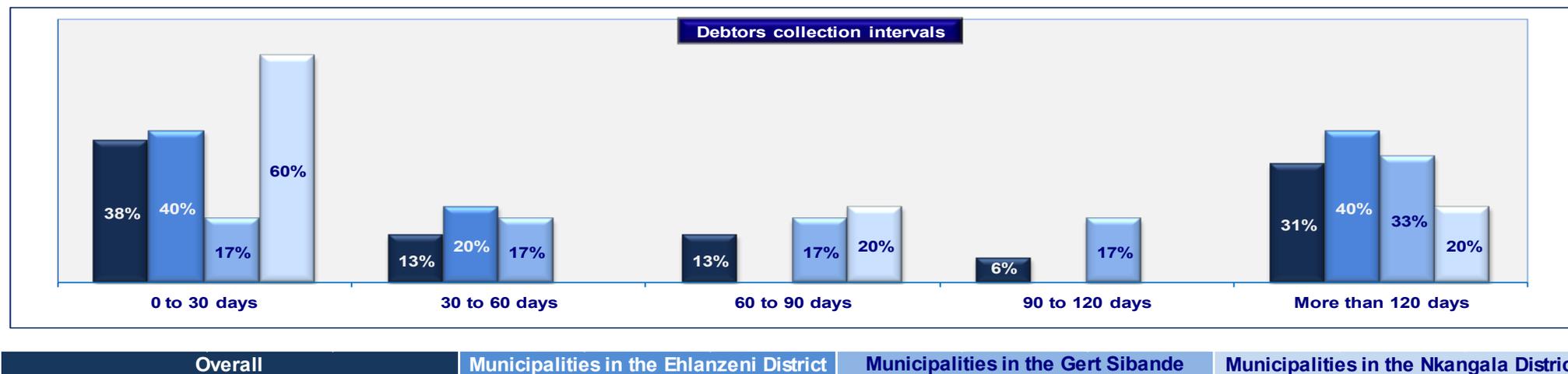
**Figure 33: Debt-collection period**



Overall, it took municipalities an average of 325 days (10,8 months) to collect outstanding amounts from consumer debtors where no provision was made for uncollectable debt. The collection period decreases to an average of 86 days (2,9 months) when nearly 60% of debts are written off. The large difference between the debt-collection period before and after write-off and the extent of impairment of debt is the result of the continuing year-on-year growth in both the outstanding debts and the provision for uncollectable debt.

The figure below elaborates on the debt-collection analysis and shows the extent of municipalities, per district, that collected their debt within the indicated debt-collection intervals after having been adjusted for the write-off of bad debt.

Figure 34: Debt-collection intervals



Municipalities in the Ehlanzeni and Nkangala districts collected 40% and more of their debts within 30 days, although an almost equal number required more than 120 days to do so. The local municipalities in the Gert Sibande district are fairly evenly spread across the different collection intervals.

### Possible reasons and impact

Extended collection periods can be attributed to the following:

- Inadequate maintenance of proper accounting records for all debtors.
- Inadequate policies and procedures for the management of debtors.
- No, or inadequate, accounting and management information systems.

The extended collection periods may result in cash-flow problems and adversely affect operational management. The excessive write-off of debt highlights the widespread culture of non-payment for services among consumers. The revenue that is not collected as a consequence thereof has a negative impact on the maintenance of infrastructure, resulting in a deteriorating level of consistent, quality service delivery.

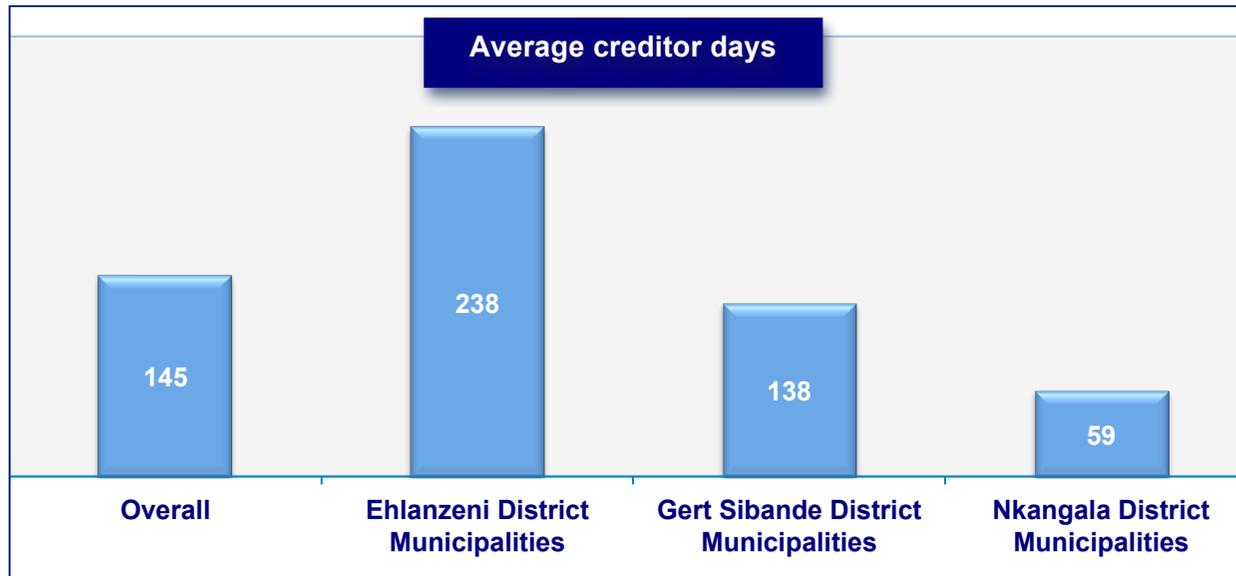
Poor revenue-collection and debtor-management practices and a lack of incentive or demand for the collection of revenue are the root causes of the long-outstanding debt of municipalities, which – in turn – could place the municipalities under financial pressure. **Accounting officers should only consider writing off these debts after they had exhausted all reasonable steps to collect the money owed. Accounting officers must also ensure that debt is written off in accordance with the write-off policy.**

### 5.2.3 Creditor management

In accordance with section 65(2)(e) of the MFMA, all money owing by the municipality must be paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise for certain categories of expenditure.

The following figure shows the average number of days it took municipalities in the three districts to pay suppliers. This reflects on how long the municipalities held onto their cash.

**Figure 35: Creditor-payment period**

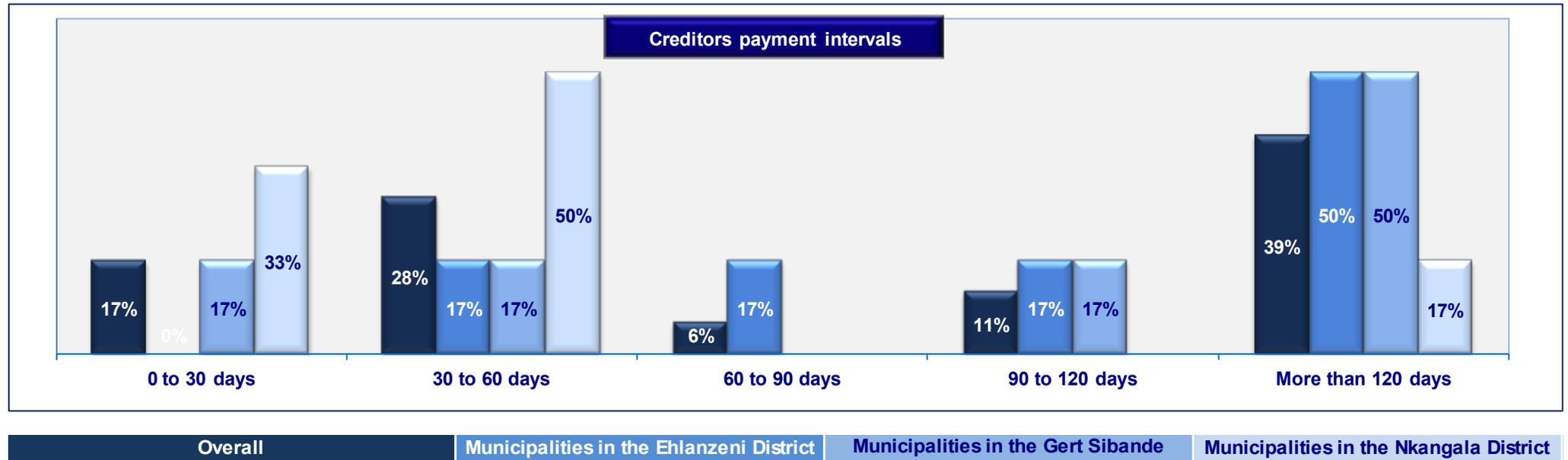


Overall, it took municipalities an average of 137 days (4,6 months) to pay creditors. Of the three districts, Ehlanzeni took the longest to pay their creditors at an average of 238 days. The average payment period of municipalities in the Nkangala and Gert Sibande districts was relatively better at 59 days (2 months) and 138 days (4,6 months), respectively.

The delayed payment of suppliers who provide goods and services to municipalities may lead to suppliers becoming reluctant to do business with local government.

The following figure elaborates on the creditor-payment analysis and shows the extent of municipalities, per district, that paid their creditors within the indicated creditor-payment intervals.

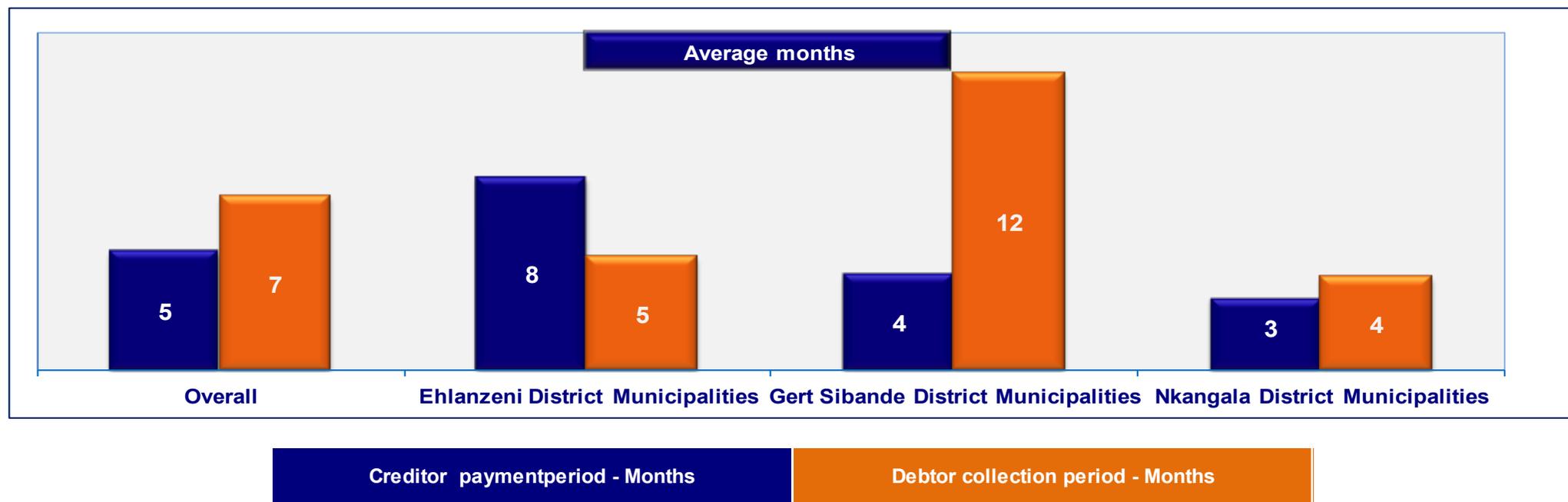
Figure 36: Creditor-payment intervals



No municipalities in the Ehlanzeni district paid their creditors within the legislated period of 30 days, while only 17% paid within 60 days. In contrast, 34% of the municipalities in the Gert Sibande district and 83% in the Nkangala district paid within 60 days.

The following figure compares the debt-collection periods and the creditor-payment periods discussed above. The figure indicates, in months, the difference between the average periods taken to collect money from consumers and to pay suppliers.

**Figure 37: Debt-collection period (after impairment) compared to creditor-payment period**



Overall, municipalities took two months longer to collect debt than they did to pay creditors. Municipalities in the Gert Sibande district took eight months longer to collect debts versus paying creditors. Interestingly, only municipalities in the Ehlanzeni district are managing on average to collect debt in a shorter period than to pay creditors.

The results reflect the time delay between turning income from consumers into payments to suppliers. It indicates how much cash reserves municipalities require to sustain their operations and manage working capital effectively and economically, as required by the MFMA.

#### **Possible reasons and impact**

Poor expenditure and creditor management can be attributed to the following:

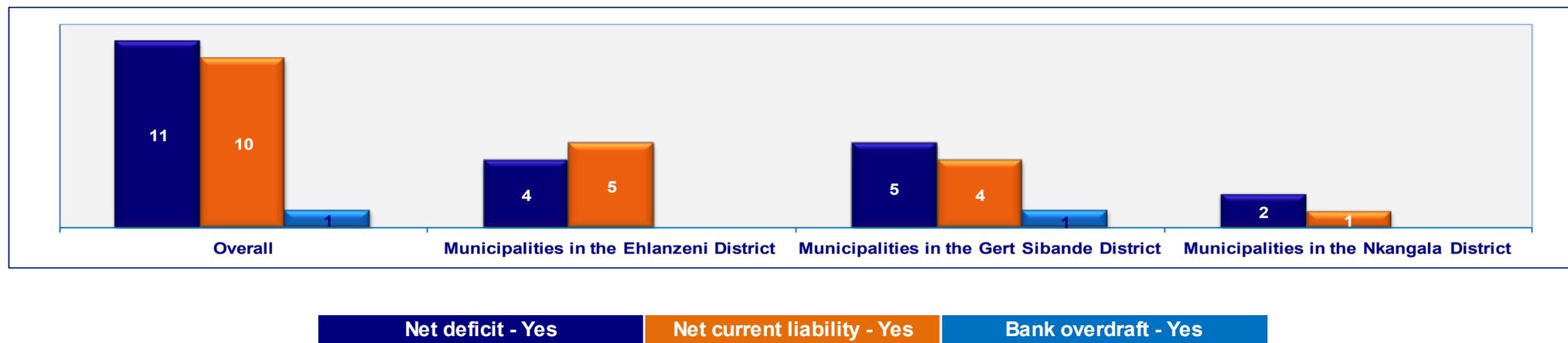
- Poor planning and budgeting for current and capital expenditure.
- Weak expenditure, cash-flow and project management.
- Approved budgets spent on unintended purposes, as evidenced by the unauthorised expenditure incurred and reported.

The lag in cash inflows from consumers and cash outflows to suppliers can result in cash-flow problems at municipalities. This may cause these municipalities to use specific-purpose conditional grants to fund operations, which – in turn – may contribute to municipalities underspending their conditional grants.

### 5.2.4 Financial performance and position as well as cash management

The following figure reflects the number of municipalities, per district, where revenue for the year exceeded expenditure (net deficit), where current assets were less than current liabilities at year-end (net current liability position), and where the year-end bank balance was in overdraft.

**Figure 38: Financial performance, financial position and cash management**



Overall, 11 and 10 municipalities realised a net deficit or had a net liability position, respectively. Most of these municipalities were in the Ehlanzeni and Gert Sibande districts. Seven municipalities had both a net deficit for the year and their current liabilities exceeded their current assets.

A further one municipality's year-end bank balance was in overdraft. This contravenes the legislated requirement in section 45 of the MFMA that prohibits municipalities from closing the financial year with any short-term debt.

#### Possible reasons and impact

Poor financial performance, financial position and cash management can be attributed to the following:

- Poor planning and budgeting for current and capital expenditure.
- Revenue and expenditure not adjusted downwards to allow for the undercollection of revenue during the year.
- Expenditure incurred not in accordance with the approved budget.
- Poor cash-flow management.
- Ineffective revenue-collection systems to give effect to the budget.

Municipalities with poor financial performance, financial position and cash management may have difficulty in meeting suppliers' demands for payment. Combined with other factors, such as negative results from operations (net deficit position) and an overdraft bank balance, it points to inefficient and

ineffective operational management. These municipalities may experience cash-flow problems and may find it necessary to use a portion of their conditional grant funding to pay for liabilities, which will have a negative impact on future activities and service delivery.

#### ***5.2.5 Conclusion on the financial health of local government***

Based on the high-level analysis, the budget planning and management processes were not effective at a number of auditees. With budgets being a government's most important economic tool, and considering the indicators of possible risks to the financial health, the leadership will struggle to translate all its policies, commitments and goals into deliverables. This will consequently have an impact on service delivery within the province overall.

It is important that the leadership should promote good budget and fiscal management by municipalities, and for this purpose monitor the implementation of municipal budgets, including expenditure, revenue collection and borrowing. The effective functioning of the budget processes will contribute significantly to developing and sustaining fiscal health in local government.



**Annexure 2: Assessment of auditees' key controls at the time of the audit**

Auditee	Leadership																								Financial and performance management															Governance														
	Movement			Effective leadership culture			Oversight responsibility			HR management			Policies and procedures			Action plans			IT governance			Movement			Proper record keeping			Processing and reconciling controls			Reporting			Compliance			IT system controls			Movement			Risk management			Internal audit unit			Audit committee					
	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C	F	P	C			
<b>Municipalities in the Ehlanzeni district</b>																																																						
Bushbuckridge Local Municipality	↓	↓	↓																																																			
Ehlanzeni District Municipality	↔	↔	↔																																																			
Mbombela Local Municipality	↔	↔	↔																																																			
Nkomazi Local Municipality	↓	↓	↓																																																			
Thaba Chweu Local Municipality	↔	↔	↔																																																			
Umgjini Local Municipality	↑	↑	↑																																																			
<b>Municipalities in the Gert Sibande district</b>																																																						
Albert Luthuli Local Municipality	↔	↔	↔																																																			
Dipaliseng Local Municipality	↔	↔	↔																																																			
Gert Sibande District Municipality	↔	↔	↔																																																			
Govan Mbeki Local Municipality	↓	↓	↓																																																			
Lekwa Local Municipality	↑	↓	↔																																																			
Mbukaligwa Local Municipality	↓	↓	↓																																																			
Pixley Ka Seme Local Municipality	↑	↑	↔																																																			
<b>Municipalities in the Nkangala district</b>																																																						
Dr JS Moroka Local Municipality	↔	↔	↔																																																			
Emakhazeni Local Municipality	↔	↓	↓																																																			
Nkangala District Municipality	↔	↓	↔																																																			
Steve Tshwete Local Municipality	↔	↔	↔																																																			
Thembisile Hani Local Municipality	↑	↑	↑																																																			
Victor Khanye Local Municipality	↓	↑	↑																																																			

Legends	Financial	F	Performance	P	Compliance	C	Good	Green	In progress	Yellow	Intervention required	Red	Improved	↑	Unchanged	↔	Regressed	↓
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### Annexure 3: Comparison of five-year audit outcomes

Auditee	Audit outcome 2011-12	Audit outcome 2010-11	Audit outcome 2009-10	Audit outcome 2008-09	Audit outcome 2007-08
<b>Municipalities in the Ehlanzeni district</b>					
Bushbuckridge Local Municipality	Disclaimer	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Qualified
Ehlanzeni District Municipality	Financially unqualified with no findings	Financially unqualified with no findings	Financially unqualified with no findings	Financially unqualified with findings	Financially unqualified with findings
Mbombela Local Municipality	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Qualified	Qualified
Nkomazi Local Municipality	Disclaimer	Financially unqualified with findings	Qualified	Qualified	Disclaimer
Thaba Chweu Local Municipality	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Qualified
Umjindi Local Municipality	Qualified	Disclaimer	Disclaimer	Qualified	Financially unqualified with findings
<b>Municipalities in the Gert Sibande district</b>					
Albert Luthuli Local Municipality	Qualified	Disclaimer	Qualified	Qualified	Qualified
Dipaliseng Local Municipality	Financially unqualified with findings	Qualified	Disclaimer	Disclaimer	Disclaimer
Gert Sibande District Municipality	Financially unqualified with findings	Financially unqualified with no findings	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings
Govan Mbeki Local Municipality	Qualified	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Qualified
Lekwa Local Municipality	Disclaimer	Disclaimer	Financially unqualified with findings	Disclaimer	Disclaimer
Mkhondo Local Municipality	Audit not finalised at legislated date	Disclaimer	Disclaimer	Disclaimer	Qualified
Msukaligwa Local Municipality	Disclaimer	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Qualified
Pixley Ka Seme Local Municipality	Qualified	Disclaimer	Disclaimer	Disclaimer	Disclaimer
<b>Municipalities in the Nkangala district</b>					
Dr JS Moroka Local Municipality	Qualified	Disclaimer	Disclaimer	Qualified	Financially unqualified with findings
Emakhazeni Local Municipality	Qualified	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings
Emalaheni Local Municipality	Audit not finalised at legislated date	Qualified	Qualified	Financially unqualified with findings	Financially unqualified with findings
Nkangala District Municipality	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings	Financially unqualified with findings
Steve Tshwete Local Municipality	Financially unqualified with no findings	Financially unqualified with no findings	Financially unqualified with no findings	Financially unqualified with findings	Financially unqualified with findings
Thembisile Hani Local Municipality	Qualified	Qualified	Disclaimer	Disclaimer	Financially unqualified with findings
Victor Khanye Local Municipality	Financially unqualified with findings	Financially unqualified with no findings	Financially unqualified with no findings	Qualified	Financially unqualified with findings



**PR194/2013**  
**ISBN: 978-0-621-41994-8**

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