AUDITOR-GENERAL

GENERAL REPORT

OF THE

AUDITOR-GENERAL

ON THE

AUDIT OUTCOMES OF LOCAL GOVERNMENT

FOR THE

FINANCIAL YEAR ENDED 30 JUNE 2005

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AUDITOR-GENERAL

AUDITOR-GENERAL

TABLE OF CONTENTS

AUDITOR-GENERAL

AUDITOR-GENERAL

FOREWORD

I have pleasure in presenting my *General report on the audit outcomes of local government for the financial year ended 30 June 2005*. This report provides an authoritative assessment of the status of financial management at local government level. This report, along with my report on provincial and national departments, provides a bird's-eye view of financial management of the public sector in South Africa. I don't think it would be a surprise to many to hear that the local government environment provides the greatest challenge.

During the implementation of the Public Finance Management Act (PFMA) in 2000, we found that the first significant challenge was to provide timely and accurate information. Twelve months after the Municipal Finance Management Act (MFMA) came into effect, we are finding similar challenges. The MFMA provisions, which require that I report on the non-submission of financial statements, have demonstrated that a significant number of municipalities cannot provide reasonable financial statements months after the period-end.

This report further compounds the situation by demonstrating that in cases where financial statements are provided and audited within a reasonable time frame, the results are not encouraging. Whilst national and provincial governments face similar challenges with regard to audit qualifications, the number at local government level is far higher. The issue of capacity, which is assessed in this report through, amongst others, initiatives taken by the national Department of Provincial and Local Government and the National Treasury, is fundamental if the audit results and service delivery are to improve.

It is generally recognised that public sector service delivery essentially rests on the shoulders of local government. Untimely and unreliable information makes it very difficult to assess the performance of management and undermines the accountability process. The challenge for role players and strategic partners is to meet the simple requirement of providing information in the public domain that can be relied upon.

The onerous and multiple accounting frameworks within the local government environment, as reported, do not lend themselves to assisting in the capacity-building process. Recognition by the National Treasury of the difference in capacity of the respective municipalities does recognise this; however, given that the high-capacity municipalities analysed are subject to numerous qualifications, this points to a serious challenge for the remainder of municipalities.

As this represents my last general report on local government, I would like to refer to some positive aspects on the horizon and offer advice on the way forward. At this stage the lesson learnt from the PFMA is that receiving information in a timely fashion can be achieved and helps to facilitate accountability. A concerted effort should be made by municipalities to achieve this goal. This information should relate to the Municipal Systems Act, 2000 (Act No. 52 of 2000) (MSA) whereby performance information is treated with the same urgency and importance as financial information.

I would like to extend a final word of thanks to all the auditors who have assisted me over the years in this challenging area. I hope that, as a team, we have added value, provided assistance and facilitated accountability.

AUDITOR-GENERAL

1. INTRODUCTION

1.1 Executive summary

This report is divided into five key areas:

1. Submission of financial statements (meeting MFMA deadline)
2. Audit opinions
3. Financial performance of 29 of the top 50 municipalities audited by 31 March 2006
4. Audits of municipal performance management and measurement
5. Improvements in service delivery and accountability initiatives

For the section on the submission of financial statements I have extracted some of the information I reported on in my *Quarterly report on the submission of financial statements by municipalities and the status of audit reports as at 31 March 2006 for the financial year ended 30 June 2005* [RP100/2006]. As at 31 March 2006, 131 of the 284 municipalities (46%) had submitted their annual financial statements by 31 August 2005. One hundred and twenty-six municipalities (44%) submitted annual financial statements between 1 September 2005 and 31 March 2006, while 27 (10%) had not submitted annual financial statements by 31 March 2006.

Of the top 50 municipalities, 33 municipalities originally met the submission date of 31 August 2005; however, five municipalities withdrew their financial statements. Thus only 28 of the top 50 municipalities met the MFMA deadline (56%). Eight (16%) of the top 50 municipalities had not submitted financial statements at all by 31 March 2006, while 36% (2003-04: 60%) submitted their financial statements between 1 October 2005 and 31 March 2006.

Two other reporting requirements under the MFMA relate to municipal entity as well as consolidated municipal financial statements. Only 41% of municipal entities complied with the MFMA deadline. In the case of consolidated financial statements, only 20% managed to comply with the MFMA as they rely on municipal entities to submit their annual financial statements.

One of the primary aims of the MFMA is to achieve effective financial management and accountability. The poor submission of timely financial statements represents a significant obstacle to achieving this goal.

As at 31 March 2006, only 126 (44%) audits had been finalised, while the audits of only 29 (58%) of the top 50 had been finalised. Of the 126 audits that were finalised, 70 (57%) were qualified. Of the 29 top 50 municipalities, 14 (48%) were qualified.

Audit qualifications can arise for several reasons. For the 14 qualified in the top 50 municipalities, 210 qualification issues were identified. This represents 7,2 issues per municipality for the 29 municipalities analysed. In contrast, national departments have only 0,6 qualification issues per department while their provincial counterparts have 2,6.

Of the 210 qualification issues, 53% related to asset management and accounts receivable and revenue. These areas clearly need to be prioritised and guidance is required from partners such as the National Treasury and national and provincial local government departments.

Key financial performance concerns presented in this report are debtors and the provision for bad debt. The 29 municipalities' consumer debt increased over a 12-month period, emphasising the general perception that customers are defaulting on their payments. Total debtors increased by R0,9 billion from 2003-04 (R20,9 billion) to 2004-05 (R21,8 billion), which represents an increase of 4,3%. The average provision for bad debt decreased by 5% from 2003-04 (66%) to 2004-05 (61%). The average increase in operating income over the same period was 9,9%, i.e. R36,3 billion (2003-04: R33,1 billion).

The average liquidity ratio is 1.21:1, which is less than the norm of 2:1 for the private sector. However, the liquidity ratio includes debtors and, as stated in the preceding paragraph, it seems that there is a significant problem to recover consumer debt.

Reticulation losses represent another area of concern. Not all of the 29 municipalities analysed disclosed reticulation losses. The disclosed amount equals a total reticulation loss for water of R354 million.

On average, there has been an increase in the number of electricity units (kilowatts) lost compared to last year. For the municipalities that disclosed this information, the total number of units lost was 1,4 billion. This represents a total reticulation loss in electricity of R273 million.

All this could impact on municipalities' ability to deliver the required services as expected by the public.

Another area covered in this report is the audit of performance management and measurement of the municipalities. With regard to all aspects except the presence of a performance audit committee, there was significant improvement in the implementation of the performance measurement structures.

From the above it is clear that the mere fact that legislation has been put in place does not automatically mean that service delivery is taking place. Instead, the outcry from citizens regarding the lack of or backlog in service delivery seems to be on the increase.

Initiatives such as Project Consolidate have been created to try systematically to address the capacity needs of local governments. At this early stage the indications of Project Consolidate have been included in this report.

1.2 Focus area

In total there are currently 284 municipalities in South Africa[1]. The National Treasury identified the top 50 municipalities based on specific criteria.

The basis on which these municipalities were selected includes the following criteria:

- Budget
- Capacity

[1] In December 2005 the number of municipalities was reduced to 283 due to the re-demarcation process and elimination of cross-boundary municipalities

- Date on which the municipality entered into the agreement relating to the financial management grant
- Placement of an international finance adviser at a municipality
- Restructuring grant agreements with large municipalities

In addition to identifying the top 50 municipalities, the National Treasury classified all municipalities as low, medium or high-capacity municipalities. All top 50 municipalities, as identified by the National Treasury, are classified as high-capacity municipalities.

The classification of municipalities is as follows:

High capacity	50
Medium capacity	107
Low capacity	127[2]

According to the 2004-05 budget information[3], the top 50 municipalities represent an estimated 72% (R72,5 billion) of the total budgeted revenue of R101,3 billion.

1.3 Structure of the report

This report focuses on several key aspects of municipalities, namely:

- Submission of financial statements (section 2) and audit opinions (section 3)
- Financial performance of 29 of the top 50 municipalities audited by 31 March 2006 (section 4)
- Audits of municipal performance management and measurement (section 5)
- Improvement in service delivery and accountability initiatives (section 6)

1.4 Top 50 municipalities

The combined budgets for local government for the 2004-05 financial year amounted to R101,3 billion, of which R17,1 billion (17%) was allocated to capital projects and R84,2 billion (83%) to operating functions.

Of the R84,2 billion operating budget, Gauteng municipalities accounted for R29,5 billion (35%), followed by the Western Cape with R15,5 billion (18%) and KwaZulu-Natal with R14,2 billion (17%). Municipalities in other provinces shared the remaining R25 billion (30%).

The operating budget was mainly funded by electricity sales of R22,6 billion (27%), property rates of R15,6 billion (19%), grants and subsidies of R12 billion (14%) and water tariffs of R11 billion (13%). The remaining income of R22,8 billion (27%) was made up of sanitation, refuse removal, RSC levies and other income.

Operating income includes all aspects that constitute service delivery, including RSC levies (which were abolished with effect from 1 July 2006), and is thus used in the analysis below. Operating income,

[2] With the reduction of the number of municipalities from 284 to 283, the number of low capacity was reduced to 126.
[3] 2004-05 Local Government Capital and Operating Expenditure Budgets, issued by the National Treasury on 1 September 2005

however, excludes grants and subsidies and other income. Budgeted operating income for the top 50 municipalities amounted to 87% (R52,5 billion) of the total budgeted operating income of R60,2 billion.

Table 1 below reflects the increase / (decrease) in operating income for each of the top 50 municipalities from 2003-04 to 2004-05. The top 50 municipalities are listed below as ranked by the National Treasury. The categories refer to the type of municipality, as mentioned in section 155 of the Constitution of the Republic of South Africa, 1996:

A: Metropolitan municipality – a municipality that has exclusive municipal executive and legislative authority in its area

B: Local municipality – a municipality that shares municipal executive and legislative authority in its area with a category C municipality within whose area it falls

C: District municipality – a municipality that has municipal executive and legislative authority in an area that includes more than one municipality

It should be noted, however, that only 29 of the top 50 municipalities' audits (58%) had been finalised by the end of March 2006. This is, however, an improvement compared to last year when audits of 23 of the top 50 municipalities (46%) had been finalised by the end of April 2005.

Table 1: Top 50 municipalities

	Cate-gory	Province	Municipality	Budgeted operating income 2004-05 R'000	Operating income 2004-05 R'000	Operating income 2003-04 R'000	% Increase/ (Decrease)
1	A	Gauteng	City of Johannesburg Municipality*	10 385 391	10 541 102	9 468 774	11,3%
2	A	Western Cape	City of Cape Town Municipality*	7 228 488	7 475 027	7 052 159	6,0%
3	A	KwaZulu-Natal	eThekwini Metropolitan Municipality	6 954 749	6 829 141	6 189 876	10,3%
4	A	Gauteng	Ekurhuleni Metropolitan Municipality	6 393 489	#	**	-
5	A	Gauteng	City of Tshwane Metropolitan Municipality	5 625 300	#	4 742 786	-
6	A	Eastern Cape	Nelson Mandela Metropolitan Municipality	2 211 189	2 179 587	1 989 035	9,6%
7	B	Free State	Mangaung Local Municipality	890 517	1 143 928	1 011 773	13,1%
8	B	Eastern Cape	Buffalo City Municipality*	956 682	788 130	701 205	12,4%
9	B	KwaZulu-Natal	The Msunduzi Municipality	962 408	856 858	799 477	7,2%
10	B	Gauteng	Emfuleni Local Municipality	952 118	#	**	-
11	B	Free State	Matjhabeng Local Municipality	609 527	#	**	-
12	B	North West	Rustenburg Local Municipality	615 247	620 343	549 551	12,9%
13	B	KwaZulu-Natal	uMhlathuze Municipality	526 728	597 197	576 419	3,6%
14	B	Limpopo	Polokwane Municipality	401 267	454 388	440 065	3,3%
15	B	Gauteng	Mogale City Local Municipality	473 879	#	#	-
16	B	Northern Cape	Sol Plaatje Municipality	326 683	#	#	-
17	B	North West	City Council of Klerksdorp	429 357	611 622	422 378	44,8%
18	B	Mpumalanga	Emalahleni Municipality*	400 328	440 970	392 861	12,3%
19	B	Western Cape	Drakenstein Municipality*	412 193	391 976	365 255	7,3%
20	B	Mpumalanga	Mbombela Municipality*	308 318	286 447	267 869	6,9%

AUDITOR-GENERAL

	Category	Province	Municipality	Budgeted operating income 2004-05 R'000	Operating income 2004-05 R'000	Operating income 2003-04 R'000	% Increase/ (Decrease)
21	B	Mpumalanga	Govan Mbeki Municipality	347 070	274 135	271 154	1,1%
22	B	KwaZulu-Natal	Newcastle Municipality	345 257	#	**	-
23	C	KwaZulu-Natal	Ugu District Municipality	186 892	174 973	139 253	25,7%
24	B	Western Cape	George Municipality*	293 556	381 146	315 761	20,7%
25	B	Western Cape	Stellenbosch Municipality*	265 542	259 467	231 734	12,0%
26	C	Eastern Cape	Amatole District Municipality*	96 200	119 746	105 945	13,0%
27	B	Mpumalanga	Steve Tshwete Municipality*	264 341	229 859	208 989	10,0%
28	B	North West	Local Municipality of Madibeng	277 901	#	**	-
29	C	Eastern Cape	OR Tambo District Municipality	95 835	#	#	-
30	B	Free State	Maluti-a-Phofung Local Municipality	133 342	#	#	-
31	B	North West	Potchefstroom Municipality*	262 833	251 335	235 785	6,6%
32	C	North West	Bojanala Platinum District Municipality	140 000	123 229	127 337	(3,2%)
33	B	Eastern Cape	King Sabata Dalindyebo Local Municipality	121 830	#	#	-
34	C	Mpumalanga	Sekhukhune Cross Boundary District Municipality	119 000	#	#	-
35	C	Mpumalanga	Nkangala Municipality*	140 000	169 309	143 024	18,4%
36	B	KwaZulu-Natal	Emnambithi / Ladysmith* Municipality	175 595	157 165	174 821	(10,1%)
37	B	Free State	Metsimaholo Local Municipality	211 250	#	**	-
38	B	Free State	Moqhaka Local Municipality	149 572	129 301	132 470	(2,4%)
39	B	Western Cape	Breede Valley Municipality*	171 043	193 927	172 290	12,6%
40	B	Gauteng	Merafong City Local Municipality	207 111	#	**	-
41	B	Limpopo	Greater Tzaneen Municipality	177 379	#	#	-
42	B	KwaZulu-Natal	KwaDukuza Municipality	191 700	#	#	-
43	C	Mpumalanga	Ehlanzeni Municipality	72 015	#	#	-
44	B	KwaZulu-Natal	Hibiscus Coast Municipality	157 458	#	#	-
45	B	Western Cape	Mossel Bay Municipality	186 948	220 009	197 195	11,6%
46	B	Gauteng	Randfontein Local Municipality	177 615	#	**	-
47	B	Western Cape	Saldanha Bay Municipality	193 072	216 322	197 934	9,3%
48	C	Eastern Cape	Ukhahlamba District Municipality	40 331	#	#	-
49	C	KwaZulu-Natal	Uthungulu District Municipality	87 159	#	**	-
50	B	Western Cape	Overstrand Municipality*	190 170	197 574	175 798	12,4%
Total				**52 541 885**	**36 314 213**	**37 798 973**	

\# Audit not finalised
* Financial statements prepared in terms of GAMAP
** Comparative information not included due to the current year's audit not having been finalised
*** 2004-05 Local Government Capital and Operating Expenditure Budgets as issued by the National Treasury on 1 September 2005

Actual operating income for the 29 municipalities amounted to R36,3 billion (budget of R35,7 billion), resulting in a difference of only 2% between actual and budgeted income. As can be seen from table 1, the municipality with the highest percentage increase in operating income was the City Council of Klerksdorp with an increase of 44,8%. The municipality with the lowest percentage increase was Govan Mbeki Municipality, with only 1,1%. This, however, excludes the following municipalities where the percentage decreased:

- Bojanala Platinum District Municipality (-3,2%)
- Emnambethi / Ladysmith Municipality (-10,1%)
- Moqhaka Municipality (-2,4%)

The average percentage increase in operating income was 9,9%.

2. SUBMISSION OF FINANCIAL STATEMENTS

2.1 Municipalities

This section consists of two elements:

- The submission of financial statements for auditing by all 284 municipalities; and
- An analysis of the audit reports of the top 50 municipalities for which audit reports were signed by 31 March 2006

In terms of section 126(1)(a) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the accounting officer must:

- Prepare the annual financial statements of the municipality
- Within two months after the end of the financial year to which those statements relate, submit the statements to the Auditor-General for auditing

These requirements are in line with the requirements set by the PFMA for national and provincial departments. From the 2004-05 financial year onwards, the financial statements had to be submitted by 31 August, and by 30 September in the case of those municipalities with a municipal entity that is required to prepare consolidated financial statements. In terms of section 126(3)(b) of the MFMA, I have three months to finalise the audit of the annual financial statements.

Basis for the preparation of annual financial statements:

Currently there are three different accounting standards available in the country, namely:

- Institute of Municipal Finance Officers (IMFO) – Framework for the preparation and presentation of financial statements by local government (2nd edition January 1996), as prescribed in terms of section 3 of the repealed Auditor-General Act of 1995.
- The old Generally Accepted Municipal Accounting Practice (GAMAP) – The old GAMAP was based on 1997 Generally Accepted Accounting Practice (GAAP) and was approved by the Minister of Finance, but not promulgated in anticipation of setting up the Accounting Standards Board.
- New GAMAP, approved by the Accounting Standards Board – The new GAMAP is a mixture of the updated old GAMAP and Standards of Generally Recognised Accounting Practice (GRAP) issued by the Accounting Standards Board (ASB). GRAP is currently being introduced progressively.

For the 2004-05 financial year, municipalities prepared their financial statements either on IMFO or on the old GAMAP and, with a few exceptions, on the new GAMAP. This means there is some inconsistency in respect of the accounting standards applied by municipalities as part of the transitional arrangements. The National Treasury has provided clear guidance and training as to which accounting standards would apply to which municipalities. The guidance is contained in MFMA circulars 36 and 18, dated 11 July 2006 and 23 June 2005, respectively.

In December 2005 the framework for the preparation and presentation of financial statements, as well as the first three standards of GRAP developed by the ASB, was approved by the Minister of Finance.

The implementation of section 122(3) of the MFMA with respect to standards of GRAP, as prescribed by the ASB, will be phased in according to municipal capacity levels as follows:

Capacity level	**Year ended**
High	30 June 2006
Medium	30 June 2007
Low	30 June 2008

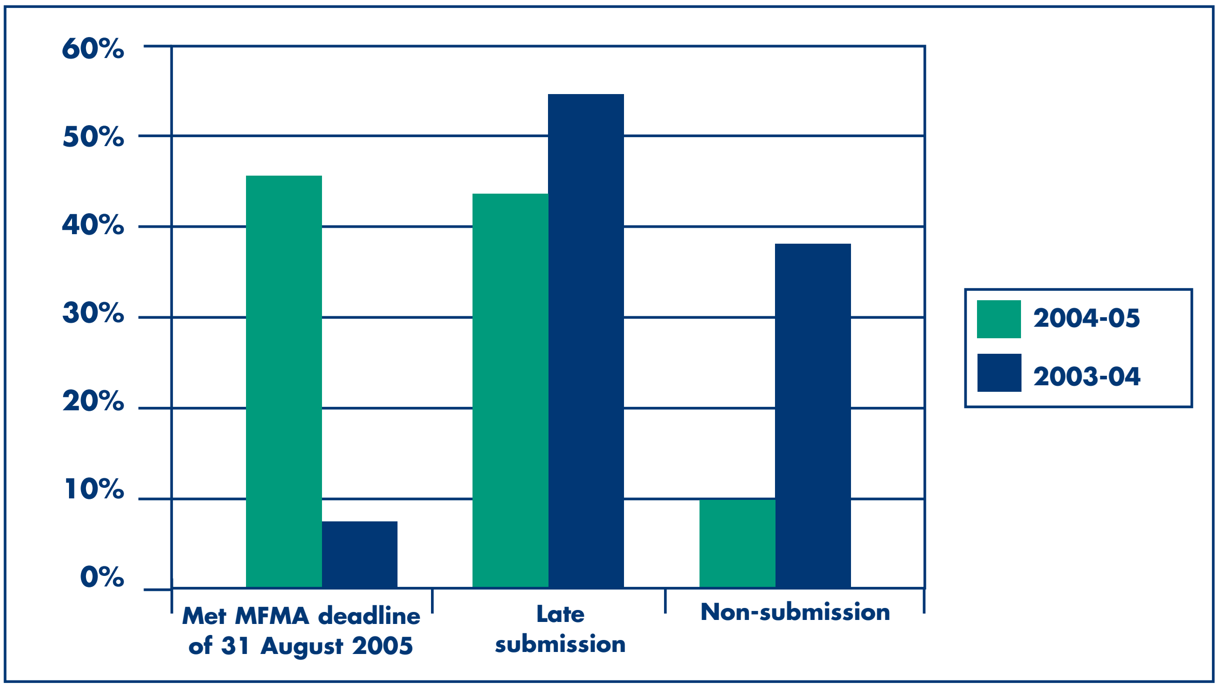
The above implies that municipalities and municipal entities must comply with the standards of GRAP issued by the ASB and regulated by the Minister of Finance as at the end of the financial year applicable to them.

Submission of financial statements:

Figure 1 below shows that as at 31 March 2006, 131 (46%) (2003-04: 20) of the 284 municipalities had submitted their annual financial statements by 31 August 2005. One hundred and fifty-nine municipalities originally met the submission date of 31 August 2005 as prescribed by the MFMA. However, 27 of these municipalities withdrew their annual financial statements.

One hundred and twenty-six municipalities (44%) submitted annual financial statements between 1 September 2005 and 31 March 2006, while 27 (10%) had not submitted annual financial statements by 31 March 2006.

Figure 1: Submission of 2004-05 financial statements by all municipalities



As at the end of March 2006, 257 of the 284 municipalities had submitted financial statements. Nine months after the year-end, this represents 90% of all municipalities (figure 3). With regard to the audits, only 126 (44%) of the 284 municipalities have been finalised. A challenge facing the Auditor-General is to provide audit reports not only on the 2004-05 financial statements, but also on financial statements that had not yet been finalised for the period before the 2004-05 financial year (backlog of financial statements).

Figure 2: Submission of 2004-05 financial statements of the top 50 municipalities

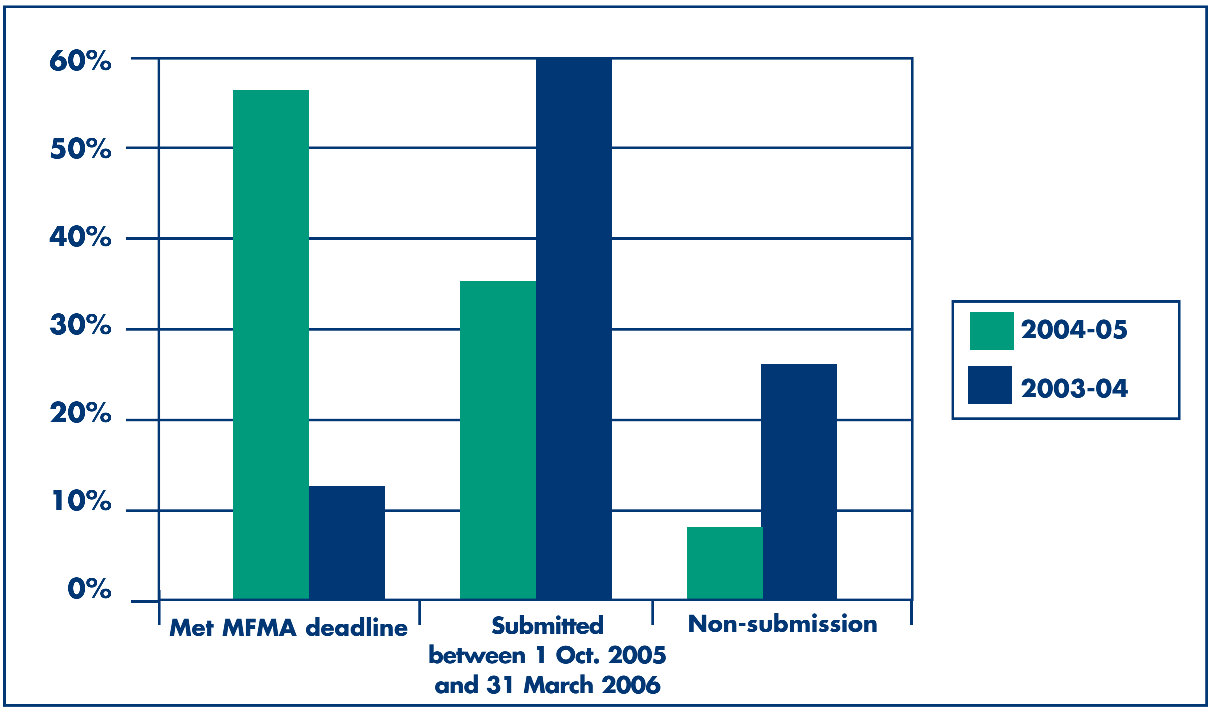


Figure 2 above shows that of the top 50 municipalities, 33 municipalities originally met the submission date of 31 August 2005; however, five municipalities withdrew their financial statements. Thus only 28 of the top 50 municipalities met the MFMA deadline (56%). Four (8%) of the top 50 municipalities had not submitted financial statements by 31 March 2006 (table 2), while 18 of the top 50 municipalities (36%) (2003-04: 60%) submitted their financial statements between 1 October 2005 and 31 March 2006 (table 3). Nine (18%) have subsequently resubmitted their financial statements.

Table 2: Top 50 municipalities that had not submitted financial statements by 31 March 2006

Ranking	Province	Municipality
11	Free State	Matjhabeng Municipality
15	Gauteng	Mogale City Local Municipality
28	North West	Local Municipality of Madibeng
30	Free State	Maluti-A-Phafung Local Municipality

Table 3: Top 50 municipalities that submitted financial statements late

Ranking	Province	Municipality	Date submitted	Withdrawn
1	Gauteng	City of Johannesburg Municipality	30 September 2005	No
10	Gauteng	Emfuleni Local Municipality	6 December 2005	Yes
13	KwaZulu-Natal	uMhlathuze Municipality	1 September 2005	No
16	Northern Cape	Sol Plaatje Municipality	30 September 2005	No
21	Mpumalanga	Govan Mbeki Municipality	30 September 2005	No
22	KwaZulu-Natal	Newcastle Municipality	17 January 2006	No
24	Western Cape	George Municipality	24 March 2006	Yes
26	Eastern Cape	Amatole Municipality	29 September 2005	Yes
29	Eastern Cape	OR Tambo Municipality	8 September 2005	No
36	KwaZulu-Natal	Emnambithi / Ladysmith Municipality	30 September 2005	No
37	Free State	Metsimaholo Local Municipality	7 December 2005	Yes
38	Free State	Moqhaka Local Municipality	10 January 2006	Yes
40	Gauteng	Merafong City Local Municipality	6 January 2006	Yes
43	Mpumalanga	Ehlanzeni Municipality	29 September 2005	No
46	Gauteng	Randfontein Local Municipality	26 October 2005	Yes
47	Western Cape	Saldanha Bay Municipality	9 February 2006	Yes
49	KwaZulu-Natal	Uthungulu District Municipality	12 October 2005	Yes
50	Western Cape	Overstrand Municipality	14 November 2005	No

With reference to table 3 above, in the case of nine of the 18 municipalities (50%) that submitted their annual financial statements late, the financial statements were submitted and subsequently withdrawn. This occurred where a municipality submitted its financial statements and subsequently, for some reason or other (mainly due to a possible negative audit opinion), withdrew those financial statements and then resubmitted the corrected financial statements at a later stage.

Table 4: Top 50 municipalities that submitted financial statements, which were subsequently withdrawn and have not yet been resubmitted

Ranking	Province	Municipality
11	Free State	Matjhabeng Local Municipality
30	Free State	Maluti-A-Phofung Local Municipality

The two municipalities in table 4 above withdrew their financial statements but had not resubmitted them as at the end of March 2006. Matjhabeng Local Municipality resubmitted their annual financial statements on 6 April 2006 and Maluti-A-Phofung Local Municipality resubmitted on 17 May 2006.

Of the 159 municipalities that originally met the submission date of 31 August 2005, 27 (17%) withdrew their financial statements. Of the 27 municipalities that withdrew their financial statements, 24 have since resubmitted (figure 3).

Financial statements were withdrawn for a number of reasons, such as the following:

- Financial statements were incomplete
- The previous year's financial statements were incomplete
- Material changes to the annual financial statements due to audit findings

Figure 3 below shows that 90% of the 284 municipalities' financial statements had been submitted and that 2% had been withdrawn but not resubmitted, while 8% of the municipalities had not submitted any financial statements to date.

Figure 3: 2004-05 financial statements accepted versus financial statements withdrawn for all 284 municipalities

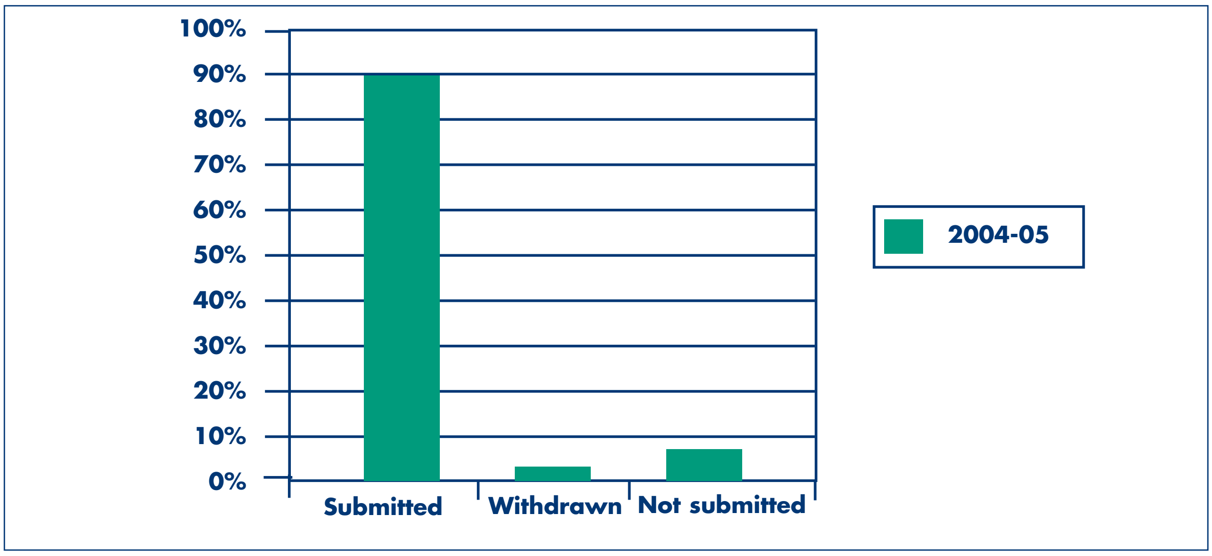
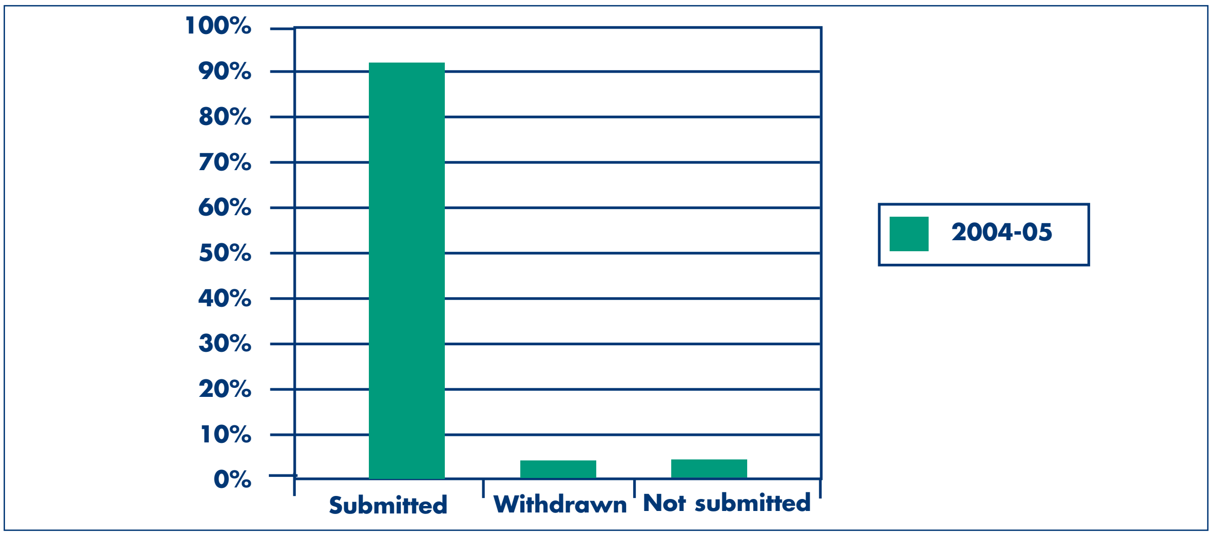


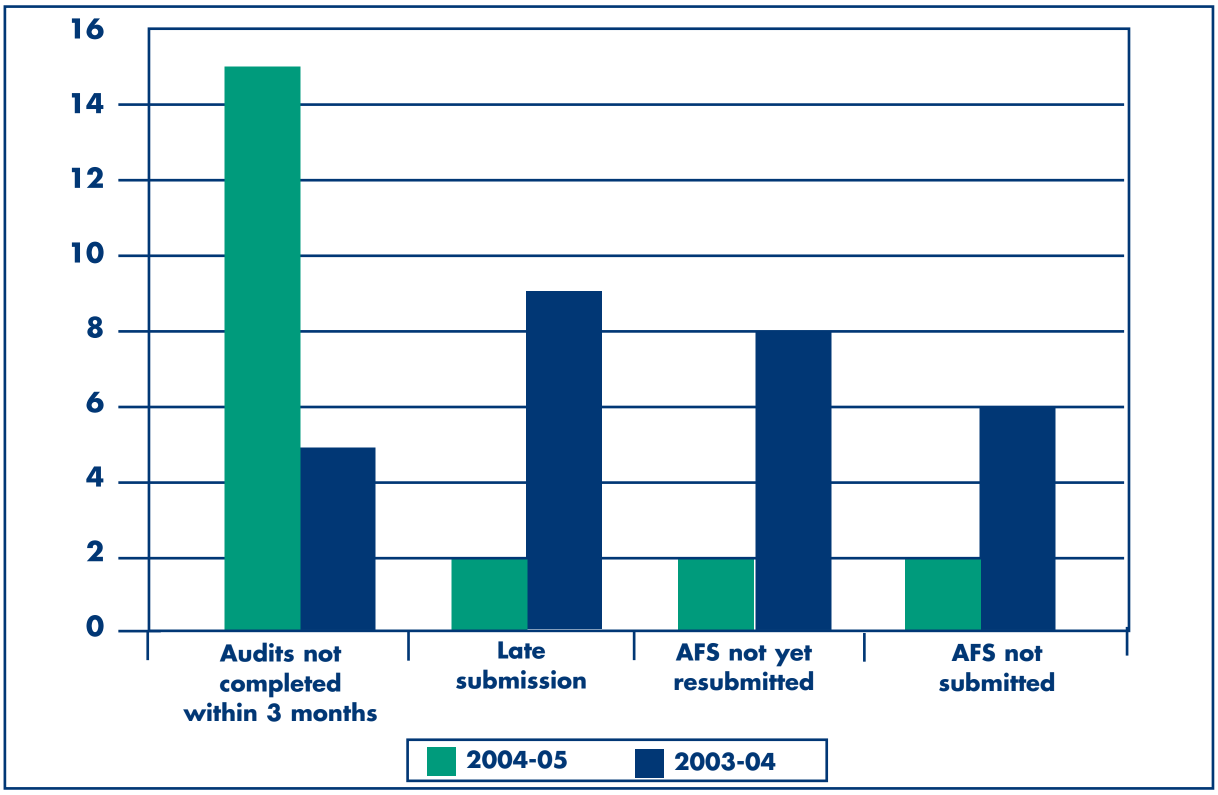
Figure 4 below shows that 92% of the top 50 municipalities' financial statements had been submitted and that 4% had been withdrawn but not resubmitted, while 4% of the municipalities had not submitted any financial statements to date.

Figure 4: 2004-05 financial statements accepted versus financial statements withdrawn for the top 50 municipalities



The status of the 21 (2003-04: 28) top 50 municipalities' audits that have not been finalised is disclosed in figure 5.

Figure 5: 2004-05 audits not finalised for the top 50 municipalities



In 16 cases the audits were not finalised within three months after receiving the financial statements. This was due to the following:

- Late finalisation of financial statements of the previous financial year (2003-04) (Ekurhuleni Metro Municipality and Uthungulu District Municipality)
- Still busy with prior year's audits (OR Tambo Municipality, Sol Plaatjie Municipality, King Sabata Dalindyebo Local Municipality, Sekhukhune Cross Boundary District Municipality, Greater Tzaneen Municipality, KwaDukuza Municipality, Ehlanzeni Municipality, Hibiscus Coast Municipality and Ukhahlamba District Municipality)
- Late submission or non-submission of supporting information (City of Tshwane Municipality and Randfontein Local Municipality)
- Awaiting management response to queries raised during the audit (Emfuleni Local Municipality and Metsimaholo Local Municipality)

The key attributes of good governance are accountability and transparency, which are achieved through the timely submission of financial statements, audit and annual reports. Receiving the financial statements after the set deadline not only impacts on the ability of my office to perform its function in this regard, but also confirms my concern about the ability of the municipality to perform within the accountability framework. However, the financial statements must be of acceptable quality and should not be submitted just for the sake of compliance with legislation.

AUDITOR-GENERAL

With the advent of the MFMA, more pressure was placed on municipalities, which still results in non-compliance with the act where municipalities are not able to meet the requirements.

The untimely submission of financial statements also has an effect on the scheduling and resourcing of the audits. This further highlights the urgency surrounding the issue of timely submission of financial statements. The withdrawal of annual financial statements also has an impact on the audit fees since it requires additional audit work and time.

Financial statements: 2003-04

The audits of 28 of the top 50 municipalities had not been finalised by 31 March 2005 due to the non-submission or late submission of financial statements.

Seventeen of these 28 had been finalised by 31 March 2006. The 11 audits that are still in progress are listed in the table below. Nine of the 11 municipalities have already submitted their 2004-05 financial statements. However, finalising the current year's audits (2004-05) hinges on the finalisation of the 2003-04 financial statements and auditing process.

Audits of the top 50 municipalities still in progress: 2003-04

Ranking	Municipality	2004-05 financial statements received
15	Mogale City Local Municipality	No
16	Sol Plaatjie Municipality	Yes
29	OR Tambo Municipality	Yes
30	Maluti-a-Phofung Local Municipality	No
33	King Sabata Dalindyebo Local Municipality	Yes
34	Greater Sekhukhune Cross Boundary Municipality	Yes
41	Greater Tzaneen Municipality	Yes
42	KwaDukuza Municipality	Yes
43	Ehlanzeni Municipality	Yes
44	Hibiscus Coast Municipality	Yes
48	Ukhahlamba District Municipality	Yes

Project management is a key challenge in any auditing environment. This becomes even more challenging with municipal audits where it is difficult to estimate when financial statements will be submitted or resubmitted because of the backlog in financial statements for previous periods and the implementation of the MFMA.

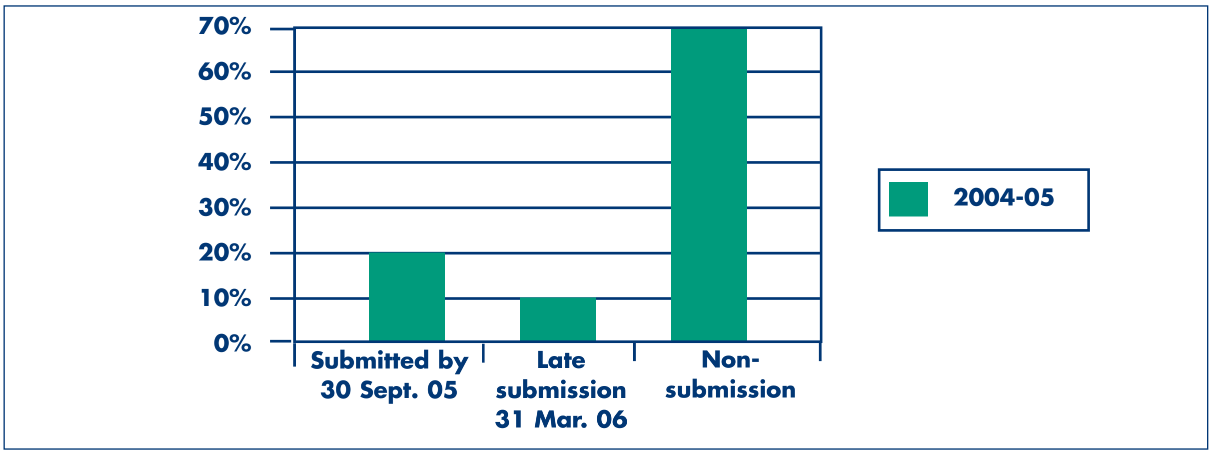
2.2 Consolidated financial statements

In terms of section 126(1)(b) of the MFMA, the accounting officer must:

- Prepare consolidated annual financial statements of the municipality
- Within three months after the end of the financial year to which those statements relate, submit the statements to the Auditor-General for auditing

According to my office, there are 20 municipalities that have control over entities and should prepare consolidated financial statements. Figure 6 below shows that of these 20 municipalities, only 4 (20%) had submitted consolidated annual financial statements by 30 September 2005, while two (10%) submitted between 1 October 2005 and 31 March 2006.

Figure 6: Submission by municipalities of the 2004-05 consolidated financial statements



The slow rate at which consolidated financial statements are submitted for auditing is a matter of serious concern. For consolidation to be completed, all information on municipalities and municipal entities is required.

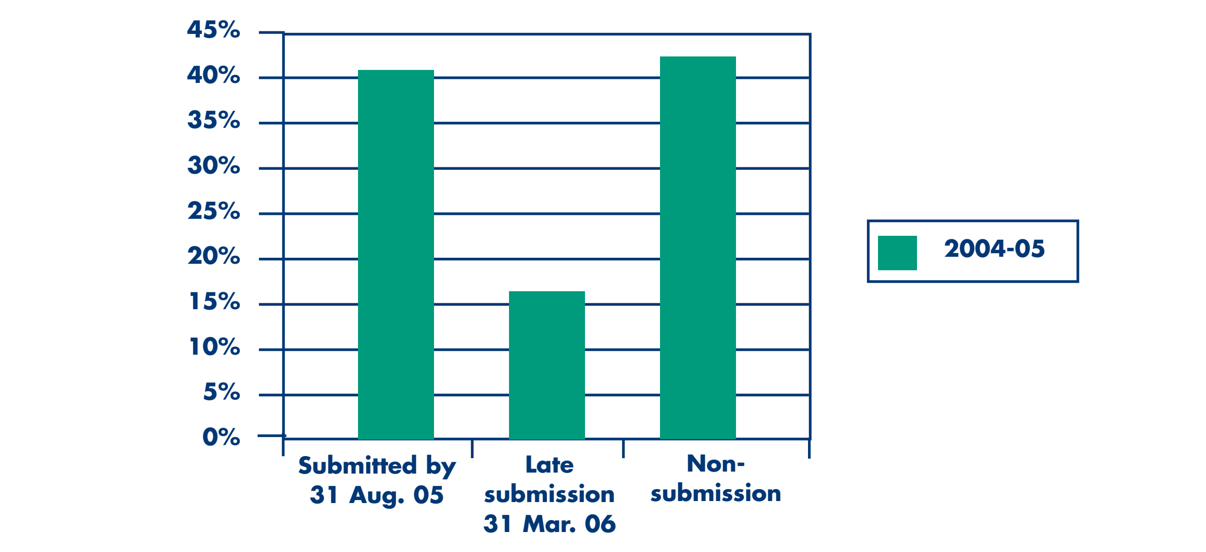
2.3 Municipal entities

In terms of section 126(2) of the MFMA, the accounting officer of a municipal entity must:

- Prepare annual financial statements of the municipal entity
- Within two months after the end of the financial year to which those statements relate, submit the statements to the Auditor-General for auditing and to the parent municipality of the entity.

According to information received by my office, there are 74 municipal entities. Figure 7 below shows that of these 74 municipal entities, 30 (41%) had submitted their financial statements by 31 August 2005 as prescribed by the MFMA. Thirty-four municipal entities (46%) originally met the submission date of 31 August 2005, but four of these withdrew their financial statements. A further 12 (16%) submitted annual financial statements between 1 September 2005 and 31 March 2006, while 32 (43%) had not submitted annual financial statements by 31 March 2006.

Figure 7: Submission of the 2004-05 municipal entity financial statements



While I recognise that the continued existence of many of the municipal entities is still under debate, the slow rate of submission of their financial statements remains a matter of concern as this affects the finalisation of consolidated annual financial statements. Municipal entities, despite potential closure, are still required to submit financial statements in accordance with the MFMA.

3. AUDIT OPINIONS[4]

Only 126 (44%) of the 284 audits had been finalised by 31 March 2006, while the audits of only 29 (58%) of the top 50 had been finalised by 31 March 2006. If the high-capacity municipalities are excluded, only 96 (41%) of the audits of medium- and low-capacity municipalities had been finalised.

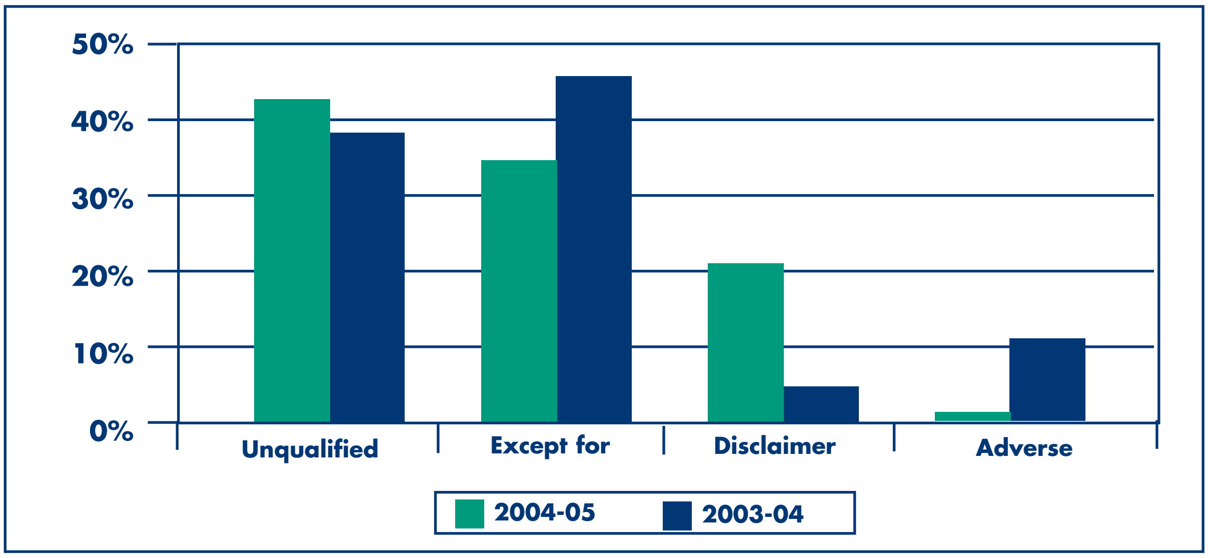
Of the 126 (2003-04: 89) audits that were finalised, 72 (57%) were qualified. The distribution of the audit opinions was as follows, and is depicted in figure 8 below:

- 26 were "disclaimers" (21%)
- 2 had an "adverse" audit opinion (1%)
- 44 were "except for" (35%)
- 54 were unqualified (43%)

A disclaimer or adverse audit opinion represents the most severe type of audit opinion. The reason for a disclaimer is that documentation could not be provided to the auditors. This is a further example of a lack of accountability and poor financial management as financial statements were submitted to comply with the MFMA although supporting evidence on which they are based could not be provided.

[4] It should be noted that comparative figures include the same 29 municipalities that have been analysed for the current year. Comparative figures will thus not agree to my previous report.

Figure 8: 2004-05 audit opinions – all municipalities that had been audited



Of the 29 top 50 municipalities audits that were finalised, 14 (45%) were qualified. The distribution of the audit opinions was as follows, and is depicted in figure 9 below:

- Fifteen were unqualified (52%), compared to 18 (62%) in 2003-04.
- Fourteen of those 15 included emphasis of matter paragraphs (table 5). One municipality, namely Emnambithi Municipality, had an unmodified ("clean") report.
- Ten were "except for" (34%), compared to 6 (21%) in 2003-04
- Four were "disclaimer" (14%), compared to 3 (10%) in 2003-04.
- No "adverse" opinions (-%), compared to 2 (7%) in 2003-04.

Figure 9: 2004-05 audit opinions – top 50 municipalities that had been audited

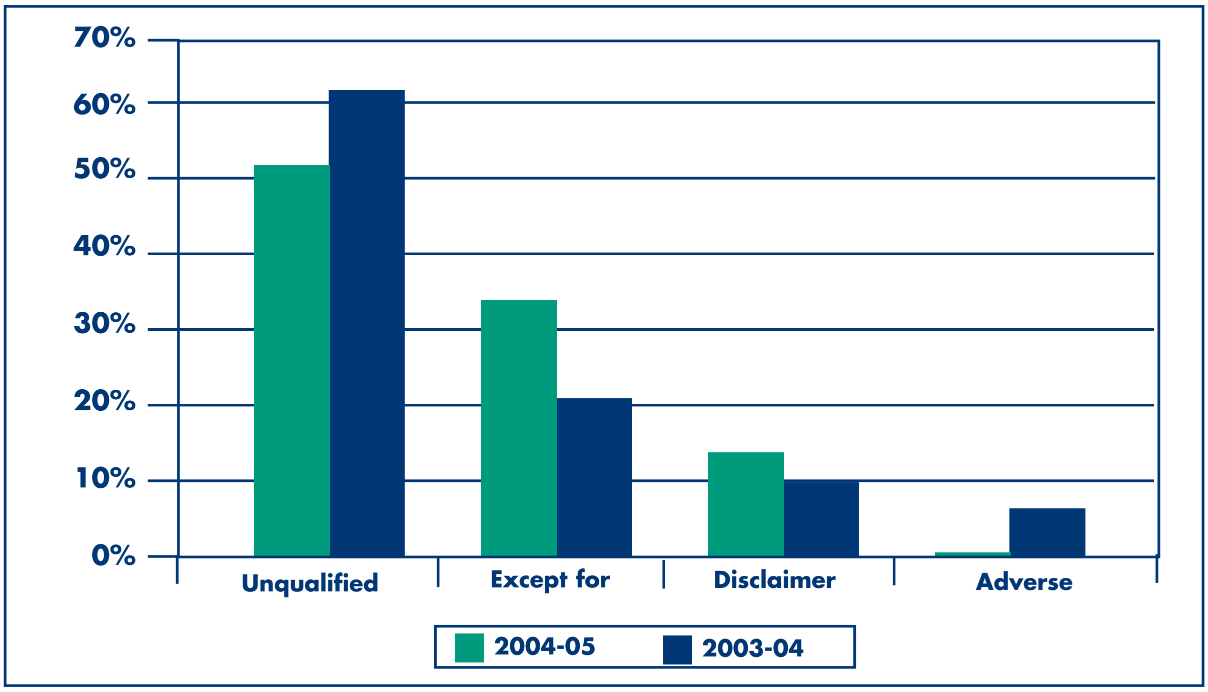


Table 5 below lists the 14 municipalities that had an unqualified audit opinion with an emphasis of matter.

Table 5: Top 50 municipalities that had an unqualified audit opinion with an emphasis of matter for 2004-05

Ranking	Province	Municipality
2	Western Cape	City of Cape Town Municipality
3	KwaZulu-Natal	eThekwini Metropolitan Municipality
13	KwaZulu-Natal	uMhlathuze Municipality
14	Limpopo	Polokwane Municipality
18	Eastern Cape	Emalahleni Local Municipality
24	Western Cape	George Municipality
25	Western Cape	Stellenbosch Municipality
26	Eastern Cape	Amatole Municipality
27	Mpumalanga	Steve Tshwete Municipality
32	North West	Bojanala Platinum District Municipality
35	Mpumalanga	Nkangala Municipality
39	Western Cape	Breede Valley Municipality
45	Western Cape	Mossel Bay Municipality
47	Western Cape	Saldanha Bay Municipality

The table above shows that six of the 14 municipalities (43%) that had unqualified audit opinions were in the Western Cape. The Eastern Cape, KwaZulu-Natal and Mpumalanga each had two municipalities that received an unqualified audit opinion with an emphasis of matter. North West and Limpopo each had one municipality that had an unqualified audit opinion with an emphasis of matter.

Audit opinions per municipality analysed

Issues contributing to qualified opinions according to the various categories are summarised in table 6 below. Issues of asset management and accounts receivable and revenue contributed to 53% of the total number of issues raised. Previously only 72 issues were raised on these two categories; however, this increased by 40 to 112. This represents an increase of 56% compared to 2003-04. Refer to annexure B for the detailed qualification paragraphs.

Table 6: Qualification: Analysis of issues

Category of qualification	2004-05 Number of issues	2003-04 Number of issues
Asset management	56	31
Accounts receivable and revenue	56	41
Personnel	13	8
Unauthorised, fruitless and irregular expenditure	4	-
Other	81	30
Total	**210**	**110**

The purpose of including emphasis of matter paragraphs in an audit report is to bring matters to the attention of the readers of the report, without qualifying the audit opinion. Table 7 below summarises certain matters that were emphasised in various audit reports:

Table 7: Emphasis of matter: Analysis of issues

Category of emphasis of matter	2004-05 Number of issues	2003-04 Number of issues
Asset management	29	50
Transfer payments (including Division of Revenue Act)	4	1
Accounts receivable and revenue	83	82
Personnel	41	50
Unauthorised, fruitless and irregular expenditure	8	9
Internal audit and audit committee	40	26
Information systems	38	71
Other	218	167
Total	**461**	**456**

From the two tables (tables 6 and 7) above it is clear that the number of qualifications increased by almost 100% from the 2003-04 to the 2004-05 financial year, while the emphasis of matter paragraphs remained virtually unchanged.

Although the number of emphasis of matter asset management paragraphs almost halved, the qualification paragraphs for the same issue virtually doubled. It is clear that asset management is an area of great concern.

In terms of section 165(1) of the MFMA, each municipality and each municipal entity must have an internal audit unit. In section 5 of this report, I report on the audit of municipal performance management and measurement. In this section I specifically report on whether or not the municipality met the requirement of having an internal audit unit and a performance audit committee. As can be seen in table 7 above, 40 of the issues reported in audit reports (emphasis of matter issues) related to the functioning of an internal audit unit and audit committee. The number of issues almost doubled compared to the previous year. One of the 40 issues related to the existence of an internal audit function and one to the existence of a performance audit committee.

AUDITOR-GENERAL

In terms of section 165(2) of the MFMA, the internal audit unit of a municipality must –

(a) Prepare a risk-based audit plan and an internal audit programme for each financial year;
(b) Advise the accounting officer and report to the audit committee on the implementation of the internal audit plan;
(c) Perform such other duties as may be assigned to it by the accounting officer.

Seventeen of the 40 issues related to the functioning of the internal audit unit. The main issues were the following:

- There were deviations from the audit plan or a plan had not been compiled.
- The internal audit function did not perform any audits or submit any reports.
- There was no internal audit training and development programme.
- Limited reliance was placed on the work of internal audit.
- The head of internal audit did not report directly to the audit committee.
- The internal audit unit's processes were not adequate according to prescribed norms and standards as stipulated by the MFMA.
- The unit did not operate independently from the general operating control environment.
- Staff of the internal audit unit were not members of the Institute of Internal Auditors.

In terms of section 166(1) of the MFMA, each municipality and municipal entity must have an audit committee. Five of the 40 issues related to the existence of an audit committee.

In terms of section 166(2) of the MFMA, an audit committee is an independent advisory body which must –

(a) Advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality and municipal entity, or the board of directors of the municipal entity, on matters relating to –
    (i) internal financial control and internal audits;
    (ii) risk management;
    (iii) accounting policies;
    (iv) the adequacy, reliability and accuracy of financial reporting and information;
    (v) performance management;
    (vi) effective governance;
    (vii) compliance with the MFMA, the Division of Revenue Act (DoRA) and any other applicable legislation;
    (viii) performance evaluation; and
    (ix) any other issues referred to it by the municipality or municipal entity.

Twelve of the 40 issues on internal audit related to the above.

The four other issues regarding an audit committee included the following:

- Council did not periodically evaluate the effectiveness and performance of the audit committee.
- No audit committee meeting had taken place.
- The audit committee did not conduct any reviews or submit any report or recommendations.
- The effective functioning of the audit committee could not be evaluated as no minutes of the meetings were prepared.

Included under other issues in table 7 above are opinions raised on reticulation losses. Eleven issues were reported on reticulation losses for those municipalities analysed. Refer to section 4.5 for analyses performed on reticulation losses for both water and electricity.

4. FINANCIAL PERFORMANCE OF 29 OF THE TOP 50 MUNICIPALITIES AUDITED BY 31 MARCH 2006[2]

The financial statements of 29 of the top 50 municipalities, whose audits had been finalised by 31 March 2006, were analysed to enable the user of those financial statements to be better able to interpret the information they provide. Key indicators pertaining to the following ratios/data were analysed:

- Debt-collection period
- Provision for bad debt in relation to total debt
- Liquidity
- Total income in relation to current liabilities
- Reticulation losses

The process of analysis and interpretation is aimed at establishing trends for the particular municipality under review and comparing the results and trends revealed by the analysis with those of other similar entities in order to determine the relative strength (or otherwise) of the municipality.

Financial performance relates to the capabilities of a municipality in terms of financial strength. Employing ratios to analyse the financial statements is very useful in assessing the financial strength of the organisation under review.

The comparative information included in this report of those municipalities that converted from IMFO to GAMAP during the 2004-05 financial year was amended to reflect the comparative information as per the financial statements.

4.1 Debt-collection period

This ratio indicates the length of time it takes consumer debtors to pay their accounts or the municipality's ability to recover outstanding debts. A long debt-collection period could have a severe impact on the liquidity of the municipality. Liquidity refers to the municipality's ability to meet its operational expenses through the income generated. Aspects such as provision for doubtful debts and the rates, credit control, indigent and debt write-off policies influence the debt-collection period as calculated in figure 10.

The collection period could translate directly into cash flow and/or going concern problems. Municipalities fulfil critical roles and responsibilities within the total service delivery system of government to its citizens. By not having the necessary funding to perform the task because debtors are not paying, municipalities could place government at risk of not being able to provide the expected services.

The average consumer debt-collection period for the 29 municipalities was 196 days (2003-04: 207 days). Only 14 municipalities (48%) were able to recover their debts within 100 days (approximately

[2] It should be noted that comparative figures include the same 29 municipalities that have been analysed for the current year. Comparative figures will thus not agree to my previous report.

three months), while the remaining 15 municipalities took 100 days or longer to recover their debts. The benchmark for the debt-collection period is 45 to 60 days.

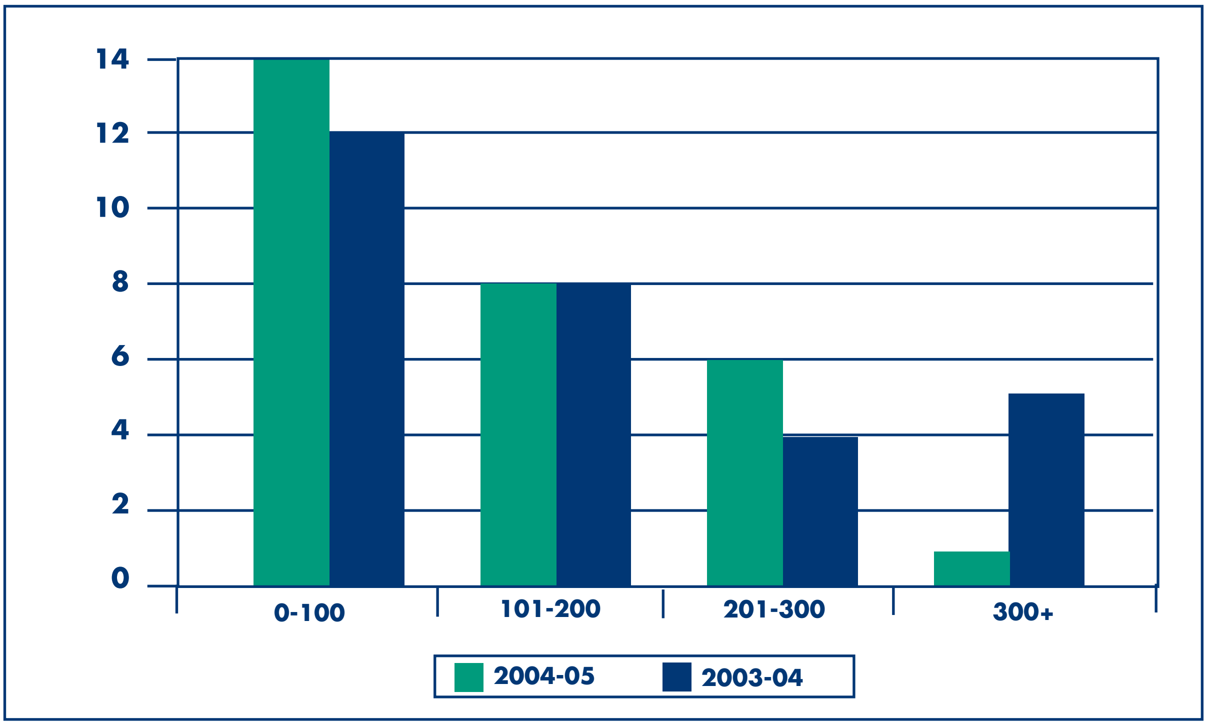
Total consumer debtors for the 29 municipalities was R19,5 billion in 2004-05 (2003-04: R18,8 billion), which represents an increase of R0,7 billion over a 12-month period. This also supports the argument that municipalities are struggling to collect outstanding consumer debts.

The information disclosed in the financial statements does not enable the reader to distinguish regarding the following:

- services rendered and debts outstanding in respect of indigent households;
- interest accumulated on debt, especially old debt;
- the percentage of debtors paying on a monthly basis; or
- the methods of payment and levels of suspense account balances.

These factors will substantially enhance the user-friendliness and relevance of the financial statements and provide more insight to facilitate benchmarking.

Figure 10: Debt-collection period in days



As seen above, the number of municipalities that recovered their consumer debts within 100 days increased from 12 to 14. The number of municipalities that recovered their consumer debts over 300 days decreased from five to only one municipality. This shows a significant improvement in some of the municipalities' ability to collect consumer debts.

However, there has been little or no improvement in consumer debts recovered within more than 100 days but less than 300 days. The majority of municipalities fall within this category.

AUDITOR-GENERAL

4.2 Provision for bad debt in relation to total debtors

Provision for bad debt is a standard ratio, expressing the provision for non-recoverable debt as a percentage of the total debt. This is also an indication of a municipality's ability to recover outstanding debt. Each individual municipality determines the debt write-off policy. The annual financial statements do not state what portion of such written-off bad debt is due to non-recovery or incorrect billing and recording.

The higher the percentage provision in relation to total debtors, the less likely the municipality will be able to recover the debt. The average provision for bad debt was 66% (2003-04: 64%), which is extremely high.

Of the non-metropolitan municipalities, Mbombela Municipality made the highest provision with 89,2% and Polokwane Municipality the lowest with 1,8%. Of the metropolitan municipalities, City of Johannesburg Municipality made the highest provision with 79,1% and eThekwini Municipality the lowest with 35,2%.

The total provision for bad debt in 2004-05 was R13,3 billion (2003-04: R12,3 billion). There was an increase of R1 billion in the provision for bad debt, which reinforces the argument that the recovery of debts is a serious issue. Total debtors amounted to R21,8 billion (2003-04: R20,9 billion), resulting in an increase of R0,9 billion.

There was an increase of 8% in total provision for bad debt compared to an increase of only 4% in total debtors.

Table 8: Provision for bad debt as a percentage of total debtors

Ranking	Municipality	2004-05	2003-04
1	City of Johannesburg Municipality	79,1%	79,1%
2	City of Cape Town Municipality	52,9%	50,3%
3	eThekwini Municipality	35,2%	27,4%
5	City of Tshwane Metropolitan Municipality	#	22,2%
6	Nelson Mandela Municipality	53,0%	48,3%
7	Mangaung Municipality	24,4%	29,9%
8	Buffalo City Municipality	38,1%	45,0%
9	Msunduzi Municipality	32,2%	21,1%
12	Rustenburg Municipality	63,4%	70,5%
13	uMhlathuze Municipality	23,7%	22,2%
14	Polokwane Municipality	1,8%	7,9%
17	City Council of Klerksdorp	76,8%	80,1%
18	Emalahleni Municipality	65,6%	72,4%
19	Drakenstein Municipality	65,8%	60,3%
20	Mbombela Local Municipality	89,2%	86,5%

Ranking	Municipality	2004-05	2003-04
21	Govan Mbeki Municipality	62,9%	26,6%
23	Ugu District Municipality	11,9%	14,0%
24	George Municipality	76,8%	61,1%
25	Stellenbosch Municipality	46,4%	41,7%
26	Amatole District Municipality	23,4%	30,8%
27	Steve Tshwete Municipality	48,3%	53,6%
31	Potchefstroom Municipality	36,1%	38,1%
32	Bojanala Platinum District Municipality	82,3%	28,9%
35	Nkangala District Municipality	29,1%	29,2%
36	Emnambithi Municipality	37,6%	66,4%
38	Moqhaka Municipality	51,8%	33,7%
39	Breede Valley Municipality	84,1%	75,5%
45	Mossel Bay Municipality	50,6%	54,3%
47	Saldanha Bay Municipality	21,1%	16,0%
50	Overstrand Municipality	50,4%	61,5%

Audit not yet finalised

4.3 Liquidity

The liquidity of a municipality revolves around its ability to meet its short-term liabilities (normally repayable within one year after accounting date) using short-term assets (current assets) and cash flows. The liquidity ratios are of concern, not only to the short-term creditors but also to the long-term creditors, as the enterprise's ability to remain liquid will directly affect its ability to repay long-term funds, for example, out of cash flows.

The norm applied by the private sector for the current ratio is 2:1, which means that there are two rands' worth of current assets for one rand in current liabilities. The average liquidity ratio for the municipalities analysed was 1,21:1 (2003-04: 1,39:1). This ratio decreased from last year by 0,18. However, although this does not seem like a lot it is very worrying. Currently the ratio is already below the norm set by the private sector and, given the current trend, it seems that the liquidity position is worsening year on year. This ratio, especially with regard to current assets, could be affected by the recovery of outstanding debt and the related provision for bad debt.

Table 9: Liquidity (short-term assets: short-term liabilities)

Ranking	Municipality	2004-05	2003-04
1	City of Johannesburg Municipality	0,88	1,00
2	City of Cape Town Municipality	1,38	1,35
3	eThekwini Municipality	0,68	1,19
5	City of Tshwane Municipality	#	1,53
6	Nelson Mandela Municipality	1,31	1,44
7	Mangaung Municipality	3,04	3,46
8	Buffalo City Municipality	1,65	1,47
9	Msunduzi Municipality	1,73	1,96
12	Rustenburg Municipality	3,32	2,85
13	uMhlathuze Municipality	0,90	1,22
14	Polokwane Municipality	9,88	8,02
17	City Council of Klerksdorp	3,02	2,65
18	Emalahleni Municipality	2,23	2,06
19	Drakenstein Municipality	2,53	2,33
20	Mbombela Local Municipality	1,56	1,69
21	Govan Mbeki Municipality	1,65	2,45
23	Ugu District Municipality	3,07	3,60
24	George Municipality	2,90	3,24
25	Stellenbosch Municipality	2,62	2,33
26	Amatole District Municipality	2,50	2,29
27	Steve Tshwete Municipality	1,00	0,98
31	Potchefstroom Municipality	2,68	3,43
32	Bojanala Platinum District Municipality	1,71	1,39
35	Nkangala District Municipality	2,16	2,74
36	Emnambithi Municipality	1,31	1,29
38	Moqhaka Municipality	1,85	3,34
39	Breede Valley Municipality	1,57	1,93
45	Mossel Bay Municipality	3,58	2,79
47	Saldanha Bay Municipality	6,20	6,27
50	Overstrand Municipality	1,47	1,35

Audit not yet finalised

Polokwane Municipality had the highest ratio, i.e. 9,88, and eThekwini Municipality the lowest with 0,68.

4.4 Total income in relation to current liabilities

Current liabilities refer to creditors of the council that will have to be paid in the short term, usually from funds generated in the new financial year or from repayments received from debtors. With the trend of increasing debtor account balances and debt-collection periods, it seems that municipalities are faced with the responsibility of repaying creditors from income generated and received in the forthcoming year. Obviously this is not a healthy situation since a portion of income will again not be recovered. For the purpose of this analysis, current liabilities are calculated as a percentage of total income.

The average ratio was 3,12 (2003-04: 3,24). Polokwane Municipality had the highest ratio with 16,70, and Amatole District Municipality the lowest with 2,21.

Table 10: Current liabilities to total income (1: ratio)

Ranking	Municipality	2004-05	2003-04
1	City of Johannesburg Municipality	2,57	2,59
2	City of Cape Town Municipality	3,09	3,33
3	eThekwini Municipality	2,39	2,64
5	City of Tshwane Municipality	#	3,38
6	Nelson Mandela Municipality	5,41	5,37
7	Mangaung Municipality	5,14	5,06
8	Buffalo City Municipality	4,65	4,09
9	Msunduzi Municipality	3,86	4,27
12	Rustenburg Municipality	5,18	5,69
13	uMhlathuze Municipality	4,25	4,84
14	Polokwane Municipality	16,70	16,28
17	City Council of Klerksdorp	7,10	5,50
18	Emalahleni Municipality	5,02	5,26
19	Drakenstein Municipality	5,54	5,01
20	Mbombela Local Municipality	3,98	5,10
21	Govan Mbeki Municipality	5,68	5,21
23	Ugu District Municipality	3,70	4,25
24	George Municipality	4,71	4,90
25	Stellenbosch Municipality	5,81	4,65
26	Amatole District Municipality	2,21	1,12
27	Steve Tshwete Municipality	3,23	3,79
31	Potchefstroom Municipality	7,66	10,42
32	Bojanala Platinum District Municipality	15,65	9,64
35	Nkangala District Municipality	3,84	3,54
36	Emnambithi Municipality	2,67	2,83
38	Moqhaka Municipality	2,78	4,29
39	Breede Valley Municipality	8,30	7,12
45	Mossel Bay Municipality	5,51	4,84
47	Saldanha Bay Municipality	6,86	8,51
50	Overstrand Municipality	3,29	3,25

\# Audit not yet finalised

4.5 Reticulation losses

Reticulation losses refer to the loss of water and electricity services provided, for instance through leakage, malfunctioning meters or illegal tapping of electricity and water lines. Losses impact negatively on the consumer, as the tariff structure accommodates the recovery of losses. It is thus critical that municipalities ensure that losses are limited by means of proper control measures.

Tables 11 and 14 indicate the percentage reticulation losses for water and electricity, respectively, while tables 12 and 15 indicate the number of units lost as disclosed in the annual financial statements. No information is available as to how much of these losses are the result of leakage, malfunction or theft. Not all municipalities disclosed this information in their financial statements. Tables 13 and 16 list the purchase price per unit for water and electricity respectively.

Table 11: Percentage water reticulation losses

Ranking	Municipality	2004-05	2003-04
1	City of Johannesburg Municipality	32,8%	*
3	eThekwini Municipality	29,0%	31,0%
5	City of Tshwane Metropolitan Municipality	#	23,6%
6	Nelson Mandela Municipality	24,1%	22,3%
7	Mangaung Municipality	36,6%	37,5%
8	Buffalo City Municipality	44,7%	44,1%
9	Msunduzi Municipality	41,8%	43,1%
12	Rustenburg Municipality	30,8%	26,2%
13	uMhlathuze Municipality	21,0%	19,9%
14	Polokwane Municipality	27,4%	30,8%
17	City Council of Klerksdorp	28,4%	32,8%
18	Emalahleni Municipality	41,8%	40,7%
19	Drakenstein Municipality	*	10,5%
21	Govan Mbeki Municipality	10,1%	*
23	Ugu District Municipality	34,6%	37,6%
24	George Municipality	5,1%	9,9%
31	Potchefstroom Municipality	8,0%	2,2%
36	Emnambithi Municipality	*	3,3%
38	Moqhaka Municipality	26,3%	53,9%
39	Breede Valley Municipality	23,4%	12,9%
45	Mossel Bay Municipality	14,3%	11,5%
47	Saldanha Bay Municipality	7,3%	10,8%
50	Overstrand Municipality	*	15,0%

* Information not available to my office
\# Audit not yet finalised

The municipality with the highest percentage reticulation loss for water was Buffalo City Municipality, with a loss of 44,7%. The municipality with the lowest percentage loss was George Municipality, with only 5,1%. Sixteen of the 19 municipalities (84%) that disclosed percentage reticulation loss for water sustained a loss of more than the benchmark of 10%.

Table 12: Water reticulation losses (kl)

Ranking	Municipality	2004-05 (thousands)	2003-04 (thousands)	Increase/ (Decrease) (thousands)
3	eThekwini Municipality	83 848	88 217	(4 370)
5	City of Tshwane Metropolitan Municipality	#	52 189	^
6	Nelson Mandela Municipality	19 740	17 322	2 418
7	Mangaung Municipality	22 605	22 394	211
9	Msunduzi Municipality	14 739	18 398	(3 659)
12	Rustenburg Municipality	8 177	6 152	2 025
13	uMhlathuze Municipality	7 423	6 862	561
14	Polokwane Municipality	4 540	5 442	(902)
17	City Council of Klerksdorp	6 279	7 482	(1 203)
18	Emalahleni Municipality	13 276	12 861	415
19	Drakenstein Municipality	*	1 687	^
24	George Municipality	484	984	(500)
31	Potchefstroom Municipality	1 002	280	722
36	Emnambithi Municipality	*	619	^
38	Moqhaka Municipality	3 298	7 075	(3 777)
39	Breede Valley Municipality	2 991	1 632	1 359
45	Mossel Bay Municipality	1 253	894	359
47	Saldanha Bay Municipality	789	1 264	(475)
50	Overstrand Municipality	*	943	^
	Total	**190 444**	**252 697**	

* Information not available to my office
\# Audit not yet finalised
^ Figure could not be calculated

The non-metropolitan municipality with the highest number of units lost was Mangaung Municipality, with 22 605 thousand units, and the municipality with the lowest number of units lost was George Municipality with only 484 thousand units. The metropolitan municipality with the highest number of units lost was eThekwini Municipality, with 83 848 thousand units. In the case of most of the metropolitan municipalities this information was not disclosed.

On average there was a general decrease in the number of units lost.

Table 13: Purchase price for water (kl)

Ranking	Municipality	2004-05 R	2003-04 R
3	eThekwini Municipality	2,61	2,47
5	City of Tshwane Metropolitan Municipality	#	2,51
8	Buffalo City Municipality	*	1,50
12	Rustenburg Municipality	2,64	2,61
14	Polokwane Municipality	2,47	2,61
18	Emalahleni Municipality	1,84	1,67
19	Drakenstein Municipality	*	2,05
21	Govan Mbeki Municipality	2,62	*
24	George Municipality	1,43	0,98
25	Stellenbosch Municipality	0,34	0,32
31	Potchefstroom Municipality	1,05	0,70
36	Emnambithi Municipality	*	0,94
38	Moqhaka Municipality	2,24	1,64
39	Breede Valley Municipality	1,96	1,91
45	Mossel Bay Municipality	1,29	1,56
47	Saldanha Bay Municipality	1,85	1,78

* Information not available to my office

\# Audit not yet finalised

The average purchase price for water per kilolitre was R1,86 (2003-04: R1,78). The municipality with the highest purchase price was Rustenburg Municipality, with R2,64 per kilolitre, and the municipality with the lowest purchase price was Stellenbosch Municipality with R0,34 per kilolitre.

Table 14: Percentage electricity reticulation losses

Ranking	Municipality	2004-05	2003-04
1	City of Johannesburg Municipality	13,6%	12,9%
3	eThekwini Municipality	5,0%	4,5%
5	City of Tshwane Municipality	#	9,1%
6	Nelson Mandela Municipality	6,5%	5,7%
7	Mangaung Municipality	9,4%	7,9%
12	Rustenburg Municipality	2,3%	1,7%
13	uMhlathuze Municipality	4,4%	4,4%
14	Polokwane Municipality	8,5%	10,5%
17	City Council of Klerksdorp	17,4%	28,1%
18	Emalahleni Municipality	22,4%	22,7%
19	Drakenstein Municipality	*	7,0%
21	Govan Mbeki Municipality	12,2%	*
24	George Municipality	10,0%	5,7%
25	Stellenbosch Municipality	1,2%	1,5%
31	Potchefstroom Municipality	9,7%	6,7%

AUDITOR-GENERAL

Table 14: Percentage electricity reticulation losses *(cont)*

Ranking	Municipality	2004-05	2003-04
36	Emnambithi Municipality	*	12,6%
38	Moqhaka Municipality	6,1%	6,2%
39	Breede Valley Municipality	5,3%	12,5%
45	Mossel Bay Municipality	11,0%	11,5%
47	Saldanha Bay Municipality	9,1%	11,0%
50	Overstrand Municipality	*	13,1%

* Information not available to my office
\# Audit not yet finalised

The municipality with the highest percentage reticulation loss for electricity was Emalahleni Municipality, with a loss of 22,4%. The municipality with the lowest percentage loss was Stellenbosch Municipality with only 1,2%. Five of the 17 municipalities (29%) that disclosed percentage reticulation loss for electricity sustained a loss of more than the benchmark of 10%.

Table 15: Electricity reticulation losses (kwh)

Ranking	Municipality	2004-05 (thousands)	2003-04 (thousands)	Increase/ (Decrease) (thousands)
3	eThekwini Municipality	552 698	475 374	77 324
5	City of Tshwane Municipality	#	764 585	^
6	Nelson Mandela Municipality	213 133	186 000	27 133
7	Mangaung Municipality	144 721	116 877	27 844
12	Rustenburg Municipality	52 481	37 208	15 174
13	uMhlathuze Municipality	52	53	(1)
14	Polokwane Municipality	46 895	55 768	(8 873)
17	City Council of Klerksdorp	95 206	148 321	(53 115)
18	Emalahleni Municipality	171 026	165 540	5 486
19	Drakenstein Municipality	*	51 311	^
24	George Municipality	41 736	22 150	19 586
25	Stellenbosch Municipality	4 342	5 129	(787)
31	Potchefstroom Municipality	41 363	27 633	13 730
36	Emnambithi Municipality	*	36 472	^
38	Moqhaka Municipality	12 532	16 163	(3 631)
39	Breede Valley Municipality	13 718	33 133	(19 415)
45	Mossel Bay Municipality	28 521	27 713	538
47	Saldanha Bay Municipality	18 388	21 357	(2 969)
50	Overstrand Municipality	*	21 999	^
	Total	**1 436 812**	**2 212 786**	

* Information not available to my office
\# Audit not yet finalised
^ Figure could not be calculated

The non-metropolitan municipality with the highest number of units lost was Emalahleni Municipality, with 171 026 thousand units, and the municipality with the lowest number of units lost was uMlhathuze Municipality, with only 52 thousand units. The metropolitan municipality with the highest number of units lost was eThekwini Municipality, with 552 698 thousand units. In the case of most metropolitan municipalities this information was not disclosed.

On average there was an increase in the number of units lost.

Table 16: Purchase price for electricity (kwh)

Ranking	Municipality	2004-05 R	2003-04 R
3	eThekwini Municipality	0,15	0,14
5	City of Tshwane Metropolitan Municipality	#	0,12
8	Buffalo City Municipality	*	0,16
12	Rustenburg Municipality	0,15	0,15
14	Polokwane Municipality	0,16	0,16
18	Emalahleni Municipality	0,24	0,22
21	Govan Mbeki Municipality	0,16	*
24	George Municipality	0,16	0,15
25	Stellenbosch Municipality	0,17	0,15
31	Potchefstroom Municipality	0,19	0,17
36	Emnambithi Municipality	*	0,16
38	Moqhaka Municipality	0,18	0,15
39	Breede Valley Municipality	0,33	0,26
45	Mossel Bay Municipality	0,17	0,16
47	Saldanha Bay Municipality	0,17	0,18

* Information not available to my office
\# Audit not yet finalised

The average purchase price for electricity per kilowatt was R0,19 (2003-04: R0,17). The municipality with the highest purchase price was Breede Valley Municipality, with R0,33 per kilowatt, and the two municipalities with the lowest purchase price were eThekwini Municipality and Rustenburg Municipality, with R0,15 per kilowatt.

4.6 Conclusion

Considering the calculated ratios, the critical issue is to determine whether municipalities can continue to operate as a going concern and the impact that citizens have by not paying their municipal accounts.

Although government is not a regular business that can be declared insolvent, defaulting on the delivery of expected services may categorise government as such and could raise a going-concern issue. This may also impact on the extent to which businesses may become involved in municipal contracts if there is a history of cash flow problems or non-payment by the municipality. Insufficient service delivery also affects the involvement of business.

Key concerns are presented in this report, namely debtors and the provision for bad debt. The 29 municipalities' consumer debtors increased by R0,7 billion over a 12-month period, emphasising the general perception that customers are defaulting on their payments. Total debtors increased by R0,9 billion from 2003-04 (R20,9 billion) to 2004-05 (R21,8 billion), which represents an increase of 4,3%. The average provision for bad debt decreased by 5% from 2003-04 (66%) to 2004-05 (61%). The average increase in operating income over the same period was 9,9%, i.e. R36,3 billion (2003-04: R33,1 billion).

The average liquidity ratio is 1,21:1, which is less than the norm of the private sector, namely 2:1. However, the liquidity ratio includes debtors and, as stated in the preceding paragraph, it seems that there is a significant problem to recover debt.

Reticulation losses are another area of concern. Not all 29 municipalities disclosed reticulation losses. On average there has been a decrease of 6,8 million units (kilolitres) in the number of water units lost. With the average unit price of R1,86 per kilolitre, this equals a R12,7 million saving in respect of last year. However, for the municipalities that disclosed this information, the total number of units lost was 190 million at R1,86. This equals a total reticulation loss of R354 million in respect of water.

On average there has been an increase in the number of units (kilowatts) lost for electricity compared to last year. For the municipalities that disclosed this information, the total number of units lost was 1,4 billion units. With the average unit price of R0,19, this equals a total reticulation loss of R273 million in respect of electricity.

All this could impact on municipalities' ability to deliver the required services as expected by the public.

5. AUDITS OF MUNICIPAL PERFORMANCE MANAGEMENT AND MEASUREMENT

5.1 Introduction

In this section the audit reports on the municipal performance management and measurement, as required by the MSA, are analysed. This is a requirement for reporting that came into effect for all municipalities in 2002-03.

Also included in this section is an explanation of the types of reports provided. This ranges from instances where elementary or no performance management systems are in place, to reports on established systems of performance management.

In terms of section 45 of the MSA, municipalities are required to implement a performance management system (PMS) to measure and monitor performance against targets, and to implement internal controls over the PMS, including internal audits. The Auditor-General is required by section 46 of the MSA to audit the results of the performance measurements annually. The performance report and audit report must be included in the annual report in terms of section 121(3) of the MFMA. Performance management, measurement and reporting are the tools utilised by municipal management to indicate to their communities or involuntary investors (tax- or ratepayers) to what extent management has addressed service delivery as envisaged in the municipality's integrated development plan (IDP).

An IDP is a municipality's strategic plan, based on community participation and within financial constraints, aimed at addressing identified developmental priorities and objectives.

5.2 Audit outcomes

In the 2002-03 financial year municipal performance measurements were audited for the first time. In terms of the audit approach followed in auditing performance measurements, findings are reported in management letters and in three types of external audit reports (categories), namely:

- A report format designed in instances where the municipality has not made sufficient progress with implementing an auditable PMS. This would mean that the municipality had essentially not complied with the PMS requirements of the MSA for that year.
- A report format designed in instances where the municipality had made some progress towards implementing an auditable PMS. This would not necessarily mean that the PMS requirements of the MSA had all been complied with, but merely that performance management in the municipality was developing towards an MSA-compliant PMS.
- A report format designed for a fully-fledged PMS audit. This is still under further development.

The performance audits of only 29 of the top 50 municipalities had been completed by 31 March 2006.

Using the reporting categories explained above, the basic results of the top 50 municipalities are as follows:

Report format	**Number of municipalities 2004-05**	**Number of municipalities 2003-04**	**Number of municipalities 2002-03**
Not made sufficient progress	-	-	3
Some progress made	29	21	20
Fully-fledged PMS audit*	-	1	1
Not yet audited	21	28	26
Total	**50**	**50**	**50**

* Although a fully-fledged PMS report has been issued, only compliance issues were addressed during the audit and not the effectiveness and efficiency of the inputs, processes, outputs and outcomes.

5.3 Conclusion

The results in respect of the 29 municipalities where the audit process had been completed can be depicted as follows:

Figure 11: Performance audit opinions

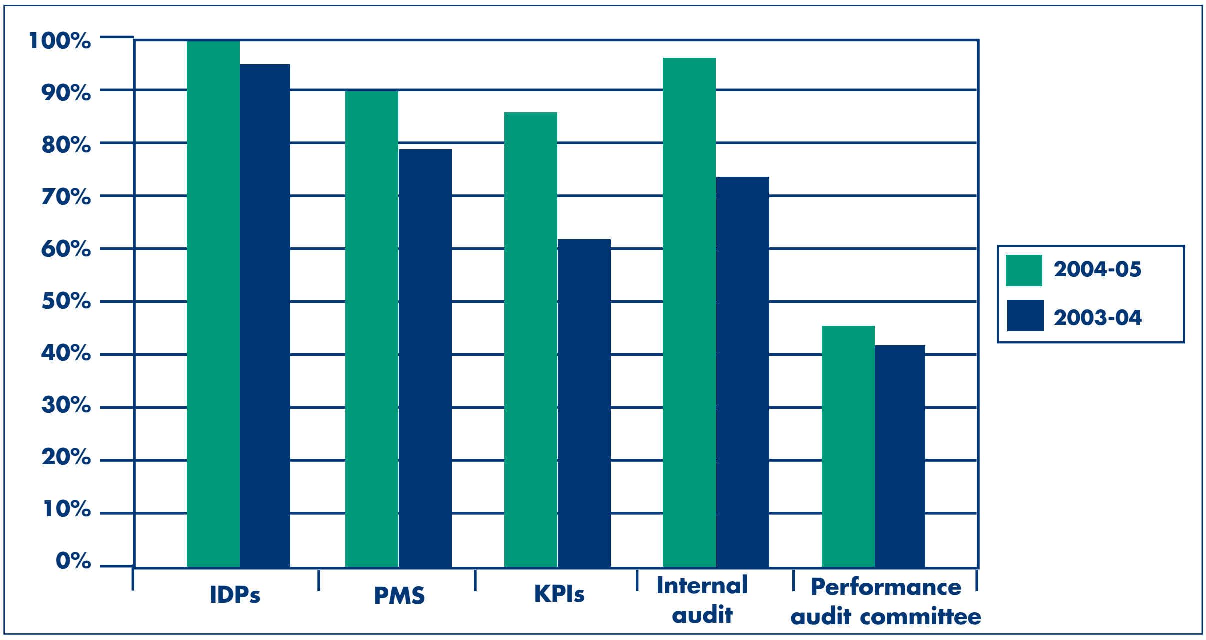


Figure 11 shows that with regard to all aspects included in this report, except the presence of a performance audit committee, there was significant improvement in the implementation of the performance measurement structures (refer to annexure C for the detailed findings). My concern, however, is that these structures do not yet translate into service delivery. Care should be taken to ensure that it does not become merely a process of blind compliance where a structure or process is put in place as a result of a legislative requirement, while it does not result in improved living conditions for the average South African citizen.

6. IMPROVEMENTS IN SERVICE DELIVERY AND ACCOUNTABILITY INITIATIVES

6.1 Introduction

As stated earlier in this report, there is a general need to improve service delivery by local government. Various commitments were made by government, and processes are being implemented to facilitate the drive to improve service delivery. These initiatives include Project Consolidate, which focuses on capacity building at municipal level, and the implementation of the MFMA, which legislates for accountable and transparent financial management and good governance.

The emphasis in local government is now clearly one of progressing from transition and establishment to delivery. President Thabo Mbeki stated in his State of the Nation address on 3 February 2006 that:

"…we must ensure that the machinery of government, especially the local government sphere, discharges its responsibilities effectively and efficiently, honouring the precepts of Batho Pele," (putting people first)

and

"After the March first local government elections, all three spheres of government will therefore continue working together to ensure that each and every Local, District and Metro municipality is properly positioned to discharge its responsibility to the people. In particular, this will mean that each of these municipalities has a realistic Integrated Development Plan, a credible Local Economic Development Programme, and the material and human resources, as well as the management and operational systems to implement these IDPs and LEDs."

As indicated earlier in my report, audits have revealed that most municipalities now have IDPs. The emphasis therefore is now on the quality and implementation of those IDPs, which will also be reflected in this and future reports. The Department of Provincial and Local Government (dplg) has issued a *Credible IDP Evaluation Framework 2006* to assist with endeavours to improve the quality of IDPs.

The dplg's final report on the *Study to determine progress with and challenges faced by municipalities in the provision of free basic services and supporting those municipalities struggling with implementation* was published in August 2005. The report states that government faces various challenges in its commitment to provide free basic services and even access to basic services. More specifically, the report contains the following findings:

- The majority of municipalities that responded indicated that they do not have sufficient finance to support their planned free basic services (FBS) initiatives. Where sufficient finance was in fact available, this could in many cases not be supported by a financial plan.
- Municipalities reflected confidence in being able to meet the national 2008 water provision target. However, this was in many cases not supported by a financial plan that indicated how the eradication of backlogs would be financed.
- A slim majority of municipalities reported that they would be able to meet the 2010 sanitation-for-all target.
- Municipalities expressed optimism about meeting the national target for free basic electricity (FBE). A high percentage of municipalities (61%) felt that they would achieve this implementation target.
- Consideration needs to be given to providing services (water and electricity) at an appropriate and affordable level that can be sustained by the municipality. Options with regard to service provision should be explored.
- In addition to the lack of funding, capacity constraints and policy uncertainties were cited as major service delivery challenges.

Government therefore continues to allocate more resources, refine social and economic policy and concentrate its coordinated efforts towards the provision of services, especially infrastructure, to society at large and to provide a safety net for the indigent as main objectives of local government transformation. Since 1994, government has adopted a particular approach to local government transformation as envisaged in the White Paper on Local Government. Transformation was to take place in three phases:

- Pre-interim phase (1994-95)
- Interim phase (1995-2000)
- Final phase (2000 and beyond), subsequently broken up into an establishment phase, a consolidation phase and a sustainability phase

Project Consolidate, as reported earlier, is a mainstay for the consolidation part of the final phase in order to progress towards sustainable service delivery in partnership with the many role players. An extraordinary local government support initiative was clearly needed in light of the above-mentioned challenges. This was also highlighted by a comprehensive profiling and assessment of local government by the dplg, which showed that, amongst others, many people still had not felt the impact of the new system of local government by 2004, which was close to the envisaged end of the consolidation part of the final phase.

As indicated by the above-mentioned service delivery challenges, financial management is another important pillar of the current phase of local government. The implementation of the MFMA is therefore another crucial initiative.

6.2 Project Consolidate

This project, which targets 136 municipalities, can be described as:

"1. A targeted hands-on support and engagement programme on building the capacity of municipalities to perform their mandate; and
2. A complementary process of systematic refinement of policy, fiscal and institutional matters that will enable the consolidation of the local government system in the long term."

According to the dplg, the following progress highlights have been achieved with Project Consolidate:

1. Service delivery facilitators have been deployed at municipalities.
2. Many municipalities have been engaged on the project through Presidential izimbizos and Ministerial izimbizos, the findings of which inform Project Consolidate Action Plans.
3. Municipal programmes of action to achieve the targets were launched in various municipalities.
4. The convergence of the three spheres of government in working together to address the challenges.

However, much still needs to be achieved. President Thabo Mbeki also stated in his State of the Nation address on 3 February 2006 that:

"Project Consolidate has identified serious capacity constraints in many of our municipalities arising from a shortage of properly qualified managers, professional and technical personnel."

To achieve what government has committed to, within this sphere of government, the strategic local government priorities flowing from Project Consolidate for 2006 to 2011 are ambitious and can now be summarised as follows:

1. Mainstreaming hands-on support to local government to improve municipal governance, performance and accountability. This entails:
   1.1 Prioritised actions for municipal transformation and institutional capacity development. (This includes attaining credible IDPs at district and metropolitan municipalities, core basic municipal systems, more effective performance management systems, a competency framework, filling of vacancies, a skills audit and a hands-on technical capacity at municipalities.)
   1.2 Prioritised actions to improve basic service delivery and infrastructure investment. (This includes eradication of service backlogs and the implementation of free basic services and various infrastructure and service delivery initiatives.)

1.3 Prioritised actions to improve local economic development. (This includes the attainment of various targets in making further progress with the LED initiatives.)

1.4 Prioritised actions to improve financial viability and financial management. (This includes the MFMA implementation, addressing obstacles and challenges, the establishment of Regional Electricity Distributors and the implementation of various finance-related initiatives.)

1.5 Strengthening good governance, community participation and ward committee systems.

2. Addressing the structure and governance arrangements of the state to be better able to strengthen, support and monitor local government as required by the Constitution of South Africa. (This includes complex issues such as the review of the structure and role of provincial government.)

3. Refining and strengthening the policy, regulatory and fiscal environment for local government and giving more attention to enforcement measures. (This includes the enforcement and refinement of local government legislation.)

It is clear from the findings of this *General report on local government* and from government's own surveys and assessments that these are challenging priorities on the road to achieving a better life for all. Now that the transitional phases are over and municipal councils have been elected, my office will also give specific attention to these priorities in the analysis of results of municipal audits.

6.3 The implementation of the Municipal Finance Management Act

Municipal finance management reform, as a key element of local government transformation, commenced around 1998. Key requirements of the MFMA were tested with pilot municipalities as from 2000. The MFMA finally took effect on 1 July 2004 with the assistance of financial grants, with some sections delayed or exempted. The objective of the MFMA can be summarised as follows:

"To secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities."

This crucial prerequisite for the achievement of government's commitments at local level is linked to all three main strategic priorities described above.

Municipalities were surveyed during 2003 and 2004 in relation to their financial management skills and capacity. For purposes of implementing the MFMA, they were then classified as high, medium or low-capacity municipalities. This classification was based on each municipality's ability to implement the reforms, using information collected from the municipalities themselves. Due regard was given to the development of staff and organisational capacity through participation in financial management reform programmes. Municipalities with a higher capacity are required to comply earlier than those with lower capacities. Phase-in schedules have been established for the reforms, with the earliest plans set for high-capacity municipalities and longer timetables for medium and low-capacity municipalities. As the MFMA is progressively implemented, the capacity levels will fall away. However, all municipalities are encouraged to implement sooner.

National Treasury MFMA circular no. 7 of 2004 was provided to help municipal councils take stock of the requirements for implementing the act. The circular includes a template for an MFMA implementation plan, which allows the municipality to plan the necessary actions for every step of the implementation process. The implementation plan guides the municipality through these steps, determines actions required, identifies who is responsible for what, makes provision for the necessary delegations, and establishes final target dates for completion. The implementation plan should be reviewed and updated at least on an annual basis and submitted to council and the National Treasury. The introductory guide to the MFMA outlined steps that a municipality should take when preparing its implementation plan. These steps were formally introduced in National Treasury MFMA circular no. 5 of 2004. Although the urgent priorities identified in this circular, as reported in my previous report [RP73/2005], were intended for 2004, many of them will remain valid until they have been achieved.

The phased-in approach of the MFMA should hopefully allow municipalities to implement the stringent requirements timeously, and ultimately improve public service delivery and accountability. The phased-in approach took note of one of the major barriers to service delivery, namely capacity constraints that exist in various forms. Although capacity constraints as well as resource restraints in the local government environment are well known, they should not be used as an excuse for a lack of service delivery. The support measures introduced by national and provincial governments via their financial management grant and systems improvement grant frameworks in terms of DORA, as well as funds allocated to municipalities over the medium term, will hopefully assist in the capacity building. According to MFMA circular no. 27, the capacity and restructuring component amounts to R749 million for the first two years of the Medium-Term Expenditure Framework (MTEF) and decreases to R400 million for 2008-09 as the Restructuring Grant is phased into the equitable share.

The initiatives of the National Treasury in meeting its responsibilities in this process can be summarised as follows:

1. Financial support through the financial management grant.
2. Technical support through the finance management technical assistance programme.
3. The municipal finance management internship programme.
4. The provision and distribution of technical information, for example through the National Treasury website and the *Guide to Municipal Finance Management for Councillors* booklet.

The National Treasury states as follows in its report *2004-05 Local Government Capital and Operating Expenditure Budgets:*

"The report highlights sluggish spending on capital budgets which reinforces the need to accelerate the roll-out of infrastructure."

This links back to the priorities identified above during Project Consolidate and government's ASGISA programme. It also links to the release of the following Treasury Regulations in terms of the MFMA:

"The Minister of Finance Mr Trevor A. Manuel, MP, on 31 May 2005 tabled in Parliament new regulations on supply chain management processes for all municipalities and their entities. The regulations spell out significant reforms for the procurement of goods and services in municipalities. This framework modernises financial governance in municipalities and improves accountability and transparency for the award of municipal bids. It further establishes key procedures to minimise fraud and corruption in the bidding process, and to prevent and minimise possible conflicts of interest." (National Treasury Media Release)

It is clear therefore that, with the advent of the MFMA on 1 July 2004 and subsequent steps, the focus in local government is now on progressing from transition and establishment to delivery and improvement. Measures such as the implementation of oversight committees, as required by section 129 of the MFMA, could also improve accountability.

The findings presented in this *General report on local government* indicate that much work still needs to be done to achieve the full effect of the MFMA. Now that the transitional phases are over and municipal councils have been elected, my office will also give specific attention to MFMA implementation in the analysis of results of municipal audits.

AUDITOR-GENERAL

ANNEXURE A: BACKGROUND TO THE LOCAL GOVERNMENT ENVIRONMENT

A new system of government has emerged since 1994 that requires dedicated councillors to play an active role in bringing about the democratic and accountable government for local communities envisaged by the Constitution of the Republic of South Africa (the Constitution). The Constitution outlines other goals for municipalities:

- to ensure the provision of services to communities in a sustainable manner
- to promote social and economic development
- to provide safe and healthy environments
- to encourage public involvement in matters of local government

The Constitution sets out the mandate for each municipality to strive to achieve these goals within its financial and administrative capacity.

In order to accomplish objectives for the local sphere of government, Parliament has enacted the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998), as amended, and the Local Government: Municipal Systems Act, 2000 (Act No. 52 of 2000) (MSA), as amended, as well as other legislation, to lead municipalities to reform and modernise financial management practices. This legislation supplements conventional procedural financial management rules with a performance-based system focusing on outputs, outcomes and measurable objectives. With the leadership of executive mayors or committees and non-executive councillors (whether full-time or part-time, ward councillor or proportional representative), and the active involvement of municipal officials, this legislation should make municipalities more participatory, transparent and accountable.

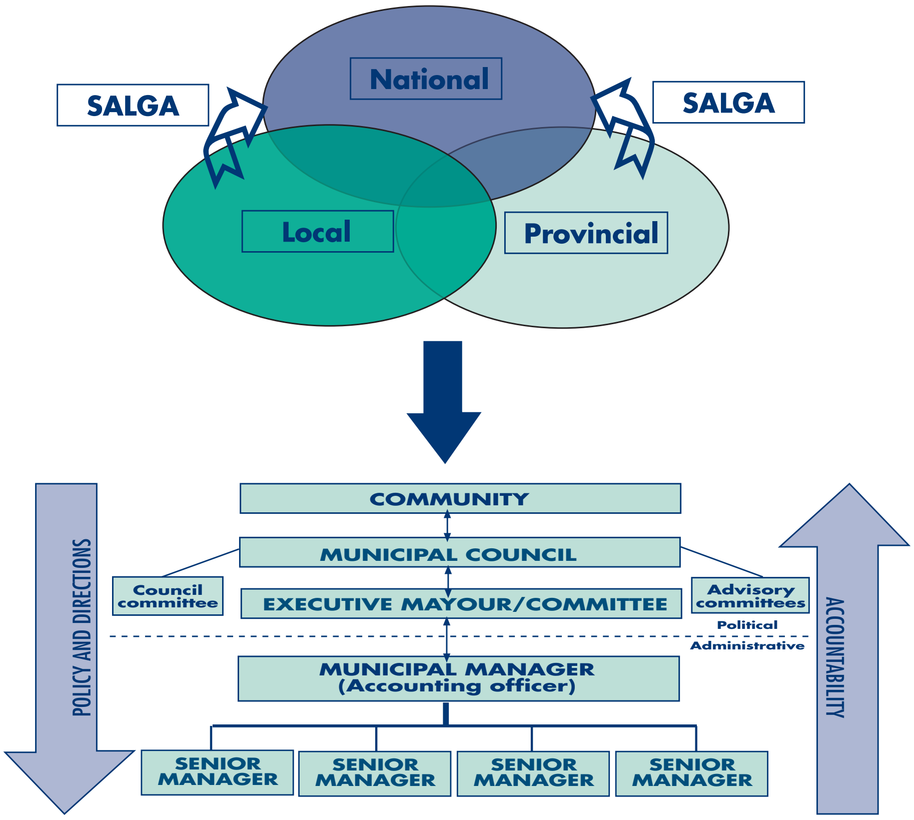
The financial reform process started in the national and provincial spheres of government and has more recently extended into the local government sphere. The MFMA is a key component of the broader legislative framework governing municipalities, and forms a major part of the reform package to bring about financial management reforms in municipalities. The MFMA aims to strengthen financial management in order to support municipalities in moving towards an even more sustainable future. Better planning and financial management should result in better delivery of sustainable municipal services to all residents, customers, users and investors. The legal framework empowers the mayor or the executive mayor or committee to provide political leadership by being responsible for policy and outcomes, and holds the municipal manager and other senior managers responsible for implementation and outputs. Councillors are empowered to play key policy-setting and oversight roles in each municipality. A crucial function is to approve the IDP and budget for the effective delivery of services to communities. Financial statements and other components of the annual reports of municipalities are likewise crucial elements of the information that is needed for transparency and accountability.

There are similarities between the PFMA, which regulates national and provincial departments, public entities and constitutional institutions, and the MFMA, in the sense that they provide for similar financial and fiscal reforms. Both acts enable managers to manage, whilst holding them accountable (the performance management aspects of municipalities are dealt with in the MSA). It provides for politicians to set the policy priorities and establishes treasury norms and standards, while setting out sound and sustainable management of financial affairs, and provides for regulations. Differences between the PFMA and the MFMA do exist, for example with regard to borrowing powers, intervention by the National Treasury and provincial treasuries, transitional provisions and the phased-in approach. The overarching legislation pertaining to local government and the resulting political and administrative accountability relationships can be diagrammatically depicted as follows:

Constitution

Enabling legislation

Municipal Systems Act (MSA)
Municipal Finance Management Act (MFMA)
Municipal Demarcation Act (MDA)
Municipal Structures Act
Municipal Property Rates Act



The MFMA and other legislation develop supportive roles for the National Treasury and provincial departments to assist municipalities in implementing the MFMA. The National Treasury chairs a working group, consisting of the relevant national and provincial departments, to promote a consistent and coherent approach to the interpretation and implementation of the MFMA. There are also different roles and responsibilities assigned to the Minister of Provincial and Local Government and the MECs for finance and local government. While the primary responsibility of provincial treasuries is to manage the financial affairs of the provinces, the MFMA provides for greater involvement of provincial treasuries in the regulation and management of the finances of municipalities. Provincial treasuries are expected to take appropriate measures to monitor, support and assist with municipal capacity building as envisaged in the Constitution of South Africa.

Municipalities have a significant role to play since they are the primary vehicle for service delivery in South Africa. It is of utmost importance that service delivery to, and ultimately the overall living conditions of, the ordinary citizen should improve. In order to fulfil this role, several important attributes are embodied in legislation.

The constitutional mandate for municipalities is that they strive, within their financial and administrative capacity, to achieve the objectives and carry out the developmental duties assigned to local government. Other legislation builds forth on this mandate. The municipal council therefore takes on the following principal responsibilities:

- to provide democratic and accountable government without favour or prejudice;
- to encourage the involvement of the local community;
- to provide all members of the local community with equitable access to the municipal services that they are entitled to;
- to plan at local and regional level for the development and future requirements of the area;
- to monitor the performance of the municipality by carefully evaluating budget reports and annual reports to avoid financial problems and, if necessary, to identify the causes of financial problems and resolve them as they arise;
- to provide services and facilities within the constitutional and legislative authority that benefit ratepayers and residents as well as visitors to its area. These would include, but are not limited to, general public services (such as electricity, water and sanitation services, waste and refuse removal), community services or facilities, and cultural or recreational services or facilities, while focusing on core functions as a priority;
- to provide infrastructure for the community and for development within the area by promoting an attractive climate and locations for the development of business, commerce, industry and tourism; and
- to manage, improve and develop resources available to the council.

In its oversight role, the municipal council takes responsibility for the financial affairs of the municipality. The council must ensure that the municipality is meeting and will continue to meet its financial commitments and that it will avoid financial problems. If serious financial problems persist, the council must be active in its oversight role to identify the causes of the problem and ensure that appropriate remedies are instituted.

However, managing a municipality is a complex matter. For example, external requirements such as the following play a role:

- Implementation of accounting standards, which are based on international principles.
- Far too many legislative requirements and volumes of guidance (not simplistic).
- Recovery of debt.
- Providing free consumer services for indigents (water and electricity).
- Providing services and infrastructure.
- Geographical size of many municipalities.
- Preparation of realistic multi-year budgets that are linked to the IDP.

AUDITOR-GENERAL

ANNEXURE B: ANALYSIS OF QUALIFICATION PARAGRAPHS

Asset management			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• Johannesburg Water (Pty) Ltd did not conduct a physical count of inventory at certain depots at year-end. Inventory amounting to R18,1 million could not be verified. • Deficiencies in the physical inventory count at Metropolitan Bus Services (Pty) Ltd were identified. Inventory amounting to R7,7 million could not be verified. • Due to significant control weaknesses and the lack of information, property, plant and equipment could not be verified for the Johannesburg Social Housing Company (Pty) Ltd. • Due to the historic devolution of the municipality and the infinite naming combinations, the audit could not confirm the completeness of the fair value of land assets amounting to R6 190,1 million. • An impairment exercise was not undertaken for the three utility companies. • Provision was not made for the rehabilitation costs of various closed landfill sites at Pikitup Johannesburg (Pty) Ltd.
Nelson Mandela Metropolitan Municipality (Eastern Cape)	6	Qualified, Emphasis of matter	• Land of an unknown value was not recorded and included in the asset register. • The project related to the physical verification and valuation of assets owned had not been finalised.
Mangaung Local Municipality (Free State)	7	Qualified, Emphasis of matter	• The value of the portion of immovable property transferred has not been determined and recorded in the asset register. • The fixed asset register was not updated timorously. • The descriptions, especially serial numbers and location of items, were insufficient to identify assets.
Buffalo City Municipality (Eastern Cape)	8	Qualified, Emphasis of matter	The fixed asset register was incomplete in respect of the following: • A detailed description and the location of assets are not included. • No detail of disposals or write-offs of property, plant and equipment during the year. • No detail of impairment losses or gains attributable to individual items of property, plant and equipment.

Asset management			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Buffalo City Municipality (cont.)			• Operating expenditure is included incorrectly in the fixed asset register. • Assets transferred to the municipality by the Amathole District Municipality have not been included in the fixed asset register due to uncertainty regarding the ownership of these assets. • Infrastructure assets have not been included in the fixed asset register. Inventory disclosed in the financial statements does not include inventories relating to - • Housing stock, and • Unsold water.
Msunduzi Municipality (KwaZulu-Natal)	9	Qualified, Emphasis of matter	• Adequate documentation and explanation for the difference of R110,7 million between the asset register and general ledger could not be provided. This placed a scope limitation on the audit of the fixed asset balance.
Rustenburg Municipality (North West)	12	Qualified, Emphasis of matter	• Sixteen per cent of a sample of assets selected from the fixed asset register could not be physically verified.
City of Klerksdorp (North West)	17	Disclaimer, Emphasis of matter	• Details provided in the fixed asset register were insufficient to determine the reasonableness and physical existence of infrastructure assets to the value of R359,9 million.
Drakenstein Municipality (Western Cape)	19	Qualified, Emphasis of matter	• Five properties selected could not be traced to the asset register. • Assets previously financed using internal loans are not included in the asset register and the value thereof cannot be quantified. • Description and location of certain assets were not adequately recorded in the asset register. • Ownership of 11 properties valued at R53,6 million could not be verified as no title deeds could be submitted. • An audit trail relating to assets disposed of amounting to R1,7 million could not be traced as having originally been accounted for in the asset register.

Asset management			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Mbombela Municipality (Mpumalanga)	20	Qualified, Emphasis of matter	• Details (descriptions and locations) provided in the fixed asset register were insufficient to determine the reasonableness and physical existence of fixed assets • The counting of physical inventories at year-end took place prior to appointment as auditor. The existence of inventory could not be verified.
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	Fixed assets to the value of R47,2 million could not be verified due to the following inadequacies on the fixed asset register: • The asset register had not been updated with additions and disposals. • The descriptions of the assets recorded in the fixed asset register are not clear. • A register was not maintained in respect of municipal stands.
Ugu District Municipality (KwaZulu-Natal)	23	Qualified, Emphasis of matter	• Inadequate evidence to verify all project and infrastructure assets of R15,6 million that were completed during the year. • Due to inadequate management review and control over fixed assets, the fixed asset register was not updated with the current additions. • The fixed asset register opening balances were also not updated for solid waste and cemetery assets amounting to R21,1 million which were transferred.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	Due to the following discrepancies, property, plant and equipment of R197,4 million could not be satisfactorily tested: • The physical existence of fixed assets of R2,4 million could not be verified. • Assets purchased have been incorrectly classified and described in the asset register. • Contracts approved and awarded amounting to R5,1 million, of which R1,6 million was for the purchase of capital goods, could not be provided. • For contracts in the register amounting to R2,2 million, the approval by the procurement committee and the contracts as such could not be provided.

Asset management			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Potchefstroom Municipality (cont.)			• Finance lease entered into during 1982 was incorrectly disclosed in the financial statements. • Depreciation as per annual financial statements differs by R4,6 million from the depreciation as per the fixed asset register. • There is an unexplainable difference of R0,5 million between the opening balance in the general ledger and the previous year's closing balance.
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	• Expenditure of R0,5 million was incorrectly capitalised. • An amount of R0,1 million spent on roads was not capitalised. • The net value of assets should be equal to the amount of external and internal loans outstanding. The difference of R30,6 million could not be explained. • Items with credit balances on the asset register totalled R0,6 million. • Projects could not be traced to the asset register to confirm that they were capitalised. • The fixed asset register was incomplete.
Overstrand Municipality (Western Cape)	50	Qualified, Emphasis of matter	The asset register does not contain all the information prescribed. This includes: • Detailed listing of individual assets not disclosed. • Infrastructure assets not separately identifiable. • Acquisition dates are not listed for all assets. • Individual items not clearly described. • Verification of investment properties could not be performed as there was insufficient detail in the investment property register. • Completeness of investment properties could not be verified as these properties are not correctly disclosed in the asset register. • Incorrect disclosure of the movement of assets during the year, resulting in a misstatement of the closing balance of property, plant and equipment, and non-compliance. • Misallocation of an amount of R2,7 million as disposal of assets, which should have been allocated to bulk service contributions.

Accounts receivable			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• Debtors with credit balances amounting to R496,4 million were included in the debtor age listing at year-end. • Debtors with credit balances amounting to R44 million were included in accounts payable to City Power Johannesburg (Pty) Ltd. • City of Johannesburg did not provide the appropriate guarantee for the inter-company debt in the financial statements of the Johannesburg Social Housing Company. The recoverability of this debtor was therefore doubtful. • Write-off of debtors totalling R636 million could not be tested against the council-approved policy. • The municipality is subsidising tenants to an extent of R4,6 million before taking into account the non-recovery of debtors.
Nelson Mandela Metropolitan Municipality (Eastern Cape)	6	Qualified, Emphasis of matter	• No agreements could be proved for state housing loans to public organisations. • These loans were authorised to be written off during 1999, resulting in long-term debtors being overstated by R13 million.
Mangaung Local Municipality (Free State)	7	Qualified, Emphasis of matter	• The provision for bad debts is understated by R54,5 million. • Consumer debtors are long outstanding. • An amount of R46 million is included under consumer debtors in respect of rates and taxes owed by government institutions. • Sundry debtors' accounts amounting to R7,1 million reflected no payments during the financial year. • No provision was made for bad debts in respect of long-term debtors. The amount that should have been provided was R10,9 million. • Long-term debtors totalling R1,7 million could not be verified as the relevant contracts could not be submitted. • Erven and housing debtors' loan accounts of R5,3 million reflected no payments during the financial year.

AUDITOR-GENERAL

Accounts receivable			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Rustenburg Municipality (North West)	12	Qualified, Emphasis of matter	• Provision for bad debts was overstated by R4,4 million. • Detailed calculation to support the short-term portion of long-term debtors of R7,4 million could not be provided. • Supporting documentation for housing long-term debtors of R1,1 million could not be provided. • Supporting documentation for suspense debtors of R2,5 million could not be provided.
City of Klerksdorp (North West)	17	Disclaimer, Emphasis of matter	• An amount of R156,5 million written off as bad debt was not disclosed in the annual financial statements. The sale of stands and housing long-term debtors of R11,5 million could not be verified due to the following: • Debtor listings and debtor sub-ledger opening balances differed from the general ledger by R3,2 million. • Contracts and amortisation tables did not reconcile with the general ledger. • An account showing an amount of R7,4 million outstanding on a single debtor could not be explained. • Contrary to the induplum rule, various contracts were identified where accounts outstanding reflected more than double the original debt.
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• The recoverability of R42,1 million in long-term debtors could not be verified. • No assurance could be provided that long-term debtors of R42,1 million have been properly recorded. • No documentation could be provided to verify the recoverability of long-outstanding sundry debtors amounting to R42,9 million. • No supporting documentation could be provided for sundry debtor balances of R7,0 million. • An amount of R2,1 million should not have been recognised as sundry debtors, but should have been offset against accruals. • The short-term portion of long-term debtors disclosed as R10,5 million is an estimate and not the actual amounts payable in the 12 months after year-end.

Accounts receivable			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Govan Mbeki Municipality (cont.)			• The provision for bad debts is understated by R83,9 million.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• General ledger balance for long-term receivables exceeds disclosed balance by R0,6 million. • Invalid sundry debtor transactions were included in the property loans general ledger account. • Property and housing loans of R4,6 million granted to indigents before 1999 were considered to be irrecoverable. No provision was made for these doubtful debts. • Consumer debtors were overstated by R3,7 million due to the exclusion of debtors with credit balances, which were incorrectly included in creditors. • The provision for doubtful debts was understated by R38,7 million. • Consumer debtors' ageing information disclosed in the financial statements does not agree to the debtor age analysis.
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	• Provision for bad debts was understated by R34,5 million. • Evidence of bad debts written off for 2003-04 amounting to R0,7 million could not be provided and entry may have been duplicated in 2004-05. • No supporting documentation was kept to confirm the existence of long-term debtors amounting of R1,7 million. • No loan schedule was kept regarding long-term debtors and therefore no evidence to support the amount disclosed in financial statements could be provided.

Personnel			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• Leave provision amounting to R28,2 million could not be confirmed at Pikitup Johannesburg (Pty) Ltd due to a breakdown in accounting controls over the recording of leave. • Actuarial valuations for five of the open retirement funds could not be obtained.
Buffalo City Municipality (Eastern Cape)	8	Qualified, Emphasis of matter	Provision for leave could not be verified because leave records were unsatisfactory due to the following: • Leave records have not been regularly updated. • Leave forms are not always captured timeously. • Leave forms not timeously filed on personnel files or not filed at all. • Leave forms not always approved by management.
City of Klerksdorp (North West)	17	Disclaimer, Emphasis of matter	• Performance bonuses of R1,9 million were paid to employees not directly accountable to the municipal manager.
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• The leave provision of R2,1 million was calculated using an average of five days per employee, instead of the actual number of leave days that were due to each employee.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• Provision for leave pay of R1,7 million does not agree to the leave pay provision of R6,3 million calculated on the payroll. No reconciliation was provided for the difference of R4,6 million. • Salaries and wages as per the monthly payroll summary reports differed by R4,5 million from the balance disclosed in the financial statements. No payroll reconciliations were performed between the payroll and general ledger.
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	The leave provision of R 2,9 million could not be verified because: • No proper leave registers were kept for several departments. • Certain leave records were not accurate as they were not being updated. • In one instance the leave record did not correspond with the leave liability calculation schedule.

Revenue			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	o The following findings impacted on the completeness of revenue: • The reconciliation of properties between the valuation roll and debtor billing system indicated differences. • No suitable reconciliations were performed between the water consumption points and the billing system. • No detailed prior year accounting records for collections on behalf of Johannesburg Water (Pty) Ltd by the core municipality. • No detailed supporting schedules and other documentation could be provided to substantiate the opening balances for consumer debtors. • Inadequate audit trails between the emergency service dispatches and the billing system. • RSC levy income was incorrectly recorded on a receipt instead of an accrual basis. Consequently, no reliable age analysis for RSC-levy debtors could be submitted. The misstatement of RSC-levy income as well as RSC-levy debtors could not be quantified.
Nelson Mandela Metropolitan Municipality (Eastern Cape)	6	Qualified, Emphasis of matter	• The completeness of levy income of R226,2 million could not be verified due to inherent uncertainties. • The external levy collection agency did not attend to the identification of non-registered levy payers. • The sample test revealed that 20% of the businesses were not registered.
Rustenburg Municipality (North West)	12	Qualified, Emphasis of matter	• No reconciliations performed between amount due to the municipality per Division of Revenue Act (DoRA) and the actual income recorded. This resulted in income from operation grants and subsidies being understated by R2,5 million.
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• The revenue and debtors generated from the sale of municipal stands could not be verified.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• Interest earned amounting to R7,4 million disclosed in the financial statements differed by R1,9 million from external confirmation received. No reconciliation was provided for the difference.

Revenue			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	• The accuracy of assessment income of R23,1 million could not be verified because an annual reconciliation between the valuation roll and the income generated was not performed. • No monthly reconciliations were performed for Viljoenskroon and Rammulotsi from July 2004 to June 2005, and for Steynsrus and Matlwangtlwang from July 2004 to May 2005. • Grants of R10,1 million were received from National Treasury; however, R10, 8 million should have been received. The difference could not be explained. • Grants of R1,2 million were received from Fezile Dabi District Municipality for which no external supporting documentation could be provided.

Expenditure			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Mangaung Local Municipality (Free State)	7	Qualified, Emphasis of matter	• For payments of R34,6 million the documentation regarding the relevant tenders was not available. • For payments totalling R37,7 million the relevant supporting documentation could not be submitted. • Purchases and internal requisitions totalling R4,6 million could not be submitted.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• Supporting documentation for grants and subsidies paid amounting to R22,8 million could not be provided. • Contributions to provisions amounting to R12,2 million could not be explained. • The amount for bulk purchases of water disclosed in the financial statements was R1,3 million less than the amount per the bulk water purchase invoice. • Expenditure transfers between departments amounting to R20,1 million were not excluded from expenditure amounts disclosed.
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	• No signature authorising payments was found for supplier invoices amounting to R34,6 million. • No supporting documentation could be found for expenses totalling R16,9 million. • Invoices totalling R5,1 million should have been recorded during the previous financial year, but were only recorded when they were paid in 2004-05.

Unauthorised, fruitless and irregular expenditure			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Mangaung Local Municipality (Free State)	7	Qualified, Emphasis of matter	• For payments totalling R14,7 million in respect of contracts for more than R120 000, no tenders were invited. • In respect of payments totalling R1,8 million the number of quotations as required were not obtained. • In respect of a vehicle purchased for R0,3 million no tenders were invited. • Payments of R0,7 million were approved by personnel who exceeded their authorisation limit.
Bank			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• A breakdown in the system of internal and financial controls at Johannesburg Fresh Produce Market (Pty) Ltd resulted in unreconciled differences in the deposit and business bank accounts as well as the guaranteed buyers accounts subsidiary ledger and debtor ledger.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• Due to unallocated deposits of R4,3 million included in the bank balance, the accuracy, completeness, proper disclosure and cut-off of debtors and revenue could not be satisfactorily tested.
Internal control weaknesses			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• Due to a breakdown in the system of internal controls and an improper accounting system at City Housing Company (Pty) Ltd, property plant and equipment, grant income and accruals could not be verified. • Various significant weaknesses existed in the control over amounts payable and general expenditure at Johannesburg Social Housing Company (Pty) Ltd.

AUDITOR-GENERAL

Other			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Journals			
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• No supporting documentation could be provided for journal entries amounting to R30,1 million made to unbundled statutory funds and reserves.
Moqhaka Municipality (Free State)	38	Disclaimer, Emphasis of matter	• The journal sheet for journals totalling R9,1 million was not signed for authorisation. • Journals of R43.1 million were passed through the appropriation account without the appropriate council approval. • Journals totalling R0,8 million were passed without adequate supporting documentation.
Creditors and payables			
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• Creditor accruals of R36,4 million were not supported by documentation. • Creditor balances to the value of R2,9 million were not supported by accounting records or supporting documentation. • Creditors that were supposed to be offset were not, resulting in those creditors being overstated by R2,1 million. • Trade creditors of R3,3 million were recorded although the liability did not exist at year-end.
Potchefstroom Local Municipality (North West)	31	Disclaimer, Emphasis of matter	• Revenue received for specific projects of R14,7 million is incorrectly included in the creditor: suspense other account. • The opening balance in the general ledger and trial balance differ by R5,3 million from the previous year's closing balance due to debtors with credit balances being incorrectly included under creditors. • Creditors were overstated because audit fees of R1,2 million were incorrectly provided for.
Other			
Johannesburg Metropolitan Municipality (Gauteng)	1	Disclaimer, Emphasis of matter	• Financial statements of City Housing Company (Pty) Ltd were incorrectly prepared on a going-concern basis. • Take-on balances from the former Midrand and Modderfontein Local Councils, which related to the Ekurhuleni Metropolitan Municipality, were still incorrectly reflected on the municipality's books and those of City Power Johannesburg (Pty) Ltd.

Other			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Johannesburg Metropolitan Municipality (cont.)			• Operating lease expenses and income were misstated as they were not recognised on a straight-line basis over the lease term as required. • Incorrect disclosure of operating lease commitments as amounts was contrary to the terms of the relevant lease agreements. • Amounts relating to operating lease income receivables were not disclosed. • Contrary to the accounting policy, the Housing Development Fund did not reflect the necessary movements in the current year.
Mangaung Local Municipality (Free State)	7	Qualified, Emphasis of matter	• Redemptions of R14,1 million were not made on a number of internal loans.
Buffalo City Municipality (Eastern Cape)	8	Qualified, Emphasis of matter	• Incorrect accounting treatment of VAT refund resulted in expenditure being overstated in the current and prior year by R5,5 million and R14,3 million respectively.
City of Klerksdorp (North West)	17	Disclaimer, Emphasis of matter	• Corrections amounting to R4,6 million were made to the Housing Development Fund without proper supporting documentation. • The fixed asset lists could not be reconciled with source funding to support the underlying reserves. • Suspense and control accounts amounting to R4,5 million debit and R11,5 million credit, were not adequately reconciled and cleared at year-end. • Credit suspense accounts of R2,1 million and debit suspense accounts of R3,3 million showed no movement for the year under review.
Mbombela Municipality (Free State)	20	Qualified, Emphasis of matter	Supporting documentation relating to suspense accounts could not be provided. These suspense accounts are: • Bank reconciliation (R4 million); • Creditors work in progress (R1,8 million); and • Consumer suspense account (R5,6 million).
Govan Mbeki Municipality (Mpumalanga)	21	Disclaimer, Emphasis of matter	• No supporting documents could be obtained for deferred charges of R17,0 million. • The municipality sustained losses of R6,4 million on sewerage services which should operate on a profit basis.

Other			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Govan Mbeki Municipality (cont.)			• Matters mentioned cast significant doubt on the municipality's ability to continue as a going concern and may cause the municipality to be unable to maintain the necessary levels of service delivery, meet its statutory duties and settle its liabilities. • The financial information of the Govan Mbeki Housing Company and the Johannes Stegmann Theatre Donors Trust was not consolidated and disclosed in the annual financial statements of Govan Mbeki Local Municipality. • Govan Mbeki Housing Company is a public company incorporated in terms of section 21 of the Companies Act, while only private companies may be municipal entities. • The bank account of the Johannes Stegmann Theatre Donors Trust was not in the name of the municipality, but in the name of the trust.
Ugu District Municipality (KwaZulu-Natal)	23	Qualified, Emphasis of matter	Capital commitments reflected the following discrepancies: • Suppliers to the value of R1,5 million were duplicated. • Contracts amounting to R2 million could not be traced to the contract register. • Certain contracts on the contract register were not included on the listings provided. • The listing also included a contract of R0,4 million which was signed after 30 June 2005.
Potchefstroom City City Council (North West)	31	Disclaimer, Emphasis of matter	Statutory funds and reserves: • Fixed asset lists could not be provided for source funding to support the underlying reserves. • Income and expenditure allocated to the statutory funds and reserves could not be satisfactorily tested. • An integrated plan could not be provided to support the closing balance on the capital replacement reserve for the future replacement of fixed assets. • The Land Trust Fund of R16,5 million was written off but not transferred to the Capital Replacement Reserve. • Fixed assets disclosed in the fixed asset register as being funded by the Donations and Public Contribution Reserve are not represented by such a reserve in the financial statements.

AUDITOR-GENERAL

Other			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Potchefstroom City City Council (cont.)			• The capital and finance cost of R6,9 million on a finance lease entered into during 1982 has been incorrectly disclosed as a Redemption of Lease Reserve. Investments: • An investment is understated by R1,3 million. • An investment of R0,3 million could not be confirmed. Grants and subsidies: • The prior year grants and subsidies of R8,8 million included in note 19 do not agree to the government grants and subsidies of R14,5 million disclosed in the statement of financial performance. Unspent conditional grants and receipts amounting to R7,2 million could not be verified due to the following: • Expenditure of R31,3 million was incorrectly allocated as unspent conditional grants. • Adequate supporting documentation substantiating that the conditions associated with conditional grants and receipts of R7,2 million had been met could not be presented. • No supporting documentation could be submitted for government grants and subsidies amounting to R18 million.
Moqhaka Local Municipality (Free State)	38	Disclaimer, Emphasis of matter	• No redemption was made on internal advances of R1,2 million. The council resolution for the approval could not be obtained. • The special investigation report could not be obtained, resulting in a serious limitation on the scope of the audit in determining the effect on the financial statements.
Overstrand Municipality (Western Cape)	50	Qualified, Emphasis of matter	• Overstatement of non-current provision of R31,3 million. • The basis used to calculate provision for rehabilitation of tip sites, clearing out of alien vegetation, clearing up of illegal dumping, and post-retirement benefits could not be provided for auditing purposes.

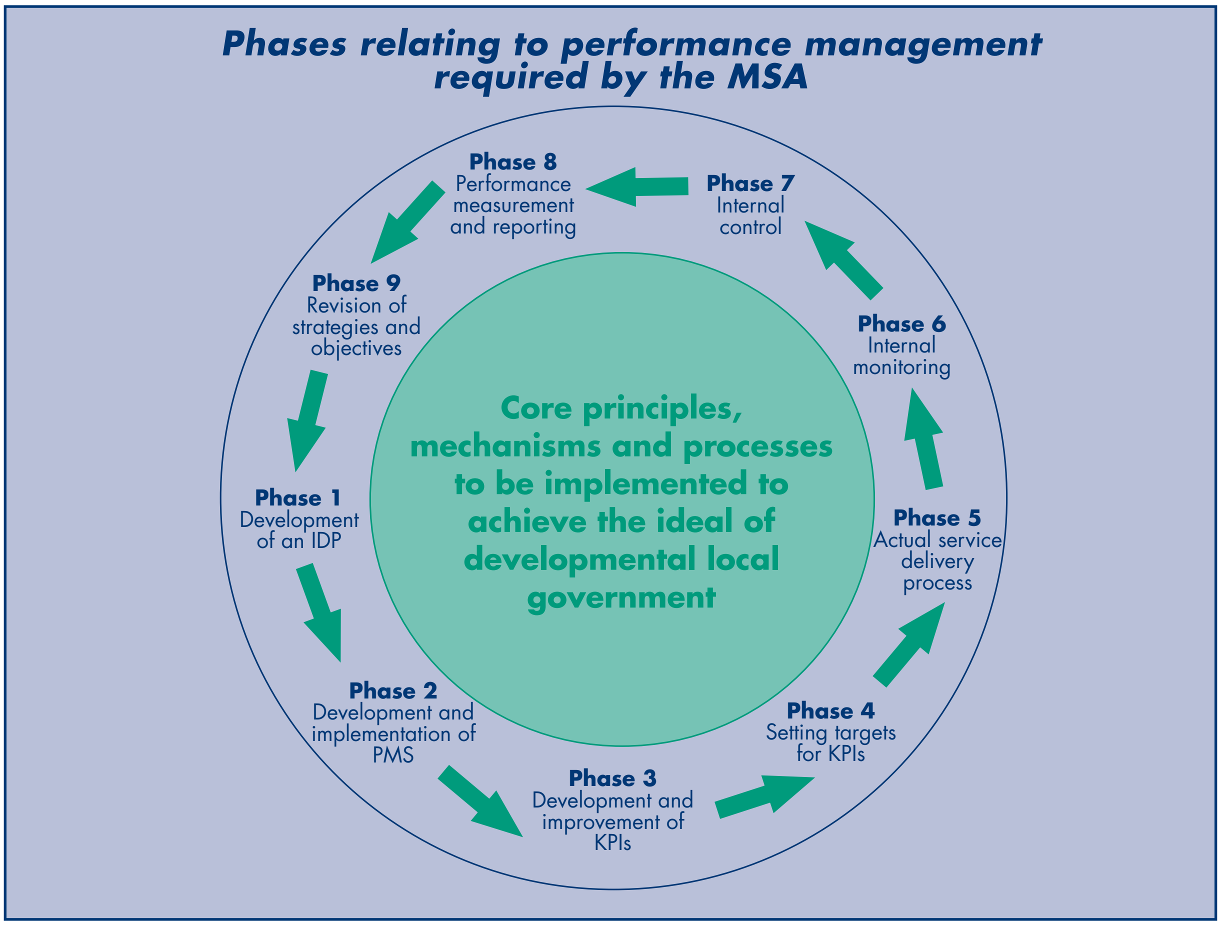
Disclosure			
Municipality (Province)	**Top 50**	**Audit opinion**	**Paragraph**
Mbombela Municipality (Mpumalanga)	20	Qualified, Emphasis of matter	• The increase in bad debt provision of R8,7 million was directly allocated to unappropriated surplus, resulting in an overstatement of the net surplus for the year.
Potchefstroom Municipality (North West)	31	Disclaimer, Emphasis of matter	• An audit trail of 179 accounts, net amounting to R3, 7 million, as included in the trail balance but not in the financial statements, could not be provided. • The net surplus for the year as per the Statement of Financial Performance differs by R54,5 million from the net surplus as per the Statement of Changes in Net Assets. • The Statement of Changes in Net Assets has not been prepared in the format prescribed by the National Treasury. • The movement of reserves and surplus for the year disclosed under Accumulated Surplus in the financial statements was incorrectly calculated, resulting in a difference of R20,4 million. • The renaming of funds, as required by the National Treasury, has not been done. • The assets and liabilities representing the Housing Development Fund of R10,3 million do not agree to the notes to the financial statements. • Executive directors' benefits and allowances were not disclosed separately. • Audit fees incorrectly include payments made for internal audit services amounting to R0,2 million. • Capital commitments reflect zero commitments, but approved and contracted commitments of R3,5 million were identified from the contract register. • The implementation of GAMAP and the associated note in respect of movement have not been disclosed. • The changes in accounting policy and the associated note in respect of the change in accounting policies have not been disclosed. Based on the financial statements, the following differences were noted in the cash flow statement which resulted in its incorrect disclosure. No supporting evidence was provided to support cash flow balances. • Net cash from operational activities is overstated by R12,1 million. • Net cash from investing activities is understated by R0,01 million. • Net cash from financing activities is overstated by R79,4 million.

AUDITOR-GENERAL

ANNEXURE C: ANALYSIS OF AUDITS OF MUNICIPAL PERFORMANCE MANAGEMENT AND MEASUREMENT

Detailed findings

The MSA established a framework for support, monitoring and standard setting so as to move progressively towards the social and economic upliftment of local communities as well as to ensure universal access for all to essential services. In order to achieve the ideal of a developmentally orientated municipality, the MSA prescribes specific core principles, mechanisms and processes to be implemented, which can be graphically summarised as follows:



Phase 1: Development of integrated development plans

In all 29 (28 of the 29 municipalities in 2003-04) cases the municipalities had submitted performance measures for auditing and where the audit and audit process could be completed, auditors could confirm that an IDP had been developed.

Although some areas for improvement were identified, the overall audit findings were satisfactory with respect to the development of IDPs. It is encouraging to note that the focus on the development of IDPs as a legislative requirement has increased.

AUDITOR-GENERAL

Phase 2: Development and implementation of performance management systems

The auditors confirmed that in 26 (23 in 2003-04) of the 29 municipalities, a PMS had been developed and some level of implementation had been attempted.

As in the case of IDPs, significant improvement was made with the implementation of PMS. However, shortcomings were identified and reported regarding the PMS. These shortcomings included inadequate consultation with communities, inadequate monitoring, targets and objectives not having been identified, and a lack of proper governance structures.

Phase 3: Development and improvement of key performance indicators

Key performance indicators (KPIs) are financial and non-financial quantitative measurements of whether progress is being made in achieving an entity's goals and objectives. A municipality must, in terms of its PMS, set appropriate KPIs as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its IDP.

The IDP of a municipality aligns the resources and capacity of the municipality with the implementation of the IDP. The KPIs and performance targets of a municipality become an undertaking of the municipality to the community. Resources should therefore be utilised for the municipality's development priorities and objectives as identified in the IDP.

The auditors confirmed that in 25 (2003-04:18) of the 29 municipalities, KPIs had been developed and included in the IDPs. However, KPIs were not always set for all the priorities and objectives.

Internal audit and performance audit committee

The regulations issued by the dplg require that a performance audit committee be established or that the current audit committee's terms of reference and composition be extended or amended to incorporate the requirements of the regulation pertaining to performance audit committees. The audit committee is also required, in terms of section 166 of the MFMA, to advise on performance management. In addition, the municipality's internal auditors must on a continuous basis audit the performance measurements and submit quarterly reports on their audits to the municipal manager and the performance audit committee. The internal audit unit is also required, in terms of section 165 of the MFMA, to advise the audit committee and accounting officer regarding performance management.

In respect of the 29 municipalities, the auditors confirmed that 28 (2003-04: 21) municipalities had met the requirement of having an internal audit unit for the PMS, while 13 (2003-04: 12) had met the requirement of having a performance audit committee. However, in most cases it was found that the internal audit units did not audit the PMS and did not report to the performance audit committees as required by section 45(a) of the MSA and section 14(1) of the regulations. The performance audit committees did not meet regularly or did not discuss internal audit reports.

It is clear that overall governance in respect of PMS was still not satisfactory at the key municipalities during the period under review.

AUDITOR-GENERAL

ANNEXURE D: EXPLANATION OF THE AUDIT PROCESS

Auditing standards

To facilitate compliance with auditing standards, the office has developed a customised audit approach that is in line with the requirements of the South African Auditing Standards (SAAS) issued by the Public Accountants' and Auditors' Board (PAAB). These standards include a public sector perspective based on those standards developed internationally to harmonise SAAS and the standards issued by the International Organisation of Supreme Audit Institutions (INTOSAI). These standards are applied in the auditing of the financial statements.

Essentially, SAAS govern the standards and provide guidance on the format and contents of an audit report. Although largely applicable to financial statements, they can be adapted to the assessment of other financial information. The key advantage of these standards is that they provide a standard framework for the expression of a written opinion on the audited entities' financial statements.

Public sector perspective

In addition to the standard application of SAAS, their application in the public sector includes additional guidance on public sector requirements, with the result that reference is made in the paragraph on the "scope of the audit" to the legislation and directives that have given rise to the audit mandate. This also allows for an outline to be given of the nature, content and form of the auditor's report. Compliance auditing specifications (i.e. compliance with relevant rules and regulations) are only included in SAAS insofar as the presentation in the financial statements subjected to audit would be affected. However, another dimension that the public sector audit may reflect is the realm of performance. The report may thus assess aspects such as compliance with rules and procedures, internal controls, value for money, wastage of resources or other matters in the public interest.

The Auditor-General also has a constitutional mandate to audit financial management.

The audit information on public sector entities is intended for legislators, government departments, other investors and the general public. Reports on public sector audits conducted by the Auditor-General and then published, are mandated by law to become public documents.

Quality review and assurance

Another benefit of the application of SAAS is the system for assuring the quality of the audit applied throughout the audit process. The auditor needs to be satisfied as to the reliability of the information on which an audit opinion will be based. The level of assurance is usually determined by risks involved, the procedures the auditor uses and the results obtained.

The quality of the audit is tested against adherence to SAAS by an internal and external appraisal or quality assurance process.

Figure 1 below provides an overall view of the audit process applied by the office which will result in an audit opinion.

Figure 1: Steps in the audit process

Professional requirements, i.e. independence, objectivity, confidentiality and professional behaviour

PRE-ENGAGEMENT ACTIVITIES

- Consider changes in circumstances of previously audited entities/ Consider circumstances of new engagements (identify risks)
- Determine skills and competency requirements of the audit team
- Establish terms of engagement and communicate to the management of the audited entity

AUDIT PLANNING

- Obtain knowledge of the business
- Obtain understanding of the accounting systems and processes operated by management to control the entity (internal control systems)
- Risk assessment: Assess financial risks facing the entity (for example, risks relating to fraud and error; liquidity/solvency problems; non-compliance with legislation)
- Evaluate the work of internal audit and determine whether reliance can be placed on it
- Evaluate the financial management of the entity in terms of the predetermined levels
- Consider whether the internal controls that management has implemented are appropriately developed and documented
  - If yes, the internal controls can be tested
  - If not, the internal control weaknesses are identified and communicated to management
- Formulate the audit approach
- Communicate the audit plan to the management of the entity

EXECUTION OF THE AUDIT

- Testing of controls – study and evaluate the internal controls of an audited entity
- Detailed test of transactions and balances in the financial statements
- Continuous communication – meetings with the management of the auditee
- Letter to management to highlight key audit findings with recommendations

REPORTING

The output of an audit is simply the expression of an opinion on the financial statements of an entity. It should also be noted that audit opinions are only expressed on financial statements and not on compliance with laws and regulations. However, any deviation from laws and regulations relating to financial matters will be considered and could result in a modified audit report. In accordance with SAAS, other statutory reporting requirements could also result in a modification by means of an emphasis of matter. The table below shows the different kinds of audit opinions in increasing order of severity.

Effectively, two types of audit reports are issued, namely (a) a "clean" report and (b) a report that is not "clean", or "modified". An audit report gives an audit opinion on the financial statements of an auditee. When the report is not "clean", one of four possible audit opinions is issued. As illustrated below, these range from emphasis of matter, which is the least severe, to a disclaimer of opinion, which is the most severe.

Figure 2: Explanation of audit opinions