AUDITOR-GENERAL

GENERAL REPORT

OF THE

AUDITOR-GENERAL

ON THE

AUDIT OUTCOMES OF LOCAL GOVERNMENT

FOR THE

FINANCIAL YEAR ENDED 30 JUNE 2004

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AUDITOR-GENERAL

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AUDITOR-GENERAL

TABLE OF CONTENTS

AUDITOR-GENERAL

AUDITOR-GENERAL

FOREWORD

I have the pleasure of presenting my *General report on the audit outcomes of local government for the financial year ended 30 June 2004.*

Local government is at the threshold of a new era as the process put in place by the promulgation of the Local Government Transition Act, 1993 (Act No. 209 of 1993) (LGTA) is nearing its end.

The legislative reforms and transformation achieved by local government through the Local Government: Municipal Demarcation Act, 1998 (Act No. 27 of 1998) (MDA), the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998) and the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) paved the way for the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). The MFMA provides the foundation for sound financial principles and practices for municipalities. The Local Government: Municipal Property Rates Act, 2004 (Act No. 6 of 2004), which addresses aspects of the valuation rolls and rates policies, is the last pillar of legislation that completes the full legislative transformation of municipalities. In terms of finalising the transformation process, local government is still facing the daunting task of repealing obsolete provincial ordinances, in order to have a coherent enabling legal framework.

The MFMA, which applies to all municipalities and municipal entities, was promulgated to take effect on 1 July 2004. Some provisions have been delayed and will be implemented at a later date. The Minister of Finance has provided extra time to comply with some of the more complex provisions where the capacity of municipalities may need to be expanded. As the various delayed provisions progressively come into effect, the MFMA will supersede all other legislation relating to financial and fiscal matters. Municipalities are actively encouraged to implement the delayed or exempted provisions sooner and not to wait until the final compliance dates.

The mere fact that legislation has been put in place does not automatically mean that service delivery is taking place. Instead, the outcry from the average citizen on the lack of service delivery seems to be on the increase. Numerous examples can be given. For example, City of Johannesburg businesses were advised to implement their own standby generators because electricity cannot be guaranteed 100 per cent (SABC news 26/04/2005). In Port Elizabeth, residents took to the streets to protest against the delay in housing delivery, threats from flooding, and a lack of sanitation and refuse collection (SABC news 03/05/2005). In the Free State, government has stepped in to help local municipalities clean up their act after a report indicated that drinking and waste water was a threat to public health in a number of Free State towns (SABC news 18/10/2004).

AUDITOR-GENERAL

In Africa the majority of the population (62,1 per cent) is still rural, while urban growth rates are the most rapid in the world at nearly four per cent a year, and nearly twice the global average. Growth rates are predicted to average 3,5 per cent per year over the next 15 years, meaning that Africa's share of the world's urban population will increase from 10 to 17 per cent between 2000 and 2015 (United Nations Population Division 2001). South Africa faces a similar urban growth rate, which implies that municipalities' responsibilities and challenges will increase on a daily basis. This includes the provision of electricity, housing, sanitation facilities and other concepts such as waste management and the creation of jobs.

Similar to my 2002-03 general report, the focus this year is again placed on the top 50 municipalities. The assumption is that if the top 50 municipalities have difficulty in implementing financial reform and improved service delivery, the remaining 234 municipalities could face similar obstacles. My report reviews the current financial capacity of local government and will form the basis for future reporting on local government issues that could impact on service delivery to the people of South Africa.

I trust that this report will at least contribute to the accountability and transparency of municipalities in their endeavour to deliver services of quality and standard, and lastly would like to emphasise the need for cooperation between my office and the municipalities during this transition period.

S A Fakie
Auditor-General

Pretoria
June 2005

AUDITOR-GENERAL

1. INTRODUCTION

1.1 Background

There are similarities between the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA), which regulates national and provincial departments, public entities and constitutional institutions, and the MFMA, in the sense that it provides 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 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 respect 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 can be graphically depicted as follows:

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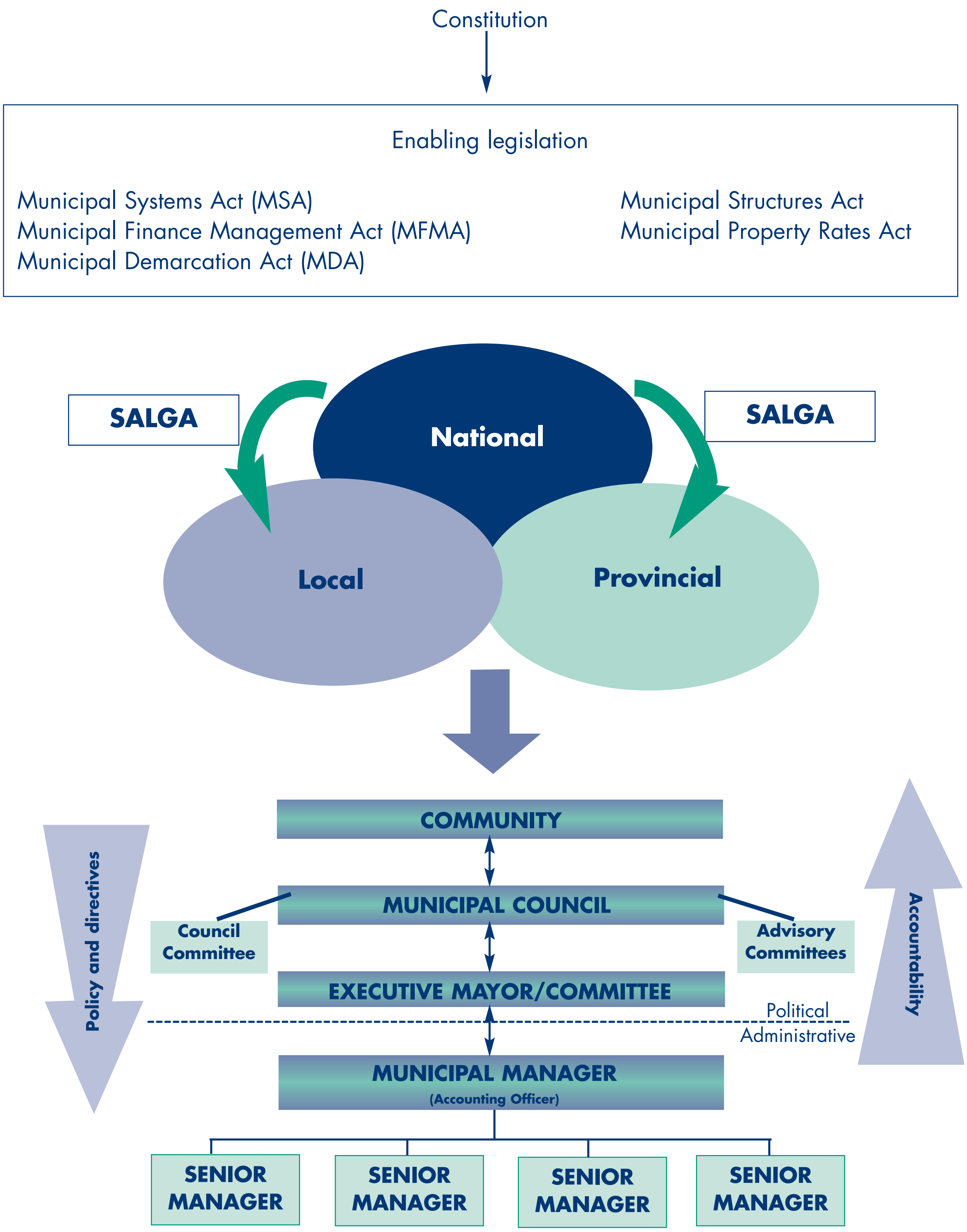


AUDITOR-GENERAL

The MFMA provides for greater involvement of the National Treasury and provincial treasuries in the supervisory functions of the financial affairs of municipalities and taking appropriate measures including monitoring, support and intervention, if necessary. In general the functions of provincial treasuries as stipulated by the MFMA are described in section 5 as follows:

- Promote cooperative governance amongst role players.
- Assist the National Treasury in enforcing compliance by municipalities with the MFMA.
- Monitor municipal budget and outcomes.
- Monitor submission of reports by municipalities.
- Assist municipalities with budget preparation.
- Exercise powers and perform duties as delegated by the National Treasury.
- Take appropriate steps if legislation is breached.
- Share all information received with the National Treasury.
- Monitor compliance with the MFMA.

The National Treasury identified 12 urgent priorities to ease the implementation of the MFMA. The successful implementation of the MFMA depends on the outcomes of these 12 priorities.

The priorities are:

1. Preparing an implementation plan.
2. Allocating responsibilities to the accounting officer.
3. Establishing a senior management team.
4. Implementation of controls over municipal bank accounts and cash management.
5. Meeting of financial commitments.
6. Reporting revenue and expenditure.
7. Revising policies for supply chain management.
8. Implementing reforms in relation to municipal entities, public-private partnerships (PPPs), long-term contract borrowings and municipal borrowings.
9. Completing past financial statements.
10. Completing the 2003-04 financial statements and tabling the annual report.
11. Complying with provisions for tender committees and boards of municipal entities as well as in relation to forbidden activities.
12. Complying fully with the Division of Revenue Act (DoRA).

The phased-in approach of the MFMA should hopefully allow municipalities to implement the stringent requirements in good time, 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 its 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 government, 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 capacity building. According to MFMA Circular No. 14, R749 million has been allocated for the 2005 Medium-term Expenditure Framework (MTEF). The purpose of these grants is to support the financial management grant, municipal systems improvement programme, and the restructuring grant.

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

These include:

- Community consultation and participation.
- Integrated development planning.
- Setting of clear objectives and the provision of means to achieve these objectives.
- The ability to achieve the objectives set, as this is dependent on institutional capacity.
- Strong systems of internal control and stewardship of resources by the management of municipalities.
- A clear and transparent reporting process to satisfy the local and national taxpayers and inform them of the achievements of their municipalities.

During the joint sitting of Parliament in February 2005, it was emphasised that municipalities should ensure properly focused development planning. Parliament made the commitment that through Project Consolidate the capacity of municipalities will be increased to improve performance. In section 6 of this report the integrated development planning and Project Consolidate of municipalities are discussed in more detail.

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 pieces of legislation and large volumes of guidance (not simplistic).
- Recovery of debt.
- Providing free consumer services for indigents (water and electricity).
- Providing services and infrastructure.
- The geographical size of many municipalities.
- Preparation of realistic multi-year budgets that are linked to the integrated development plan.

Role players such as the national Department of Provincial and Local Government (DPLG) and the National Treasury play an important role in assisting municipalities to fulfil their mandate, especially with regard to the development and transfer of skills in the form of a municipal training system, the standardisation of systems across municipalities, and the implementation of newly developed accounting standards and legislation.

The implementation of oversight committees as recommended by section 129 of the MFMA could also improve accountability.

Section 129 of the MFMA requires the following:

- The council of a municipality must consider within two months after tabling, the annual report of the municipality and of any municipal entity under the municipality's sole or shared control.
- The council of a municipality must adopt an oversight report containing the council's comments on the annual report, which must include a statement whether the council:
  - (a) has approved the annual report with or without reservations;
  - (b) has rejected the annual report; or
  - (c) has referred the annual report back for revision of those components that can be revised.
- The accounting officer must in accordance with section 21A of the MSA make public an oversight report within seven days of its adoption.

Also in terms of section 129, the National Treasury may issue guidelines on the following:

- The manner in which municipal councils should consider annual reports and conduct public hearings.
- The functioning and composition of any public accounts or oversight committees established by the council to assist it to consider an annual report.

Guidelines issued by the National Treasury are not binding on a municipal council unless adopted by the council.

In terms of section 86B of the MSA, different kinds of municipal entities can be established, namely a private company (subject to certain conditions), a service utility established by a municipality in terms of part 3 of the MSA, and a multi-jurisdictional service utility established by two or more municipalities in terms of part 4 of the MSA. According to information available to my office, the top 50 municipalities have 44 municipal entities.

1.2 Focus area

Arising from the demarcation process, as well as the move towards the development of a service-oriented culture, the total number of municipalities was reduced from 843 to 284. The National Treasury, based on specific criteria, identified the top 50 municipalities in South Africa.

AUDITOR-GENERAL

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

- Budget
- Capacity
- Date on which the municipality entered into the agreement related to the financial management grant

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 distribution of municipalities is as follows:

High capacity	50
Medium capacity	107
Low capacity	127

According to the 2001 census information, the top 50 municipalities represent an estimated 68 per cent (30,6 million out of 44,8 million) of the total population, while the total area covered by the top 50 municipalities represents approximately 18 per cent of total land in South Africa.

1.3 Structure of the report

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

- Submission of financial statements (section 2) and audit opinions (section 3).
- Financial performance of municipalities (section 4).
- Audits of municipal performance management and measurement (section 5).
- Improvements in service delivery and accountability initiatives (section 6).

1.3.1 Audit findings on financial statements

This section consists of two elements, namely:

- The submission of financial statements for auditing by all 284 municipalities.
- An analysis of the audit reports of the top 50 municipalities for which audit reports had been signed by 30 April 2005.

1.3.2 Financial performance of municipalities

The financial statements of the top 50 municipalities of which the audits had been finalised by 30 April 2005 were examined. Key indicators pertaining to the following ratios or 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

1.3.3 Audits of municipal performance management and measurement

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, which came into force for all municipalities in 2002-03.

Included in this section is an explanation of the types of audit reports provided. These range from instances where elementary or no performance management systems are in place, to reports on established systems of performance management.

1.3.4 Improvements in service delivery and accountability initiatives

The last part of the report highlights certain initiatives that focus on improving accountability arrangements and service delivery within local government. Two areas are discussed, namely integrated development planning and Project Consolidate.

1.3.5 Top 50 municipalities

Table 1 lists, in order, the top 50 municipalities as ranked by the National Treasury. The categories refer to the type of municipality, as referred to in section 155 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), namely:

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.

1.3.6 Quality assurance process

To ensure that the quality of the audits performed complies with the South African Auditing Standards (SAAS) set by the Auditing Standards Committee, my office follows a rigorous quality assurance process. This provides for the performance of an independent engagement quality control review prior to the audit report being signed, as well as a mandatory quality review, performed jointly by my office and the Public Accountants' and Auditors' Board after the report has been issued.

AUDITOR-GENERAL

Table 1: Top 50 municipalities

	Category	Province	Municipality	Operating income 2003-04 R'000**	Operating income 2002-03 R'000**	Percentage increase or decrease
1	A	Gauteng	City of Johannesburg*	9 670 217	8 567 448	12,9%
2	A	Western Cape	City of Cape Town*	7 052 159	7 697 954	-8,4%
3	A	KwaZulu-Natal	eThekwini	6 189 876	5 530 781	11,9%
4	A	Gauteng	Ekurhuleni	#	***	-
5	A	Gauteng	City of Tshwane	4 742 786	4 440 498	6,8%
6	A	Eastern Cape	Nelson Mandela	1 989 035	1 747 901	13,8%
7	B	Free State	Mangaung	1 011 773	899 985	12,6%
8	B	Eastern Cape	Buffalo City	980 456	967 266	1,3%
9	B	KwaZulu-Natal	Msunduzi	1 089 352	966 802	12,7%
10	B	Gauteng	Emfuleni	#	***	-
11	B	Free State	Matjhabeng	#	***	-
12	B	North West	Rustenburg	#	***	-
13	B	KwaZulu-Natal	uMhlathuze	576 418	502 971	14,6%
14	B	Limpopo	Polokwane	440 065	401 044	9,7%
15	B	Gauteng	Mogale City	#	***	-
16	B	Northern Cape	Sol Plaatje	#	***	-
17	B	North West	Klerksdorp	#	***	-
18	B	Mpumalanga	Emalahleni	#	***	-
19	B	Western Cape	Drakenstein	414 899	384 985	7,8%
20	B	Mpumalanga	Mbombela	#	***	-
21	B	Mpumalanga	Govan Mbeki	#	#	-
22	B	KwaZulu-Natal	Newcastle	#	***	-
23	C	KwaZulu-Natal	Ugu District Municipality	139 253	121 374	14,7%
24	B	Western Cape	George	315 761	276 198	14,3%
25	B	Western Cape	Stellenbosch*	231 734	191 893	20,8%
26	C	Eastern Cape	Amatole District Municipality	110 569	109 049	1,4%
27	B	Mpumalanga	Steve Tshwete*	208 989	193 949	7,8%
28	B	North West	Madibeng	#	***	-
29	C	Eastern Cape	OR Tambo District Municipality	#	#	-
30	B	Free State	Maluti-a-Phofung	#	***	-
31	B	North West	Potchefstroom	#	***	-
32	C	North West	Bojanala Platinum District Municipality	127 337	100 858	26,3%

AUDITOR-GENERAL

Table 1: Top 50 municipalities (continued)

	Category	Province	Municipality	Operating income 2003-04 R'000**	Operating income 2002-03 R'000**	Percentage increase or decrease
33	B	Eastern Cape	King Sabata Dalindyebo	#	#	-
34	C	Limpopo	Greater Sekhukhune Cross Boundary	#	#	-
35	C	Mpumalanga	Nkangala District Municipality	162 107	160 961	0,7%
36	B	KwaZulu-Natal	Emnambithi / Ladysmith	180 875	162 282	11,5%
37	B	Free State	Metsimaholo	#	***	-
38	B	Free State	Moqhaka	#	#	-
39	B	Western Cape	Breede Valley*	172 290	145 394	18,5%
40	B	Gauteng	Merafong City	#	***	-
41	B	Limpopo	Greater Tzaneen	#	***	-
42	B	KwaZulu-Natal	KwaDukuza	#	***	-
43	C	Mpumalanga	Ehlanzeni District Municipality	#	#	-
44	B	KwaZulu-Natal	Hibiscus Coast	#	***	-
45	B	Western Cape	Mossel Bay	197 195	175 463	12,4%
46	B	Gauteng	Randfontein	#	***	-
47	B	Western Cape	Saldanha Bay	197 934	168 317	17,6%
48	C	Eastern Cape	Ukhahlamba District Municipality	#	#	-
49	C	KwaZulu-Natal	Uthungulu District Municipality	#	***	-
50	B	Western Cape	Overstrand	194 634	171 451	13,5%
				36 395 714	**34 084 824**	**11,1%**

\# Audit not finalised.
* Financial statements prepared on GAMAP.
** For the purpose of this report all aspects that constitute service delivery were classified as operating income, including RSC levies. For example, income from interest received, sale of fixed assets, grants, donations, dividends, fines and licence fees (administered on behalf of the provinces) were not included.
*** Comparative information not included due to the current year's audit not having been finalised.

The highest percentage increase in operating income was in Bojanala Platinum District Municipality with an increase of 26,3 per cent. The lowest percentage increase was in Nkangala District Municipality with an increase of only 0,7 per cent. This is excluding City of Cape Town Municipality that had a decrease of 8,4 per cent. The average percentage increase in operating income was 11,1 per cent.

AUDITOR-GENERAL

2. SUBMISSION OF FINANCIAL STATEMENTS

Section 10G(2)(e)(i) of the LGTA requires that the financial statements of municipalities be submitted to the Auditor-General for audit within three months after the financial year-end.

The MFMA places a stronger statutory obligation on municipalities to submit their financial statements for audit purposes. In terms of the MFMA, municipalities have to submit their financial statements for audit within two months of their financial year-end, which is in line with the requirements set by the PFMA for national and provincial departments. From the 2004-05 financial year onwards, the financial statements must 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.

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.
- Old Generally Accepted Municipal Accounting Practice (GAMAP) – 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 the setting up of the Accounting Standards Board (ASB).
- New GAMAP, approved by the ASB – Mixture of updated old GAMAP and standards of Generally Recognised Accounting Practice (GRAP) issued by the ASB. GRAP is being progressively introduced. In the interim and in the absence of GRAP standards, financial statements are generally prepared in accordance with old GAMAP. The National Treasury and the ASB are in the process of finalising the new GAMAP specimen financial statements in consultation with my office. The Minister of Finance has the authority to promulgate the implementation of these standards in terms of section 91(1)(b) of the PFMA, which has not yet been done. In terms of a tripartite agreement between the aforementioned three parties, adequate guidance, capacity and support should be put in place first.

Municipalities are currently preparing financial statements either on IMFO or old GAMAP, with a few exceptions on new GAMAP. There is thus some inconsistency in respect of the accounting standards being applied by municipalities as part of the transitional arrangements. The National Treasury has undertaken to provide clear guidance and training (where necessary) on which accounting standards will apply to which municipalities.

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:

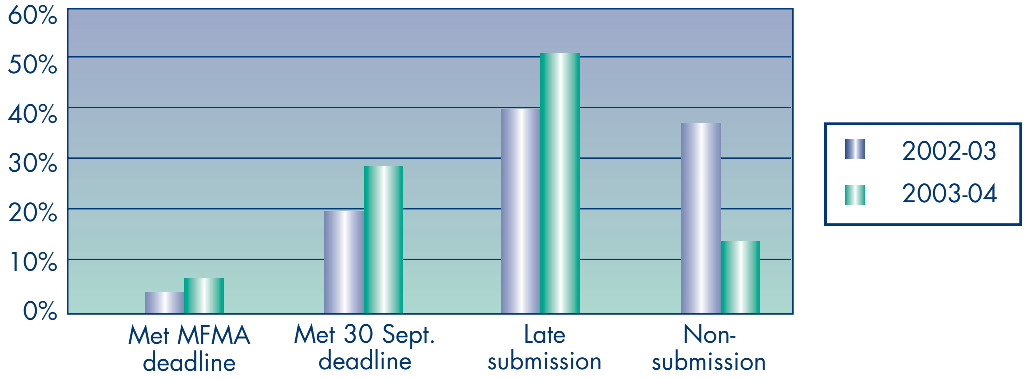
AUDITOR-GENERAL

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.

At 30 April 2005, 40 (14 per cent) of the 284 municipalities had not submitted financial statements, while 145 (51 per cent) submitted it after the deadline of 30 September 2004. Only 17 (six per cent) (2002-03: three per cent) of the municipalities were able to meet the submission deadline of 31 August as prescribed by the MFMA, while an additional 83 of the 284 municipalities (29 per cent) (2002-03: 20 per cent) submitted financial statements by 30 September 2004. This is only an indication of the impact of the stringent requirement that will be enforced from the 2004-05 financial year on all municipalities (figure 1).

Figure 1: Submission of 2003-04 financial statements by all municipalities



Of the top 50 municipalities, 50 per cent (2002-03: 42 per cent) submitted financial statements by 30 September 2004. Two (four per cent) of the top 50 had not submitted financial statements at all by 30 April 2005 (table 2), while 46 per cent (2002-03: 46 per cent) submitted it between 1 October 2004 and 30 April 2005 (table 3). Forty-eight of the top 50 municipalities submitted financial statements, of which 22 (46 per cent) were rejected, due to factors such as the financial statements being incomplete or the prescribed format not being used. Fourteen (64 per cent) had subsequently resubmitted their financial statements (figure 4). Eight of the rejected financial statements were not resubmitted (table 4).

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Figure 2: Submission of 2003-04 financial statements by the top 50 municipalities

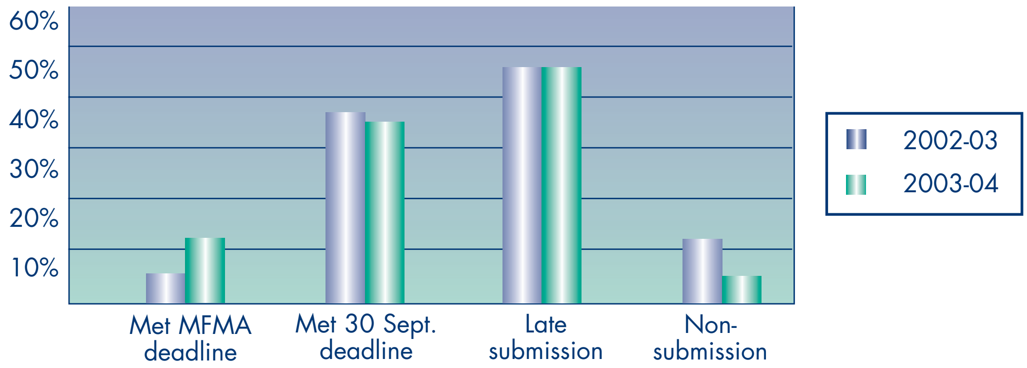


Table 2: Top 50 municipalities that had not submitted financial statements by 30 April 2005

Ranking	Province	Municipality
34	Limpopo	Greater Sekhukhune Cross Boundary Municipality
42	KwaZulu-Natal	KwaDukuza Municipality

Table 3: Top 50 municipalities that submitted financial statements late

Ranking	Province	Municipality	Date submitted	Rejected
4	Gauteng	Ekurhuleni Municipality	1 October 2004	No
10	Gauteng	Emfuleni Local Municipality	1 October 2004	Yes
12	North West	Rustenburg Local Municipality	3 January 2005	Yes
15	Gauteng	Mogale City Local Municipality	18 April 2005	Not yet evaluated
16	Northern Cape	Sol Plaatje Municipality	8 October 2004	No
18	Mpumalanga	Emalahleni Municipality	3 January 2005	Yes
20	Mpumalanga	Mbombela Municipality	10 January 2005	No
21	Mpumalanga	Govan Mbeki Municipality	22 December 2004	Yes
22	KwaZulu-Natal	Newcastle Municipality	2 March 2005	No
23	KwaZulu-Natal	Ugu District Municipality	1 October 2004	No
25	Western Cape	Stellenbosch Municipality	6 October 2004	No
28	North West	Madibeng Local Municipality	3 January 2005	No
29	Eastern Cape	OR Tambo District Municipality	11 October 2004	Yes
30	Free State	Maluti-a-Phofung Local Municipality	4 November 2004	Yes
31	North West	Potchefstroom Municipality	15 October 2004	Yes
32	North West	Bojanala Platinum District Municipality	20 October 2004	No
33	Eastern Cape	King Sabata Dalindyebo Municipality	31 March 2005	No
36	KwaZulu-Natal	Emnambithi Municipality	13 October 2004	Yes
37	Free State	Metsimaholo Local Municipality	26 November 2004	Yes
40	Gauteng	Merafong City Local Municipality	19 January 2005	No
41	Limpopo	Greater Tzaneen Municipality	6 November 2004	Yes
44	KwaZulu-Natal	Hibiscus Coast Municipality	3 February 2005	Yes
48	Eastern Cape	Ukhahlamba District Municipality	15 October 2004	No

AUDITOR-GENERAL

Table 4: Top 50 municipalities that submitted financial statements that were rejected and had not yet been resubmitted

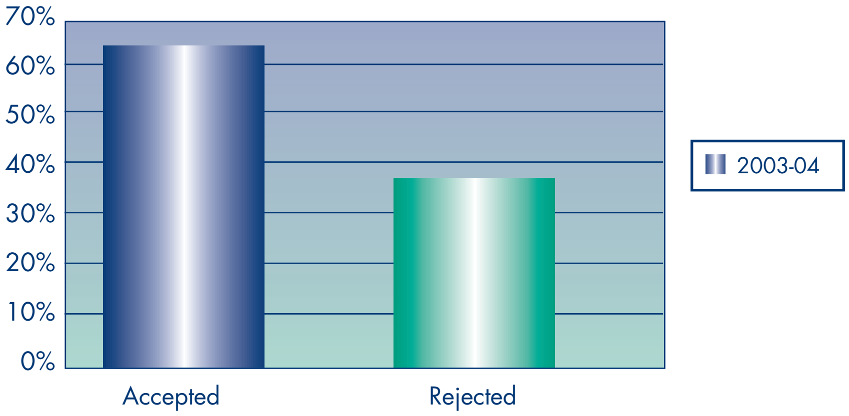
Ranking	Province	Municipality
12	North West	Rustenburg Local Municipality
21	Mpumalanga	Govan Mbeki Municipality
37	Free State	Metsimaholo Local Municipality
38	Free State	Moqhaka Local Municipality
40	Gauteng	Merafong Local Municipality
41	Limpopo	Greater Tzaneen Municipality
44	KwaZulu-Natal	Hibiscus Coast Municipality
49	KwaZulu-Natal	Uthungulu District Municipality

Of the 246 municipalities that had submitted financial statements to my office, 90 (37 per cent) were rejected. Of the 90 that were rejected, 36 (40 per cent) have since been resubmitted (figure 3).

Financial statements were rejected based on a number of reasons, such as the following:

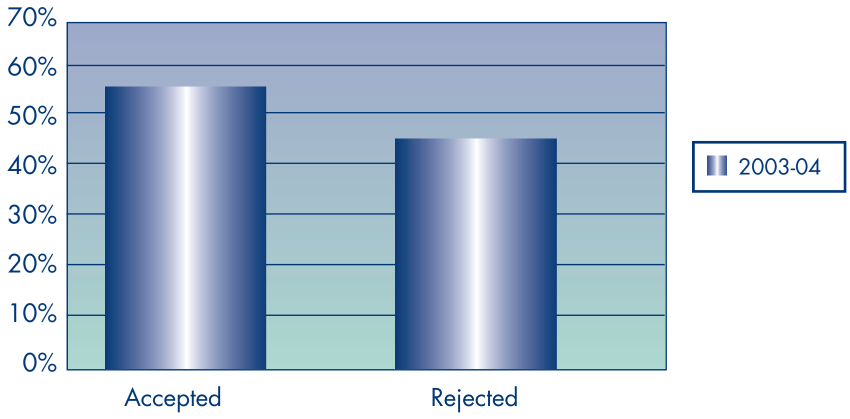
- Financial statements were incomplete.
- The prescribed format for financial statements was not used.
- Unacceptable quality or compilation errors.
- The previous year's financial statements were incomplete.

Figure 3: The 2003-04 financial statements accepted versus the financial statements rejected for all municipalities



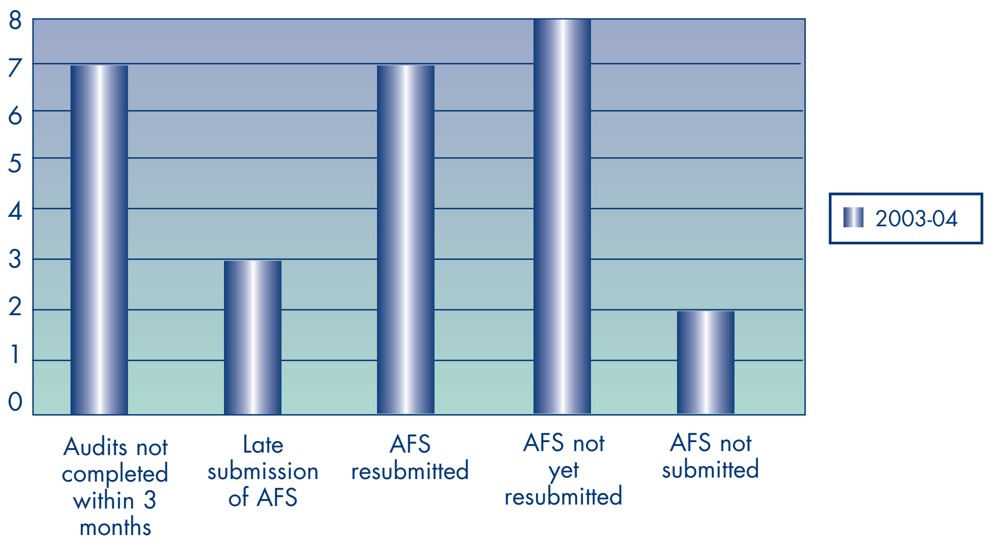
AUDITOR-GENERAL

Figure 4: The 2003-04 financial statements accepted versus the financial statements rejected for the top 50 municipalities



The status of the 27 audits that have not been finalised is disclosed in figure 5.

Figure 5: The 2003-04 audits of the top 50 municipalities that have not been finalised



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

- Change in the management of the municipality causing delays (Ehlanzeni District Municipality).
- Late finalisation of financial statements for the previous financial year (2002-03). This was in respect of three municipalities, namely Ekurhuleni Metro Municipality, Ukhahlamba District Municipality and OR Tambo District Municipality.
- Severe difficulties extracting data from newly implemented system (Sol Plaatje Municipality).
- Staff shortages to complete the audit (Mbombela Municipality).
- Delay in the submission of information by the local municipality (Madibeng Local Municipality).

The key attributes of good governance are accountability and transparency, which are achieved through the timeous submission of financial statements and audit 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. In addition, benchmarking is not possible without timeous information.

Rejecting the annual financial statements also has an impact on the audit fees, since it requires additional audit work and time.

With the advent of the MFMA more pressure will be placed on municipalities, which may result in non-compliance with the act should they not be able to meet the requirements. I have a serious concern regarding the ability of these municipalities to comply in both intent and spirit with the requirements of the MFMA.

Financial statements: 2002-03

At the time of compiling my previous general report on local government, the audits of 22 of the top 50 municipalities had not been finalised due to the non-submission or late submission of financial statements.

Since my previous report, the audits of 15 of these 22 have been finalised, six are in progress, and one municipality has not yet submitted financial statements. Finalising the 2003-04 audits is also dependent on the finalisation of the 2002-03 financial statements and audit process.

AUDITOR-GENERAL

Audits in progress: 2002-03

Ranking	Municipality
21	Govan Mbeki Municipality
29	OR Tambo District Municipality
33	King Sabata Dalindyebo Municipality
38	Moqhaka Municipality
43	Ehlanzeni District Municipality
48	Ukhahlamba District Municipality

Financial statements not submitted: 2002-03

Ranking	Municipality
34	Greater Sekhukhune Cross Boundary Municipality

AUDITOR-GENERAL

3. AUDIT OPINIONS

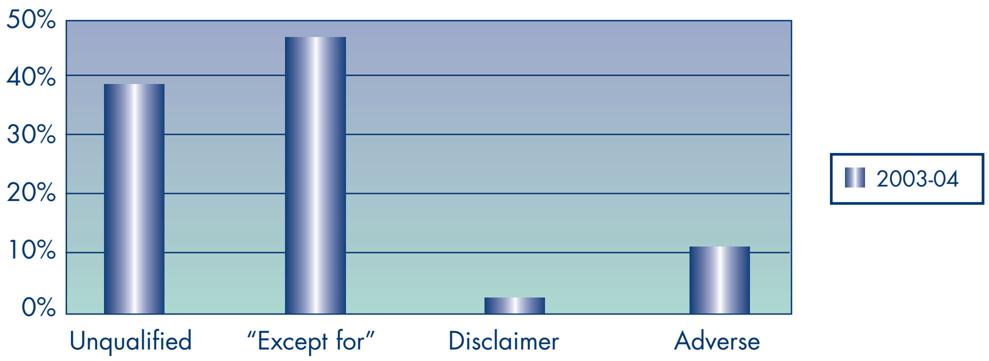
Only 95 (34 per cent) of the 284 audits had been finalised by 30 April 2005, while the audits of only 23 (46 per cent) of the top 50 had been finalised by 30 April 2005. If the high-capacity municipalities are excluded, only 72 (31 per cent) of the audits of medium- and low-capacity municipalities had been finalised.

Of the 95 audits that were finalised, 58 (61 per cent) were qualified. The distribution of the audit opinions was as follows, and is depicted in figure 6:

- Twenty-seven were unqualified (39 per cent).
- Forty-five were "except for" opinions (47 per cent).
- Three were "disclaimers" (three per cent).
- Ten had an "adverse" audit opinion (11 per cent).

(A disclaimer or adverse audit opinion represents the most severe type of audit opinion.)

Figure 6: The 2003-04 audit opinions for all municipalities that had been audited



AUDITOR-GENERAL

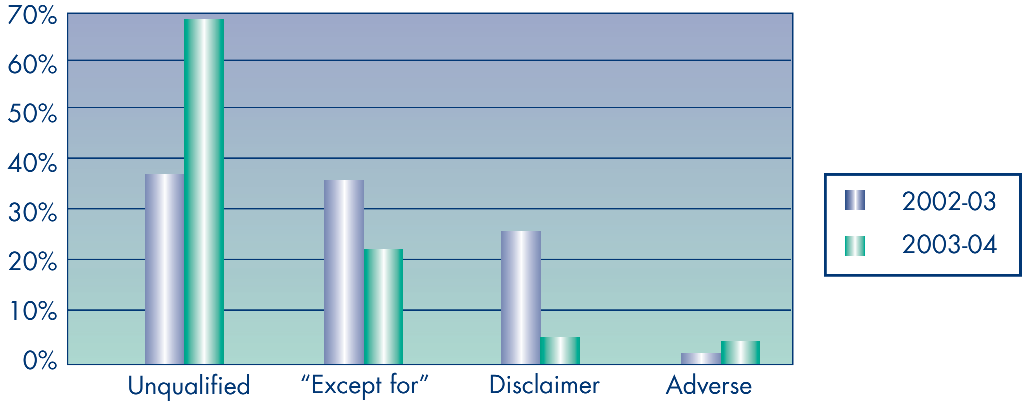
An analysis of the 23 audit reports of the top 50 municipalities that had been finalised, indicated the following:

- Sixteen were unqualified (70 per cent), compared to sixteen (37 per cent) in 2002-03.
- Fifteen of those sixteen included emphasis of matter paragraphs (table 5). Nkangala District Municipality was the only municipality that had an unmodified ("clean") report.
- Five were "except for" opinions (22 per cent), compared to fifteen (35 per cent) in 2002-03.
- One had a "disclaimer" (four per cent), compared to eleven (26 per cent) in 2002-03.
- One had an "adverse" opinion (four per cent), compared to one (two per cent) in 2002-03.

Refer to annexure B for detailed audit opinions.

Of the 22 audits for the 2002-03 financial year that had been outstanding in my previous general report, 15 had been finalised. Eleven audit reports were qualified, of which six were "disclaimers". This may be an indication that a municipality that struggles to comply with the submission dates, is also struggling to implement sound financial management and principles.

Figure 7: Audit opinions: top 50 municipalities that had been audited



AUDITOR-GENERAL

Table 5: Top 50 municipalities that had an unqualified audit opinion with an emphasis of matter for 2003-04

Ranking	Province	Municipality
2	Western Cape	City of Cape Town Municipality
3	KwaZulu-Natal	eThekwini Municipality
8	Eastern Cape	Buffalo City Municipality
13	KwaZulu-Natal	uMhlathuze Municipality
14	Limpopo	Polokwane Municipality
23	KwaZulu-Natal	Ugu District Municipality
24	Western Cape	George Municipality
25	Western Cape	Stellenbosch Municipality
26	Eastern Cape	Amatole District Municipality
27	Mpumalanga	Steve Tshwete Municipality
32	North West	Bojanala District Municipality
36	KwaZulu-Natal	Emnambithi Municipality
45	Western Cape	Mossel Bay Municipality
47	Western Cape	Saldanha Bay Municipality
50	Western Cape	Overstrand Municipality

3.1 Transversal issues reported on in audit reports

Certain aspects were identified in the audit reports that were of a transversal nature. These were:

- Asset management
- Debtors
- Personnel expenditure
- Internal audit
- Unauthorised expenditure
- Information and communication technology
- Other internal control matters

AUDITOR-GENERAL

Table 6: Summary of transversal issues

Reported matters	Number of matters reported on in audit reports				
	Adverse	Disclaimer	Qualified	Emphasis of matter	Total
Asset management	2	3	8	11	24
Debtors	2	2	4	25	33
Personnel expenditure	1	1	-	29	31
Internal audit	-	-	-	13	13
Unauthorised expenditure	-	-	-	5	5
Information and communications technology	-	-	-	29	29
Other internal control matters	-	-	-	28	28

The transversal issues identified in each of the seven categories are listed below (refer to annexure A for more detail).

3.1.1 Asset management

- Asset register incomplete or not updated.
- Assets not physically verified.
- Assets incorrectly stated in financial statements.
- Stocktaking not approved by the council.
- No asset management policy in place.
- No proof of tender for disposals.

3.1.2 Debtors

- Escalation in outstanding debt due to non-collection.
- Inadequate provision for doubtful debts.
- Consumer debts with credit balances and unallocated receipts.
- Shortcomings in the completeness and verification of debtors.

3.1.3 Personnel expenditure

- Leave entitlement not properly managed.
- Insufficient record keeping.
- Outstanding service fees and private expenses not recovered.
- Excessive overtime claimed and no overtime policy.

AUDITOR-GENERAL

3.1.4 Internal audit

Reported matters	Number of matters emphasised in audit reports	Number of municipalities
Work performed not according to annual internal audit work plan	2	2[1]
Internal audit not functional or not optimally functional during the year	4	4[2]
No reliance can be placed on internal audit	3	3[3]
Audit committee not operational	3	3[4]
Internal audit does not function independently from the treasury department	1	1[5]
Total	**13**	

3.1.5 Unauthorised expenditure

Reported matters	Number of matters emphasised in audit reports	Number of municipalities
Previous year's expenses not resolved	2	2[6]
Expenditure not approved	3	3[7]
Total	**5**	

[1] Nelson Mandela Municipality and Msunduzi Municipality.
[2] Buffalo City Municipality, Drakenstein Municipality, Breede Valley Municipality and Overstrand Municipality.
[3] City of Johannesburg Municipality, Mangaung Municipality and Breede Valley Municipality.
[4] Buffalo City Municipality, eThekwini Municipality and Saldanha Bay Municipality.
[5] Saldanha Bay Municipality.
[6] City of Cape Town Municipality and Drakenstein Municipality.
[7] Drakenstein Municipality, Bojanala Platinum District Municipality and Buffalo City Municipality.

AUDITOR-GENERAL

3.1.6 Information and communications technology

- Inadequate audit trails.
- Defined project methodologies and information technology (IT) policies not in place.
- No disaster recovery plan.
- Backups not made regularly.
- Unauthorised access.
- Inadequate segregation of duties.

3.1.7 Other internal control matters

- Procurement policy not followed.
- Control environment insufficient.
- Underspending of capital budget.
- Creditors reconciliation not performed.
- Inadequate stocktaking procedures and inventory management.
- Inadequate bank and cash management.

4. FINANCIAL PERFORMANCE OF THE 23 TOP 50 MUNICIPALITIES AUDITED BY 30 APRIL 2005

Financial statements are analysed to enable the user of those statements to be better able to interpret the information they provide. The process of analysis and interpretation is aimed at establishing trends for the particular municipality under review as well as at 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.

4.1 Different analyses

Different analyses are performed, for example trend analysis and ratio analysis.

4.1.1 Trend analysis

As the name implies, this determines a trend in the financial results of a particular enterprise or sector of industry. It is not a technique that can be used on its own; it is used as a type of summary after the other techniques have been applied. A summary is made over a period, for example five years, and the trend of these figures, percentages or ratios is determined in order to establish whether the municipality is heading in the right direction or not.

4.1.2 Ratio analysis

Ratio analysis is sometimes considered to be merely another technique used by analysts. However, it is by far the most informative, and therefore the most important, of all the techniques. Ratios have been and can be developed to supply crucial information on each and every aspect of a municipality's financial position.

Financial performance relates to the capabilities of a municipality in terms of financial strengths. Using ratios to analyse the financial statements is very useful to assess the financial strengths of the organisation under review.

For the purpose of this report, the following analyses were performed to determine financial strength at municipal level:

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

The comparative information included in this report of those municipalities that converted from IMFO to GAMAP during the 2003-04 financial year, was amended to reflect the comparative information as per the financial statements.

AUDITOR-GENERAL

4.2 Debt-collection period

This ratio indicates the length of time it takes debtors to pay their accounts or the municipality's ability to recover outstanding debts. The 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 the provision for doubtful debts and the debt write-off policy influence the debt-collection period as calculated in figure 8.

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 debt-collection period for the 23 municipalities was 136 days. Only nine municipalities were able to recover their debt within 100 days (approximately three months), while the remaining 14 municipalities took 100 days or longer to recover their debt.

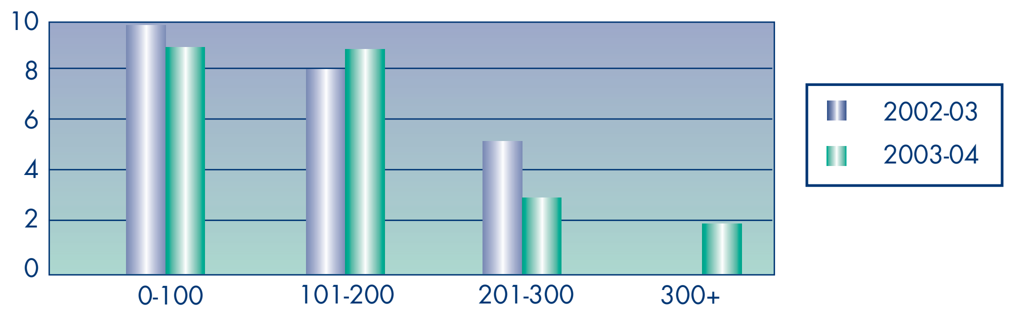
Total debt for the 23 municipalities in 2003-04 was R19,2 billion (2002-03: R17,3 billion), which represents an increase of R1,9 billion over a 12-month period. This also supports the argument that municipalities are struggling to collect outstanding debt.

The information disclosed in the financial statements does not enable the reader to determine:

- 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 method of payment and levels of suspense account balances.

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

Figure 8: Debt-collection period in days



4.3 Provision for bad debt in relation to total debt

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 amount of bad debt written off due to non-recovery or incorrect billing and recording, is not stated in the annual financial statements.

The higher the percentage provision in relation to total debt, the less likely the municipality is to recover the debt. The average provision for bad debt was 59 per cent, which is extremely high. Of the non-metropolitan municipalities, Breede Valley (75,6 per cent) and Bojanala Platinum District Municipality (75,2 per cent) made the highest provision, while Polokwane made the lowest provision with eight per cent. The total provision for bad debt in 2003-04 was R11,4 billion (2002-03: R9,2 billion). There was an increase of R2,2 billion in the provision for bad debt, which also emphasises the argument that the recovery of debt is a controversial aspect.

Of the metropolitan municipalities, the City of Johannesburg had the highest provision with R7,2 billion (2002-03: R5,6 billion). The total consumer debts were R8,3 billion (2002-03: R6,8 billion). Subsequent to year-end the City of Johannesburg initiated a process to write off R1,5 billion of the debt.

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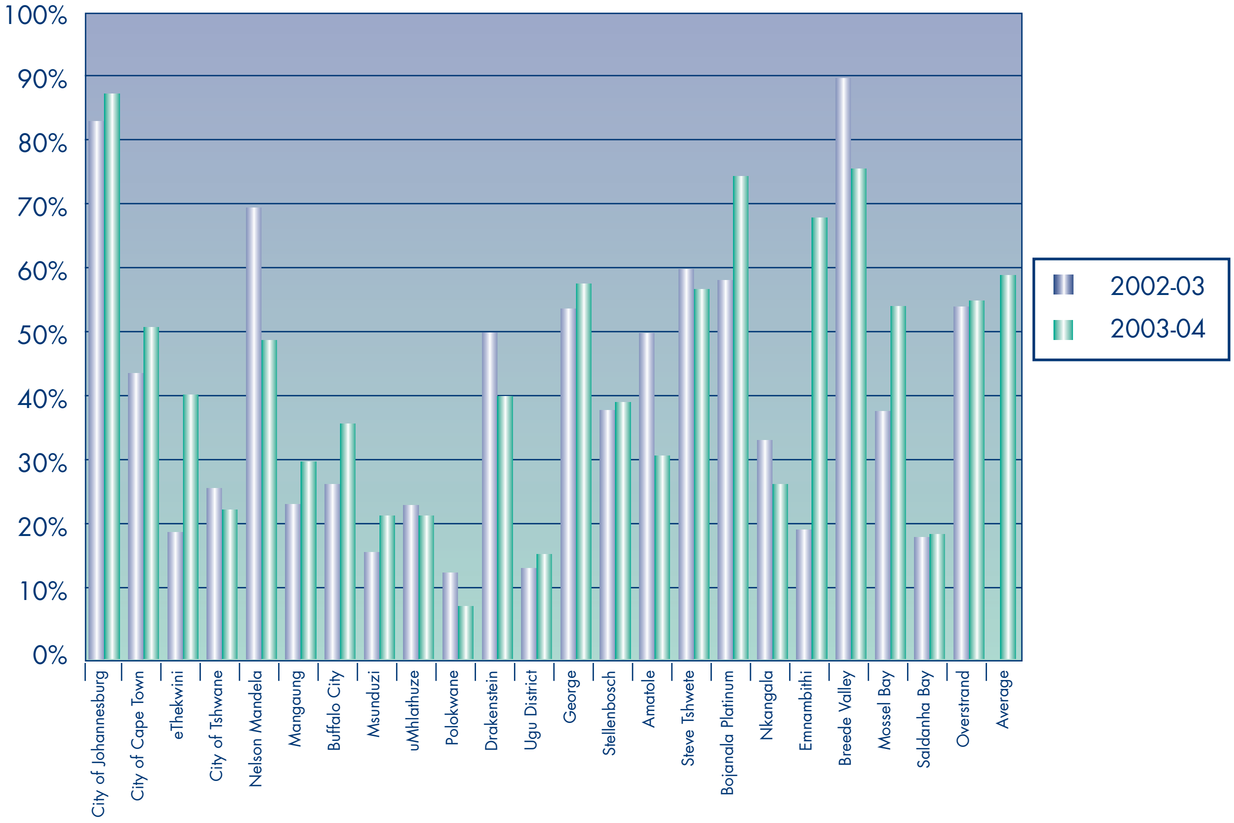
Figure 9: Provision for bad debt



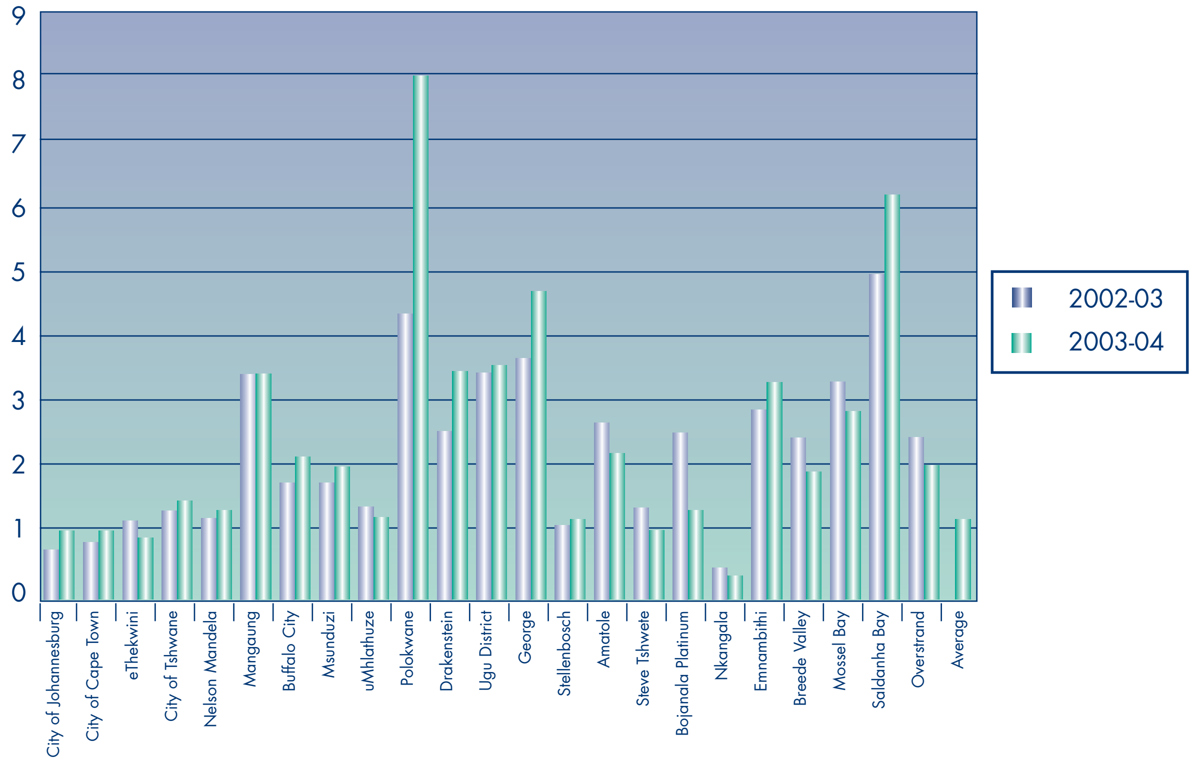
AUDITOR-GENERAL

4.4 Liquidity

The liquidity of a municipality revolves around its ability to meet its short-term liabilities (normally repayable within one year after accounting date) out of 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, meaning that there are two rands' worth of current assets for each one rand of current liabilities. The average liquidity ratio for the municipalities was 1,2:1. Whilst this is below the norm in the private sector, it is adequate for this sector. Polokwane's liquidity ratio was 8:1, mainly as a result of short-term deposits of R150 million, while Nkangala was the lowest at 0,5:1. However, this ratio – especially with regard to current assets – could be affected by the recovery of outstanding debt and the related provision for bad debt.

Figure 10: Liquidity (short-term assets : short-term liabilities)



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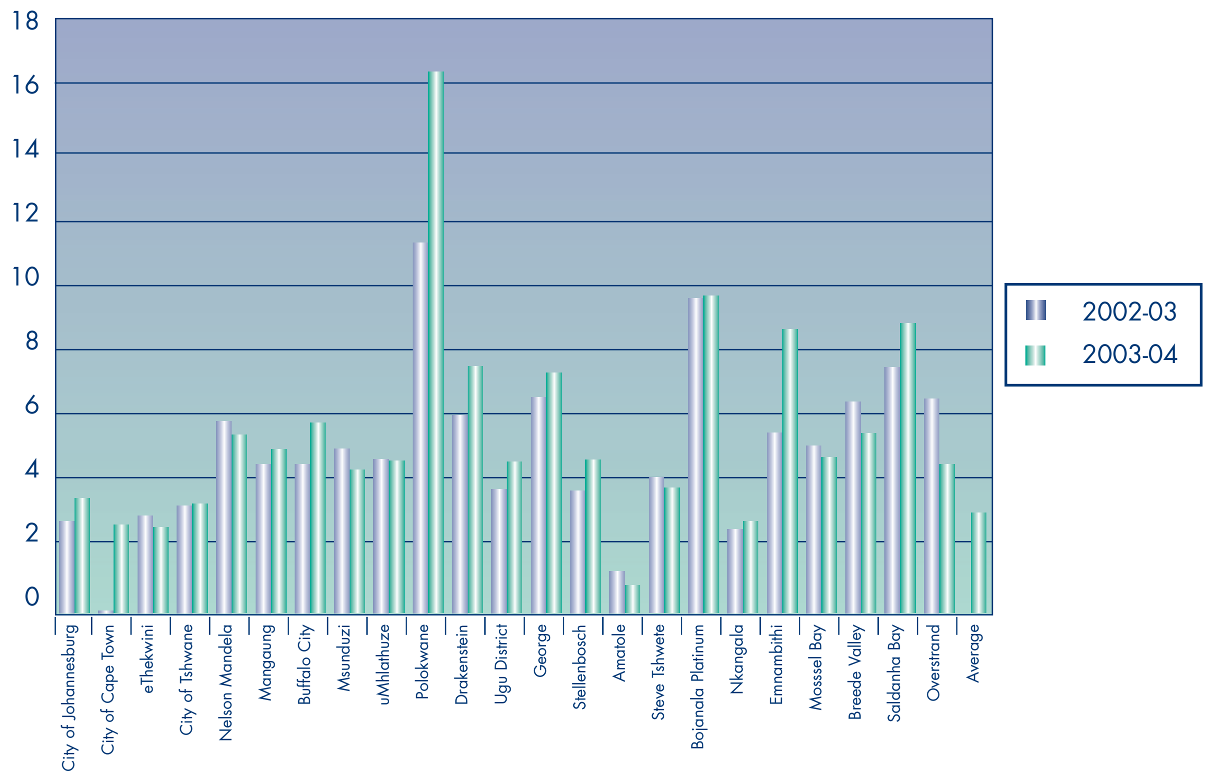
4.5 Total income in relation to current liabilities

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 debtors 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, the current liabilities are calculated as a percentage of total income.

The average ratio was 3,24:1. Polokwane had the highest ratio with 16:1, and Amatole the lowest with 1:1.

Figure 11: Total income in relation to current liabilities

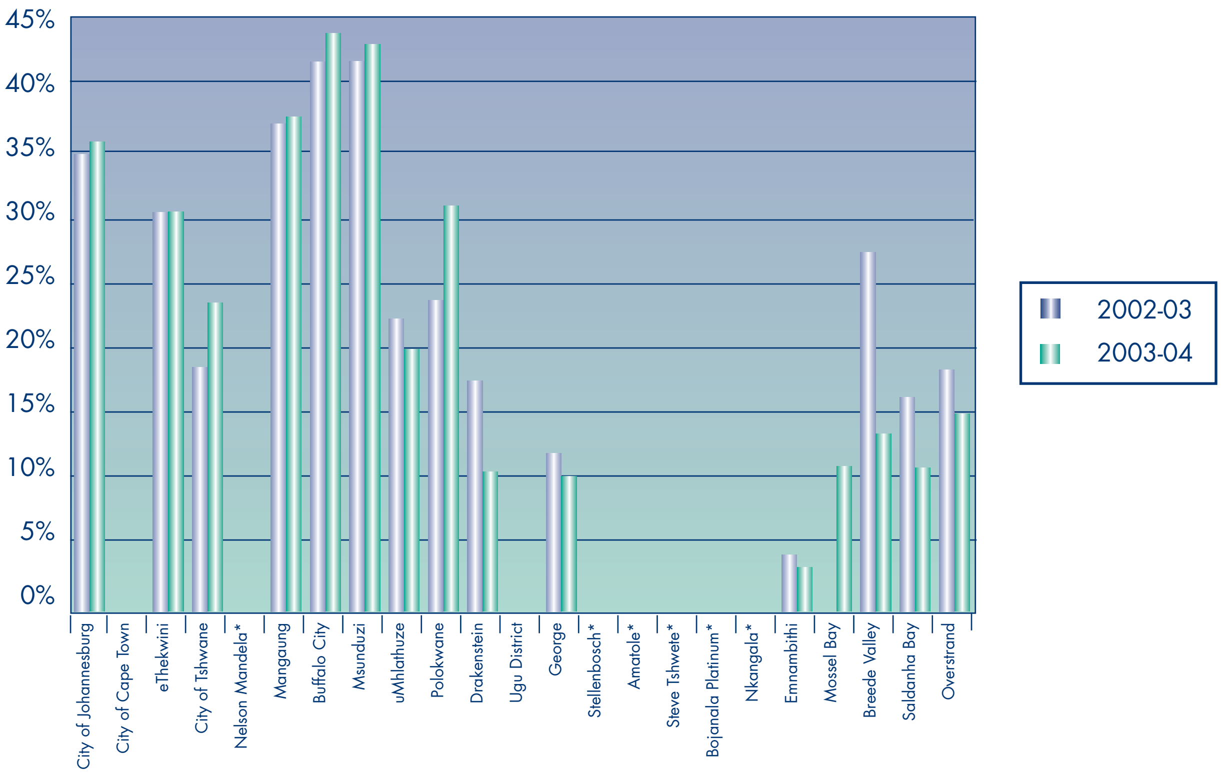


4.6 Reticulation losses

Reticulation losses refer to the loss of water and electricity services provided, for instance through leakage, malfunctioning meters, or the 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 through proper control measures.

Figures 12 and 13 indicate the percentage reticulation losses for water and electricity, respectively, while tables 7 and 9 indicate the rand values as disclosed in the financial statements. No information is available as to how much of these losses are the results of leakage, malfunction or theft. Not all municipalities disclosed this information in their financial statements. Tables 8 and 10 list the purchase price per unit for water and electricity, respectively.

Figure 12: Water reticulation losses



* Information not disclosed.

AUDITOR-GENERAL

Table 7: Reticulation losses in rands for water

Ranking	Municipality	2003-04 R'000	2002-03 R'000	Increase R'000
1	City of Johannesburg Municipality	*	*	*
2	City of Cape Town Municipality	*	*	*
3	eThekwini Municipality	217 808	194 119	23 689
5	City of Tshwane Municipality	131 197	92 380	38 817
6	Nelson Mandela Municipality	*	*	*
7	Mangaung Municipality	*	*	*
8	Buffalo City Municipality	37 924	33 854	4 070
9	Msunduzi Municipality	*	*	*
13	uMhlathuze Municipality	*	*	*
14	Polokwane Municipality	14 204	10 771	3 433
19	Drakenstein Municipality	3 457	4 246	-789
23	Ugu District Municipality	*	*	*
24	George Municipality	965	965	-
25	Stellenbosch Municipality	*	*	*
26	Amatole District Municipality	*	*	*
27	Steve Tshwete Municipality	*	*	*
32	Bojanala Platinum District Municipality	*	*	*
35	Nkangala District Municipality	*	*	*
36	Emnambithi Municipality	585	782	-197
39	Breede Valley Municipality	3 115	6 480	-3 365
45	Mossel Bay Municipality	1 394	1 504	-110
47	Saldanha Bay Municipality	2 250	3 485	-1 235
50	Overstrand Municipality	*	*	*
	Total	**412 899**	**348 586**	**64 313**

* No information available.

Table 8: Purchase price for water (kl)

Ranking	Municipality	2003-04 R	2002-03 R
1	City of Johannesburg Municipality	*	*
2	City of Cape Town Municipality	*	*
3	eThekwini Municipality	2,47	2,29
5	City of Tshwane Municipality	2,51	2,31
6	Nelson Mandela Municipality	*	*
7	Mangaung Municipality	*	*
8	Buffalo City Municipality	1,50	1,45
9	Msunduzi Municipality	*	*
13	uMhlathuze Municipality	*	*
14	Polokwane Municipality	2,61	2,28
19	Drakenstein Municipality	2,05	1,47
23	Ugu District Municipality	*	*
24	George Municipality	0,98	0,98
25	Stellenbosch Municipality	*	*
26	Amatole District Municipality	*	*
27	Steve Tshwete Municipality	*	*
32	Bojanala Platinum District Municipality	*	*
35	Nkangala District Municipality	*	*
36	Emnambithi Municipality	0,94	1,05
39	Breede Valley Municipality	1,91	1,60
45	Mossel Bay Municipality	1,56	1,39
47	Saldanha Bay Municipality	1,78	1,81
50	Overstrand Municipality	*	*

* No information available.

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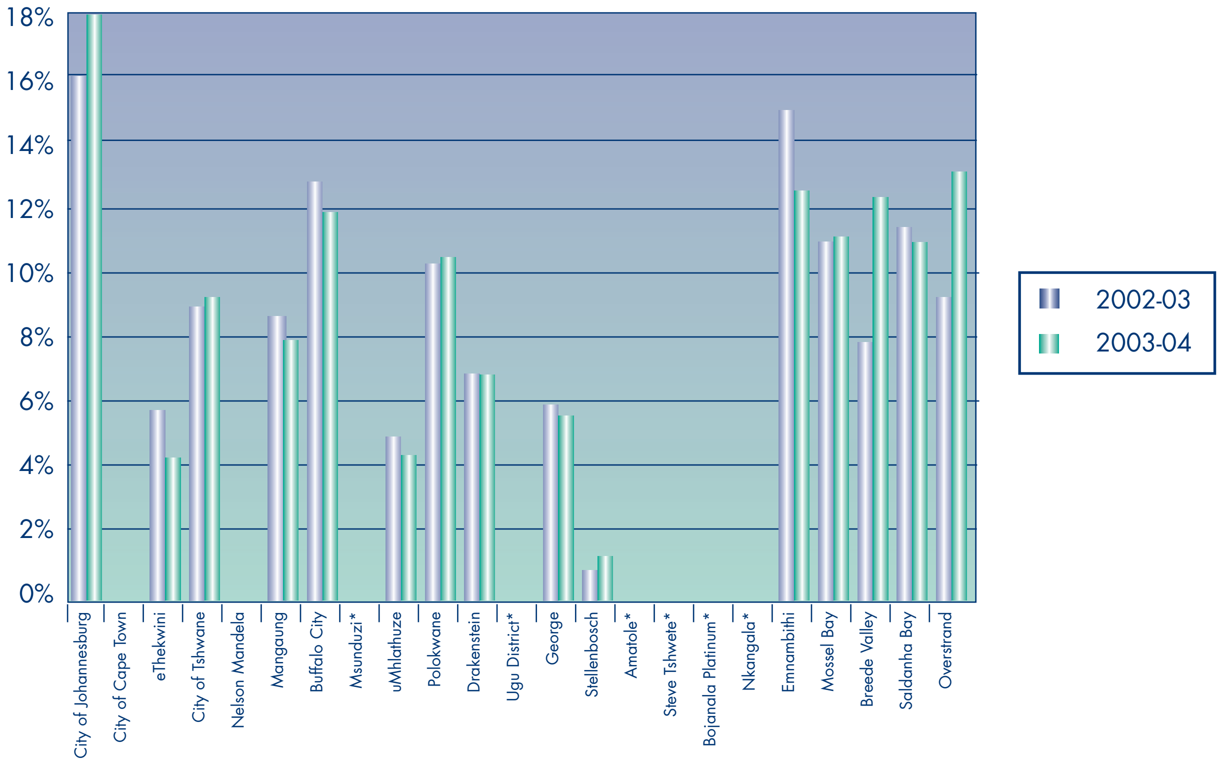
Figure 13: Electricity reticulation losses



* Information not disclosed.

AUDITOR-GENERAL

Table 9: Reticulation losses in rands for electricity

Ranking	Municipality	2003-04 R	2002-03 R	Increase R
1	City of Johannesburg Municipality	*	*	*
2	City of Cape Town Municipality	*	*	*
3	eThekwini Municipality	67 978	81 261	-13 283
5	City of Tshwane Municipality	93 356	78 020	15 336
6	Nelson Mandela Municipality	*	*	*
7	Mangaung Municipality	*	*	*
8	Buffalo City Municipality	25 215	24 703	512
9	Msunduzi Municipality	*	*	*
13	uMhlathuze Municipality	*	*	*
14	Polokwane Municipality	8 761	7 777	984
19	Drakenstein Municipality	*	*	*
23	Ugu District Municipality	*	*	*
24	George Municipality	3 323	2 968	355
25	Stellenbosch Municipality	764	460	304
26	Amatole District Municipality	*	*	*
27	Steve Tshwete Municipality	*	*	*
32	Bojanala Platinum District Municipality	*	*	*
35	Nkangala District Municipality	*	*	*
36	Emnambithi Municipality	5 675	6 437	-762
39	Breede Valley Municipality	8 579	4 729	1 850
45	Mossel Bay Municipality	4 556	3 718	838
47	Saldanha Bay Municipality	3 740	3 140	600
50	Overstrand Municipality	*	*	*
	Total	**221 947**	**213 213**	**8 734**

* No information available.

AUDITOR-GENERAL

Table 10: Purchase price for electricity (kwh)

Ranking	Municipality	2003-04 R	2002-03 R
1	City of Johannesburg Municipality	*	*
2	City of Cape Town Municipality	*	*
3	eThekwini Municipality	0,14	0,13
5	City of Tshwane Municipality	0,12	0,11
6	Nelson Mandela Municipality	*	*
7	Mangaung Municipality	*	*
8	Buffalo City Municipality	0,16	0,15
9	Msunduzi Municipality	*	*
13	uMhlathuze Municipality	*	*
14	Polokwane Municipality	0,16	0,15
19	Drakenstein Municipality	*	*
23	Ugu District Municipality	*	*
24	George Municipality	0,15	0,15
25	Stellenbosch Municipality	0,15	0,15
26	Amatole District Municipality	*	*
27	Steve Tshwete Municipality	*	*
32	Bojanala Platinum District Municipality	*	*
35	Nkangala District Municipality	*	*
36	Emnambithi Municipality	0,16	0,15
39	Breede Valley Municipality	0,26	0,26
45	Mossel Bay Municipality	0,16	0,15
47	Saldanha Bay Municipality	0,18	0,15
50	Overstrand Municipality	*	*

* No information available.

4.7 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 could 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. Numerous examples can be given. For example, City of Johannesburg businesses were advised to implement their own standby generators, as electricity cannot be guaranteed *(SABC news 26/04/2005).*

Key concerns are presented in this report, namely debtors and the provision for bad debt. The 23 municipalities' consumer debt increased over a 12-month period, emphasising the general perception that customers are defaulting on their payments. Total debt increased by R1,9 billion from 2002-03 (R17,3 billion) to 2003-04 (R19,2 billion), which is an increase of 11,3 per cent. The average provision for bad debt also increased by five per cent from 2002-03 (54 per cent) to 2003-04 (59 per cent). The average increase of income over the same period was 11,1 per cent (R36,4 billion) (2002-03: R34,1 billion).

The average liquidity ratio is 1,21:1, which is less than the norm of the private sector of 2:1. The liquidity ratio includes debtors, however, 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. Ten municipalities disclosed reticulation losses. There was an increase in total losses of R73,047 million from the previous financial year.

	2003-04 R'000	**2002-03 R'000**
Water	412 899	348 586
Electricity	221 947	213 213
Total loss	**634 846**	**561 799**

All of this could impact on municipalities' ability to deliver the required services as expected by the public. Critical analyses have been conducted on the available information incorporating these key concerns, which led to the conclusion that municipalities are defaulting on their responsibilities and mandates.

AUDITOR-GENERAL

5. AUDITS OF MUNICIPAL PERFORMANCE MANAGEMENT AND MEASUREMENT

5.1 Introduction

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, including internal audit, over the PMS. The Auditor-General is required by section 46 of the MSA to annually audit the results of the performance measurements. 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 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 for instances where the municipality has not made sufficient progress to implement an auditable PMS. This would mean that the municipality essentially did not comply with the PMS requirements of the MSA for that year.
- A report format designed for 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 were all complied with, but 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 22 of the top 50 municipalities have been completed.

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

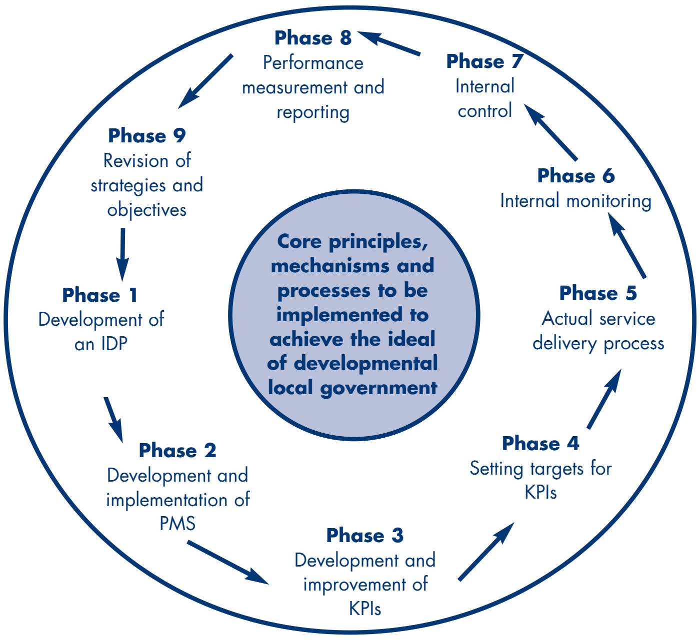
Report format	Number of municipalities 2003-04	Number of municipalities 2002-03
Sufficient progress not made	-	3
Some progress made	21	20
Fully-fledged PMS audit*	1	1
Not yet audited	28	26
Total	**50**	**50**

* Although a fully-fledged PMS report had 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 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:

Phases relating to performance management required by the MSA



5.3.1 Phase 1: development of integrated development plans

In 21 (21 in 2002-03) of the 22 (24 in 2002-03) municipalities that 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.

5.3.2 Phase 2: development and implementation of performance management systems

The auditors confirmed in 17 (7 in 2002-03) of the 22 (24 in 2002-03) municipalities that a PMS had been developed and some level of implementation had been attempted.

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

5.3.3 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. In terms of its PMS, a municipality must 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 in 12 of the 22 municipalities that KPIs had been developed and included in the IDPs. However, KPIs were not always set for all the priorities and objectives.

5.3.4 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 compilation are 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.

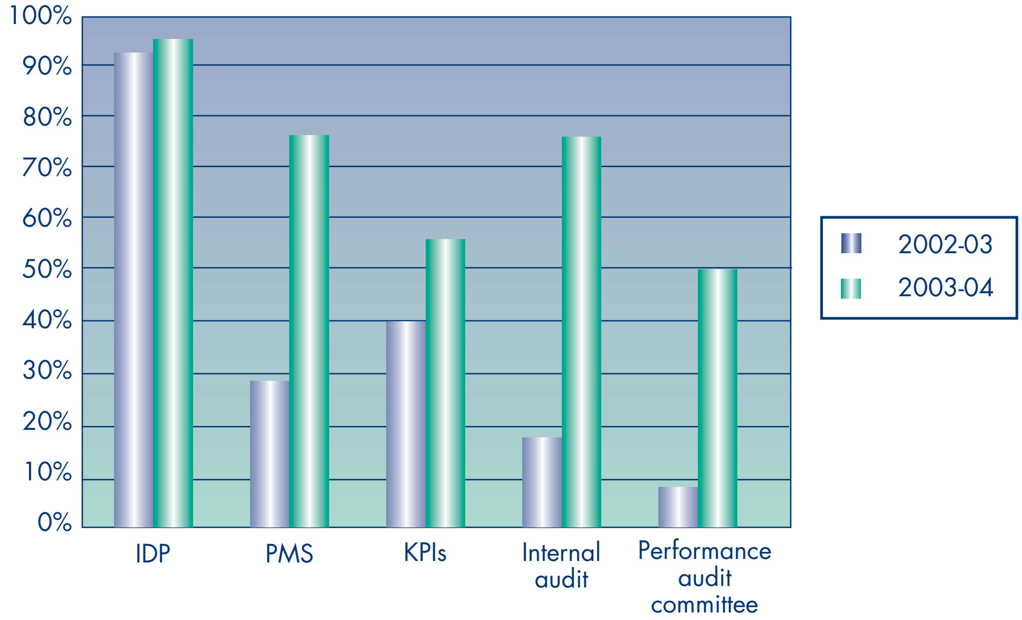
In respect of the 22 (2002-03: 24) municipalities, the auditors confirmed that 17 (2002-03: 4) municipalities complied with the requirement of having an internal audit unit for the PMS, and 11 (2002-03: 2) complied with the requirement of a having a performance audit committee. However, in most cases 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 PMSs was still not satisfactory at the key municipalities during the period under review.

5.3.5 Conclusion

The results in respect of the 22 municipalities where the audit process had been completed can be depicted as follows:

Figure 14: Audit opinions on performance management



With regard to all the aspects included in this report, there was significant improvement in the implementation of the performance measurement structures, but my concern is that these structures do not yet translate into service delivery. Care should be taken that it does not become a process of blind compliance where a structure or process is put in place as a result of a legislative requirement, but it does not result in the improved living conditions of the average citizen.

AUDITOR-GENERAL

6. IMPROVEMENTS IN SERVICE DELIVERY AND ACCOUNTABILITY INITIATIVES

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 implemented to facilitate the drive to improve service delivery. Processes implemented to improve service delivery include integrated development planning and Project Consolidate.

President Thabo Mbeki announced the following during the second joint sitting of Parliament in Cape Town on 11 February 2005:

"To ensure properly focused development planning, Cabinet is working to align the National Spatial Development Perspective with the Provincial Growth and Development Strategies and the municipal Integrated Development Plans (IDPs)."

During the course of the year Parliament indicated its commitment to:

- complete discussions with Eskom, the provincial government and local government to ensure that free basic electricity is provided to all, with minimum delay; and
- improve the capacity of municipalities to ensure that the target of providing sanitation to 300 000 households per year is met as from 2007.

With regard to the social sector, government has continued to allocate more resources and put in more effort to provide services to the society at large and a safety net for the indigent. Project Consolidate of the DPLG consists of projects aimed at increasing the capacity of the municipalities to improve performance.

Through Project Consolidate, 136 municipalities were identified to be at risk, and will be assisted to develop their capacity.

Two other aspects that could impact on the revenue generated by municipalities are:

- the abolishment of Regional Services Council (RSC) levies; and
- the impending restructuring of the electricity industry.

With the phasing out of the RSC levies on 30 June 2006, as announced by the Minister of Finance in his budget speech, national government intends to replace the RSC levy with another tax or grant. It is the intention to table new legislation with any replacement taxes by the end of 2005. Municipalities were advised to use the next year to prepare for the phasing out of the RSC levy and the phasing in of an alternative. However, in the transition period and in respect of the 2005-06 budget, municipalities should budget for similar levels of RSC income over the three years, with an increment in line with the inflation projections. The budget forecasts for 2006-07 and 2007-08 will be reviewed when the reforms are finalised. The joint venture company involving Eskom and local government, to form Regional Electricity Distributors (REDS), is restructuring the electricity industry, which could mean that a substantial portion of the municipal revenue could be forfeited.

6.1 Integrated development planning

Integrated development planning is one of the key tools institutionalised by the government to enable local government to tackle its developmental role. Integrated development planning is a function of municipal management and is part of an integrated system of planning and service delivery at local level. The integrated development planning process is meant to arrive at decisions on issues such as municipal budgets, land management, promotion of local economic development and institutional transformation in a consultative, systematic and strategic manner. According to the MSA, all municipalities have to undertake an integrated development planning process to produce IDPs. As the IDP is a legislative requirement, it has a legal status and it supersedes all other plans that guide development in municipalities.

An IDP contains short-, medium- and long-term objectives and strategies. An IDP is not just about spatial planning; its management should thus not be delegated to municipal planning developers or to consultants. It is a mechanism to manage the affairs of the municipality and its municipal area, and hence holds a very high status within a municipality.

The plan should be strategic, and it must take into account the development needs of the country and how government wants delivery to be well managed. It must be detailed or specific enough to guide the local budgets, business planning and land use management decisions within the municipality. It should be linked to the budget and be revised on an annual basis.

The IDP is to provide a consolidated plan that will look at the many ways in which service delivery can be improved in a municipality. It is a framework for economic and social development of a local area and the residents of that area.

IDPs help to make sure that the plans of the three spheres of government, namely national, provincial and local government, align or 'speak to each other' about the different sectors of development, as it:

- serves as a basis for communication and interaction between spheres and sectors;
- ensures accountability and partnership by debating planning and resource allocation decisions; and
- promotes integration of sector responsibility areas at local level.

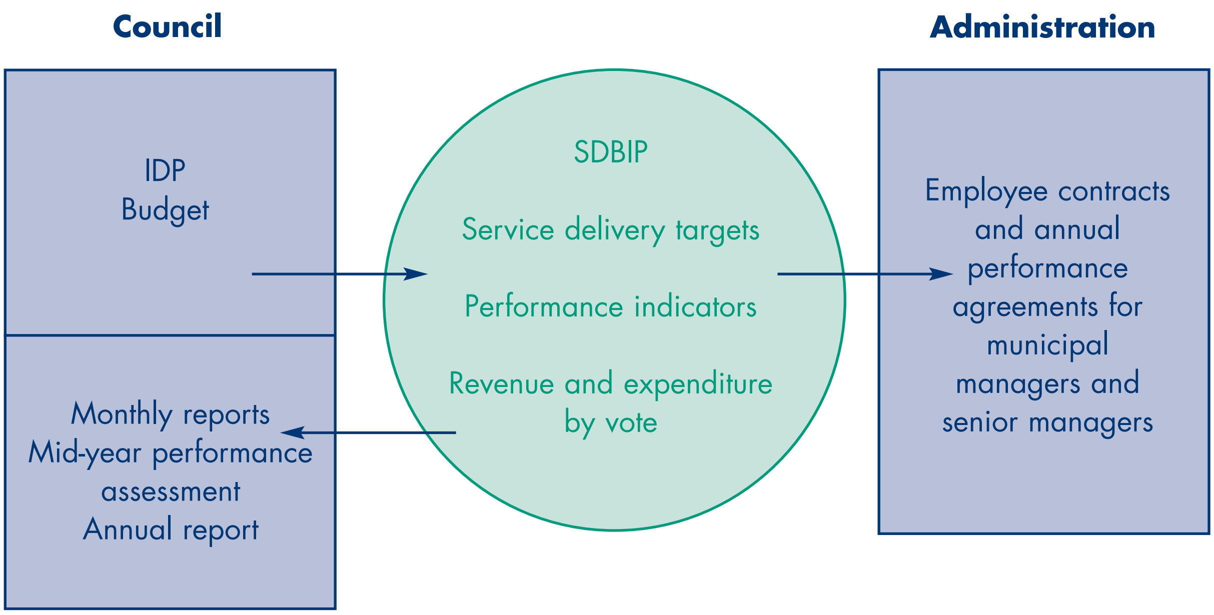
The DPLG held meetings in April and May 2005 in all provinces to discuss the impact of IDPs on the communities. These meetings are known as IDP hearings. It should be noted that at local government level there is no accountability mechanism in the form of public accounts committees, as is the case in national and provincial government. However, section 129 of the MFMA requires a council to adopt an oversight report containing the council's comments on the annual report of the municipality.

The objective of the IDP hearings was to assess the state of IDPs and to enable municipalities to show:

- what they have achieved; and
- provide feedback on plans and mechanisms to address integrated development planning.

The service delivery and budget implementation plan (SDBIP) is aimed at giving effect to the IDP and budget of the municipality, by serving as a contract between the administration, council and community. This includes the goals and objectives set by the council as quantifiable outcomes. High-capacity municipalities will be required to prepare an SDBIP for the 2005-06 budget. The outcomes of the SDBIP will be audited as part of the normal regularity audit.

The relevance of the SDBIP can be depicted as follows:



6.2 Project Consolidate

Over the last 10 years government has made enormous strides in tackling poverty and providing basic services. Notwithstanding this progress, service delivery backlogs still exist in key areas, and have been subject to significant media profile.

Informed by these lessons and the analysis of local government, a support initiative for local government known as Project Consolidate has been developed. Cabinet endorsed Project Consolidate in May 2004. Since then the Ministry of Provincial and Local Government and the DPLG have consulted extensively with provincial governments and organised municipalities (the South African Local Government Association) on this initiative.

The Ministry of Provincial and Local Government and the DPLG have undertaken a thorough profiling and analytical exercise of all 284 municipalities. This profiling looked at critical service delivery indicators and provided a clear diagnosis of the main problems and bottlenecks in municipalities. For the purpose of Project Consolidate, 136 municipalities were targeted.

The primary focus of the targeted, hands-on engagement programme will be on areas requiring immediate and direct action. Teams will be deployed to work at municipal level to assist in addressing practical issues of service delivery and local governance. Specific areas will include:

- Public participation, ward committees and community development workers.
- Indigent policy, free basic services, billing systems and municipal debt.
- Expanded public works programme, municipal infrastructure grant and local economic development.
- Performance management framework, indices and communication.

Another element of Project Consolidate will focus on addressing the billing problems in key municipalities. An innovative proposal has been developed, which will bring together appropriate established and prospective service providers or companies working in this area of billing, in order to provide targeted assistance to 12 municipalities throughout the country.

AUDITOR-GENERAL

ANNEXURE A: TRANSVERSAL ISSUES REPORTED ON IN AUDIT REPORTS

Asset management

Reported matters	Number of matters reported on in audit reports[8]					
	Adverse	Disclaimer	Qualified	Emphasis of matter	Total	Number of municipalities
Asset register incomplete or not updated	1	2	2	4	9	9[9]
Assets not physically verified	1	-	3	3	7	6[10]
Assets incorrectly stated in financial statements	-	1	1	1	3	3[11]
Stocktaking not approved by the council	-	-	2	-	2	2[12]
No asset management policy in place	-	-	-	2	2	2[13]
No proof of tenders for disposals	-	-	-	1	1	1[14]
Total	**2**	**3**	**8**	**11**	**24**	

Debtors

Reported matters	Number of matters reported on in audit reports[8]					
	Adverse	Disclaimer	Qualified	Emphasis of matter	Total	Number of municipalities
Escalation in outstanding debt due to non-collection	1	-	1	12	14	14[15]
Inadequate provision for doubtful debts	1	-	2	2	5	5[16]
Consumer debtors with credit balances and unallocated receipts	-	2	-	4	6	5[17]
Shortcomings in the completeness and verification of debtors	-	-	1	1	2	2[18]
Other	-	-	-	6	6	5[19]
Total	**2**	**2**	**4**	**25**	**33**	

8 There can be more than one issue raised per entity.
9 City of Johannesburg Municipality, City of Cape Town Municipality, City of Tshwane Municipality, Nelson Mandela Municipality, Mangaung Municipality, Msunduzi Municipality, Ugu District Municipality, Breede Valley Municipality and Overstrand Municipality.
10 Nelson Mandela Municipality, Steve Tshwete Municipality, Msunduzi Municipality, Drakenstein Municipality, Breede Valley Municipality and Overstrand Municipality.
11 City of Johannesburg Municipality, City of Tshwane Municipality and Mangaung Municipality.
12 Drakenstein Municipality and Breede Valley Municipality.
13 Msunduzi Municipality and City of Johannesburg Municipality.
14 Mangaung Municipality.
15 City of Cape Town Municipality, eThekwini Municipality, City of Tshwane Municipality, Nelson Mandela Municipality, Mangaung Municipality, Buffalo City Municipality, Msunduzi Municipality, Drakenstein Municipality, Stellenbosch Municipality, Emnambithi Municipality, Breede Valley Municipality, Mossel Bay Municipality, Saldanha Bay Municipality and Overstrand Municipality.
16 City of Cape Town Municipality, Stellenbosch Municipality, Msunduzi Municipality, Mangaung Municipality and Breede Valley Municipality.
17 City of Johannesburg Municipality, Nelson Mandela Municipality, Buffalo City Municipality, Breede Valley Municipality and Overstrand Municipality.
18 Nelson Mandela Municipality and Mangaung Municipality.
19 Mangaung Municipality, Ugu District Municipality, Overstrand Municipality, Drakenstein Municipality and Msunduzi Municipality.

Personnel expenditure

Reported matters	Number of matters reported on in audit reports					
	Adverse	**Disclaimer**	**Qualified**	**Emphasis of matter**	**Total**	**Number of municipalities**
Leave entitlement not properly managed	1	1	-	9	11	6[20]
Insufficient record keeping	-	-	-	5	5	3[21]
Outstanding service fees and private expenses not recovered	-	-	-	4	4	4[22]
Excessive overtime claimed and no overtime policy	-	-	-	4	4	4[23]
Other	-	-	-	7	7	5[24]
Total	**1**	**1**	**-**	**29**	**31**	

Information and communications technology

Reported matters	Number of matters reported on in audit reports					
	Adverse	**Disclaimer**	**Qualified**	**Emphasis of matter**	**Total**	**Number of municipalities**
Inadequate audit trails	-	-	-	1	1	1[25]
No defined project methodologies and IT policies in place	-	-	-	13	13	8[26]
No disaster recovery plan	-	-	-	8	8	8[27]
Backups not made regularly	-	-	-	1	1	1[28]
Unauthorised access	-	-	-	1	1	1[29]
Inadequate segregation of duties	-	-	-	5	5	5[30]
Total	**-**	**-**	**-**	**29**	**29**	

[20] City of Johannesburg Municipality, Msunduzi Municipality, Mangaung Municipality, Buffalo City Municipality, George Municipality and Emnambithi Municipality.
[21] Drakenstein Municipality, Msunduzi Municipality and Saldanha Bay Municipality.
[22] City of Cape Town Municipality, Mangaung Municipality, Saldanha Bay Municipality and Breede Valley Municipality.
[23] eThekwini Municipality, Msunduzi Municipality, Drakenstein Municipality and Mangaung Municipality.
[24] City of Johannesburg Municipality, City of Cape Town Municipality, Nelson Mandela Municipality, Msunduzi Municipality and eThekwini Municipality.
[25] City of Johannesburg Municipality.
[26] City of Johannesburg Municipality, Buffalo City Municipality, Steve Tshwete Municipality, Bojanala Platinum Municipality, George Municipality, Stellenbosch Municipality, Mossel Bay Municipality and Overstrand Municipality.
[27] City of Johannesburg Municipality, Buffalo City Municipality, George Municipality, Stellenbosch Municipality, Steve Tshwete Municipality, Bojanala Platinum Municipality, Mossel Bay Municipality and Overstrand Municipality.
[28] Buffalo City Municipality.
[29] Buffalo City Municipality.
[30] Buffalo City Municipality, George Municipality, Bojanala Platinum Municipality, Mossel Bay Municipality and Overstrand Municipality.

AUDITOR-GENERAL

Other internal control matters

Reported matters	Number of matters reported on in audit reports					
	Adverse	Disclaimer	Qualified	Emphasis of matter	Total	Number of municipalities
Procurement policy not followed	-	-	-	3	3	3[31]
Control environment insufficient	-	-	-	6	6	6[32]
Underspending of capital budget	-	-	-	6	6	6[33]
Creditors reconciliation not performed	-	-	-	8	8	8[34]
Inadequate stocktake procedures and inventory management	-	-	-	2	2	2[35]
Inadequate bank and cash management	-	-	-	3	3	3[36]
Total	**-**	**-**	**-**	**28**	**28**	

31 City of Cape Town Municipality, Nelson Mandela Municipality and Mangaung Municipality.
32 eThekwini Municipality, Msunduzi Municipality, Drakenstein Municipality, Stellenbosch Municipality, Breede Valley Municipality and Overstrand Municipality.
33 City of Cape Town Municipality, eThekwini Municipality, Nelson Mandela Municipality, Amatole District Municipality, Emnambithi Municipality and Saldanha Bay Municipality.
34 City of Tshwane Municipality, Mangaung Municipality, Buffalo City Municipality, Msunduzi Municipality, Drakenstein Municipality, Emnambithi Municipality, Saldanha Bay Municipality and Overstrand Municipality.
35 City of Tshwane Municipality and Mangaung Municipality.
36 Nelson Mandela Municipality, Mangaung Municipality and Buffalo City Municipality.

AUDITOR-GENERAL

ANNEXURE B: DETAILED AUDIT OPINIONS

Municipality	Top 50 ranking	Reason for qualified audit opinion
City of Johannesburg – Disclaimer	1	• Lack of supporting information: Due to a lack of supporting documentation, it was not possible to vouch the expenses or verify the balances below, nor was it feasible to perform alternative audit procedures. (a) Consumer debtors with credit balances: At year-end, a significant number of consumer debtors accounts had credit balances totalling R464,5 million, which could not be verified. These balances were either not reviewed on a regular basis or contained some invalid transactions. (b) Unallocated receipts: Unallocated receipts totalling R95,2 million (2003: R105,5 million), as per the debtors listing, were not cleared at 30 June 2004, and could not be verified. (c) Leave pay: The leave pay accrual of R184,9 million was calculated based on the balance of the leave days as reflected on the payroll system. My audit established that the leave recorded in the payroll system did not always agree to the details on the leave forms, and that recorded leave was not always supported by leave forms. As a result I could not verify the accuracy of the leave pay accrual. Management was busy with a project to address the leave capturing backlog. (d) Interest on RSC levies: As reported, interest was included in the RSC levies income line. Consequently, value-added tax (VAT) was incorrectly charged on the interest portion included under RSC levies, and the effect on the group financial statements could not be quantified. • Fixed assets: As reported in the previous year, the fixed asset records for movable and immovable properties held by the municipality were incomplete and were not adequately detailed to allow identification of the physical assets. Management had embarked on a land register project in order to update the municipality's records with the correct information, identify and update the information of all buildings owned by the municipality, and place a value on both land and buildings. The project had a target completion date of 31 March 2005. Attention is drawn to the following significant audit findings: (a) Fixed asset registers were incomplete in respect of asset descriptions and locations as required by Statement of GAMAP No. 17. The physical verification of immovable assets was hampered by the incomplete descriptions contained in the asset register, while title deeds could not be traced to the fixed asset register and vice versa. (b) Subsidised houses funded from provincial government subsidies were capitalised in the books of the municipality instead of being expensed, which resulted in an overstatement of the reported surplus and accumulated reserves. The effect on the group financial statements could not be quantified.

AUDITOR-GENERAL

Municipality	Top 50 ranking	Reason for qualified audit opinion
		(c) Fleet assets, which were subject to a maintenance management arrangement in terms of the fleet outsourcing contract and which were still owned by the municipality, did not appear in the fixed asset register. It was therefore not possible to verify the valuation, completeness, accuracy, ownership and existence of fixed assets of the municipality totalling R3 596,1 million. • Completeness of revenue and debtors: (a) Billing for assessment rates, refuse services, electricity, water and sewerage services: A reconciliation between the rates base used in the billing system for assessment rates and the rates base used in the valuation roll was conducted during the year. As the reconciliation project was still in progress and contained a significant number of unmatched properties, it was not possible to determine whether all properties and areas were billed for assessment rates and services. Management was in the process of investigating and resolving the differences identified during the reconciliation and had set a target completion date of 30 June 2005 for the project. Furthermore, properties were identified that had been included in both the billing system and the valuation roll and their values were reflected as nil or a value lower than the valuation amount recorded in the billing system. Therefore, it was not possible to verify the completeness of assessment rates revenue of R2 559,9 million (2003: R2 286,8 million), and domestic refuse removal fees of R208,4 million (2003: R264,6 million). Consequently, the consumer debtors of R2 339,3 million (2003: R2 759,4 million) relating to the municipality may be misstated. Similarly, for the revenue managed by the municipality, it was not possible to verify the completeness of electricity revenue of R1 239,7 million, water and sewerage revenue of R1 646,4 million as well as the related municipal service debtors of R1 288,5 million and R3 085,0 million, respectively. (b) Housing debtors: The collection rate on housing income was 33 per cent for the year ended 30 June 2004, and 98 per cent of the rental debtors balances of R425,9 million were provided for as doubtful debts at year-end. One of the causes was that the detail of tenants occupying municipal housing stock was not up to date due to original tenants' details not being updated when they vacated the houses. The houses were then occupied by new tenants whilst the authorised tenant who had since vacated the house, continued to be billed. The municipal and service charges relating to housing stock amounted to R52,0 million, whilst the total charged to the tenants was R14,0 million, resulting in the municipality

Municipality	Top 50 ranking	Reason for qualified audit opinion
		subsidising the tenants to an extent of R38,0 million, before taking into account the non-recovery of amounts invoiced to the tenants referred to above. Due to the above, it was not possible to verify the completeness of housing rental revenue of R63,7 million (excluding interest) as well as the housing rental debtors of R425,9 million (2003: R336,6 million).
City of Tshwane – Qualified opinion	5	• Fixed assets: Tshwane was in the process of implementing a new system, the One Integrated Transaction Processing System. Incorporated in this system is a comprehensive fixed asset register, which was still in the process of being finalised. As at 30 June 2004, the fixed asset register of Tshwane was incomplete. In specific instances the asset registers were not adequately detailed and certain assets were not uniquely marked to allow the identification of physical assets. A position paper was approved in order to guide Tshwane with a purification process of assets and to ensure that effective asset management is maintained.
Nelson Mandela – Qualified opinion	6	• Post-retirement benefits: Adequate provision had not been made for the ill-health pensions and medical aid fund contributions of employees, the estimated liability of which entails a significant amount. Per an actuarial valuation performed in the 2001-02 financial year, the liability at that date amounted to R878,7 million. The actuarial report concluded that: "In order to show accurate estimates of the employer's liability with respect to post-retirement contributions, annual recalculation of the liability will have to be done." As far as could be established, this has not been done. Management disclosed the liability as follows in the 2003-04 financial statements: (a) Accounting policy 10.1 states that "A provision is maintained in respect of the liability relating to post-retirement benefits such as medical aid contributions." (b) Note 5 – long-term liabilities R249 924 199 (c) Note 24 – contingent liabilities R628 800 000 In terms of GAMAP 110, the full liability in respect of the benefits should be raised in the books and records of the metro. GAMAP does not make provision for transitional arrangements, i.e. to phase in the recognition of the liability on the face of the balance sheet over a number of years. Liabilities are therefore understated and the operating results overstated by an amount of R628,8 million (R878,7 million - R249,9 million). • Levy income: Per annexure C to the financial statements, levy income amounted to R194 million (budgeted: R179,6 million).

AUDITOR-GENERAL

Municipality	Top 50 ranking	Reason for qualified audit opinion
		1. Inherent uncertainty: Due to the inherent uncertainties relating to levies, such as the completeness of registered levy payers and the integrity of the financial information submitted by levy payers on a self-assessment basis, the completeness and accuracy of levy income could not be verified. In this regard my audit tests revealed the following: (a) A sample extracted from the telephone directory and traced to the levy debtors database indicated that 14 per cent (29/200) were not registered for RSC levies. (b) Six per cent of the sample had not paid any RSC levies for the entire period under review. (c) Doubts exist over the efficiency and effectiveness of the work conducted by the external levy-collection agency. An inspection of reports submitted for the period December 2003/January 2004 revealed that of the 339 inspections and 201 follow-ups done for the municipality, only nine new registrations were done and 34 were in the process of registration. 2. External levy-collection agency: The external levy-collection agency was appointed in the 2002-03 financial year for the purpose of identifying unregistered levy payers and to assist the municipality in the collection of levy amounts in arrears. It was noted that the external levy-collection agency did not submit information and reports as required in terms of the agreement entered into between itself and the municipality and had also not done so on a monthly basis. Management, in turn, had not performed regular monitoring of the performance of the collection agency. Further testing revealed that a total of 66 businesses within the parameters of the municipality were registered by the external levy-collection agency for the payment of RSC levies for the period under review (an average of five registrations per month). • Property, plant and equipment: 1. Land not valued nor included in fixed asset register: GAMAP 113 requires that an item of property, plant and equipment be recognised as an asset when it satisfies the definition and recognition criteria for an asset, i.e. "An asset is a resource controlled by a municipality as a result of past events and from which future economic benefits are expected to flow to the municipality. An asset is recognised when it is possible that future economic benefits or potential service provision will flow to the municipality and the asset has a cost or value that can be measured reliably." The only land included in the fixed asset register was land acquired for road-widening purposes. The council indicated that a land audit was currently under way to identify all land in the metropolitan area for inclusion in the fixed asset register. To date this process had not been finalised.

Municipality	Top 50 ranking	Reason for qualified audit opinion
		Until such a time as the land is complete, the metro will not be in a position to determine the correct classification of land owned by the municipality. As a result, land had not been valued nor was it included in the inventory records (land for resale) or in the asset register (land for use by the metro). As reported in the prior year, land sales were accounted for as operating income amounting to R8,8 million (2003: R13,6 million). During the current year, it was noted that land sales had been incorrectly allocated to the asset financing fund instead of being reflected as operating income. 2. Physical verification and valuation and status of the fixed asset register: No physical verification or valuation of assets owned by the municipality had been performed. This matter had been reported in the prior year and the council's response indicated that an asset management unit had been established to oversee this process and report to the municipal manager. The process is supposed to be finalised by June 2005, effectively four months away, and as far as can be determined the unit has not finalised any particular business unit's assets. As a result, the extent to which property, plant and equipment are potentially misstated could not be determined in view of the uncertainty as stated above. • Housing stock issues not captured: The council's Financial Standing Orders (FSO) 9.13 determines that: "Subject to the Audit Ordinance (9), the amount and value of any surpluses or shortages in stock, as well as slow-moving stock, revealed in stock-taking shall be reported by the Business Unit Manager Budget and Treasury to the Executive Mayor, together with the reasons for discrepancies. Where the stock is not under the control of the Business Unit Manager Budget and Treasury, the Business Unit Manager Budget and Treasury may require the responsible Business Unit Manager to furnish the said reasons. Any adjustments thereafter must be authorised by the Council, except that the Business Unit Manager Budget and Treasury may authorise adjustments in stocks and losses not involving negligence or identifiable theft, provided favourable internal audit reports are presented in all cases." Housing stock purchased in prior years and issued to contractors in respect of certain housing projects had not been captured on the warehouse and general ledger systems. Treasury performed a stock count at the various housing stores to determine actual physical stock on hand at 30 June 2004. The inventory balances for the affected housing stores in the general ledger were then adjusted by the allocation of what was deemed to be the movement of the stock to the applicable housing projects amounting to R16,3 million. Although these issues were apparently recorded in the housing requisition books, the following were discovered:

AUDITOR-GENERAL

Municipality	Top 50 ranking	Reason for qualified audit opinion
		(a) The stock was held at housing sub-stores, which were staffed by temporary clerks and a few security guards. (b) Internal controls were lacking at these sub-stores, as there were no supervisors to review or approve stock requisitions, taking on charge of purchases, and returns from completed projects. (c) The permanent stock clerks never captured the issues on the warehouse systems and hence the inventory balances per the records were not updated. (d) No reconciliation was performed between the housing warehouse systems and actual stock held at the various housing stores. (e) Although a reconciliation was prepared with regard to the subsequent inventory adjustment as at 30 June 2004, no previous reconciliation was prepared between the housing warehouse systems and the general ledger system. (f) This reconciliation did not reconcile or take into consideration original purchases allocated to the housing stores (i.e. opening balances plus additions), to ensure that all stock purchases had been accounted for in the subsequent issues. (g) The reconciliation also did not take into account the taking on charge of surplus goods and materials after completion of works. (h) The movement of stock by which the affected housing projects were subsequently charged and the inventory balance was adjusted, was not verified by the budget and treasury or the housing and land business units to be a true reflection of actual stock issues that had taken place. Due to the above, I could not conclude on the validity, accuracy or completeness of the movement of stock held at the various housing stores (and subsequently expensed to the projects) amounting to R16,3 million.
Mangaung – Qualified opinion	7	• Fixed assets: Due to the following matters, I was not able to verify the completeness and accuracy of fixed assets in the sum of R728 568 075, as disclosed in note 6 to the financial statements: (a) A portion of the immovable property of the former Botshabelo Transitional Local Council was still registered in the name of the Free State Provincial Government and had not yet been transferred to and recorded by the council. The value of the property could not be quantified. Consequently, fixed assets are understated by an unknown amount. (b) As reported in the previous year's audit report, the former Botshabelo and Thaba Nchu Transitional Local Councils failed to maintain complete and adequate asset registers upon which any reliance could be placed. Therefore, with the exception of motor vehicles, the council was unable to record individual fixed asset items in the fixed asset register of the Mangaung Local Municipality, as the details of individual asset balances were not available.

Municipality	Top 50 ranking	Reason for qualified audit opinion
		(c) Procedures and practices followed by the council were not consistently effective to ensure sufficient control over assets. Although fixed asset registers were maintained, as a result of the matters reported on in (a) and (b) above, and as descriptions, especially serial numbers and location of items, were insufficient to identify assets, it was not always possible to verify the assets and it could not be confirmed that all assets included in the register still existed. (d) Fixed assets amounting to R11 748 300 were recorded against a provision. At year-end the projects had not yet been completed. This resulted in fixed assets and provisions being overstated. • Debtors: (a) Short-term debtors: According to note 10 to the financial statements, the provision for bad debts amounted to R169 841 980 at 30 June 2004. According to my calculation, this amount is understated by approximately R25 899 632 (2003: R51 836 782). (b) Long-term debtors: According to note 8 to the financial statements, no provision was made for bad debts. According to my calculation, an amount of R12 395 181 (2003: R15 065 621) should have been provided in respect of long-term debtors. • Expenditure – tenders: In terms of section 10G(5)(a) of the LGTA, a municipality shall award contracts for goods and services in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. For payments totalling R21 003 697, the relevant tenders were not available for audit purposes. It could therefore not be verified whether the tender procedures had been followed with regard to these payments.
Msunduzi – Adverse opinion	9	• Outstanding debtors: Despite significant effort made by the council and management during the period in implementing policies to increase the recovery of outstanding debt, the substantial increase in the consumer debt levels of the municipality is still of concern: (a) The monthly consumer debtors report as at 30 June 2004 reflected outstanding debt in excess of 60 days of R204 million, compared to R150 million in 2003 and R129 million in 2002. The increase over the years in the level of debt in excess of 60 days impacts on the municipality's cost of short-term borrowings and its related cash flow. The continued increase in debt due further impacts on the going concern of the municipality, as its ability to meet operating expenses could be impeded. (b) An endeavour has once again been made to age consumer debtors by means of utilising a separate non-integrated programme within the consolidated billings department. This spreadsheet did not reconcile with the general ledger Promis system, and therefore precluded an accurate and easily identifiable assessment of potential bad debt. As reported

Municipality	Top 50 ranking	Reason for qualified audit opinion
		previously, this is in contravention of section 10G(2)(a)(i) of the LGTA, which states that accounting records are to be kept as are necessary to reflect the transactions and financial state of affairs of the council. (c) A similar debt collection problem is evident in the rates department where rates debtors had increased from R133 million at 30 June 2003 to R152 million in the current year. Furthermore, the municipality's current collection procedures were ineffective in recovering debts from prior years and the total debt relating to 2002 and prior periods amounting to R60,5 million is therefore likely to be doubtful. (d) Based on a sample of confirmations received from attorneys for the sundry debtors handed over for collection, it appears that 80 per cent of the debtors handed over were considered irrecoverable as these debtors could either not be traced, were insolvent, were deceased or their files were closed based on instruction from the municipality. (e) Despite the above increased levels of indebtedness, the provision for doubtful debts increased from R67 million to R104 million. Due to the above factors I am of the view that the annual financial statements do not reflect a fair presentation of the recoverability of the debts due to the municipality. I believe that the provision is understated and accumulated reserves are overstated by at least R35 million. • Fixed assets: I was unable to place reliance on the asset register produced and could not satisfy myself as to the existence and completeness of assets owned by the municipality. The municipality is in contravention of section 10G(2)(a)(i) of the LGTA and section 55(2)(b) of the MSA, which require the municipality to maintain a proper fixed asset register to safeguard and control the custody of fixed assets. • Leave pay provision: The municipality had not provided for an amount of R45 million (2003: R40 million) in respect of employees' accrued leave pay. An amount of R5 million (2003: R4 million) was provided for in the annual financial statements, but this amount is not adequate in terms of the actual liability disclosed as a contingent liability in note 25 to the annual financial statements. Per the IMFO guidelines, this amount should be provided for in full. Therefore, provisions and related expenditure in the annual financial statements are materially misstated. • Market: During the current year, cash receipts recorded for the year exceeded the amount banked per deposit slips by R700 000. The cumulative effect of the errors relating to the previous years could not be quantified; consequently I am unable to conclude on the fair presentation of the reserves and the related assets.

Municipality	Top 50 ranking	Reason for qualified audit opinion
		• VAT: A reconciliation of the output VAT suspense account was not performed for vote 7018930893 (output VAT suspense – consolidated billing) with a balance of R35 302 328. The above balances were transferred to the main VAT control account at year-end. The VAT control account and other related balances may be materially misstated at year-end.
Drakenstein – Qualified opinion	19	• Assets amounting to R30 341 728 could not be traced to the physical asset or deed of transfer documentation, due to the fact that a valid audit trail did not exist. The validity and completeness of assets could therefore not be verified. • Ordinance 7 of 1938 requires that an annual stocktaking report should be presented to the council for authorisation. Although detail of the stocktaking was presented to the mayoral committee on 10/11/2004, the stock report for 2003-04 had not yet been approved by the council. Furthermore, according to the stocktaking report submitted for audit purposes, assets to the value of R3 483 118, which include a computer to the value of R2 231 352, could also not be traced from the asset register to the physical assets. The validity of the stocktaking report could therefore not be determined and it would appear that total fixed assets are overstated by R3 484 118.
Breede Valley – Qualified opinion	39	• Debtors: Outstanding consumer debtors amounted to R119 455 632 at 30 June 2004, compared to R141 723 866 at 30 June 2003. Debtors outstanding for longer than 120 days amounted to R102 974 322 at 30 June 2004, whilst the provision for bad debt amounted to R90 357 052 according to note 13 to the financial statements. In view of the amount of debtors that are outstanding for long periods as well as the current economic situation and tendency of non-payment, the provision for bad debt still appears to be insufficient to address the risk of irrecoverable consumer debtors. • Long-term debtors: The outstanding long-term debtors indicated in note 11 to the financial statements amounted to R12 432 455 at 30 June 2004. Included in this amount are housing loans amounting to R3 435 442 (2003: R3 733 206), which have shown minimal movement since the previous year. No further provision for bad debt has been made in respect of these debtors. • Fixed assets: The reasonability of the council's fixed assets, which amounted to R143 220 050 at 30 June 2004 according to note 9 to the financial statements, could not be verified. This was due to the fact that the reasonable value at which certain fixed assets were valued for the purposes of GRAP could not be determined as well as because certain infrastructure assets were reflected at no value. • Stores: The reasonability of the council's stores, which amounted to R3 362 955 at 30 June 2004 according to note 12 to the financial statements, could not be verified because the extent of obsolete and damaged stores could not be determined.

AUDITOR-GENERAL

Municipality	Top 50 ranking	Reason for qualified audit opinion
		• Long-term liabilities: The net outstanding long-term liabilities, which amounted to R61 359 519 at 30 June 2004 according to note 3 to the financial statements, differed by R1 081 091 from the external confirmation obtained from the relevant financing institution. Total interest of R5 939 731 paid during the year under review, as indicated in note 23 to the financial statements, differed by R915 309 from the actual interest payments made to external parties. This resulted in long-term liabilities and interest paid being understated by R1 081 019 and R915 309, respectively. • Housing development fund: Included in the housing development fund balance of R21 532 854, as indicated in note 1 to the financial statements for the year ended 30 June 2004, is bad debt of R6 639 613 that has been written off. However, no detailed analysis of the write-offs could be provided. The validity of these write-offs against the fund could therefore not be verified.