

**Benchmarking of the internal budgetary control system of the Tlokwe City
Council**

Pamela Nelly Richtje Wilgenbus

Student number 22641858

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Supervisor: Prof P.W. Buys

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KEYWORDS

- Accountability
- Benchmarking
- Budgetary control
- Budget formulation
- Clean audit
- Delegation
- Effectiveness
- Efficiency
- Internal control
- Service delivery
- Tlokwe City Council

ABSTRACT

Benchmarking of the internal budgetary control system of the Tlokwe City Council

Keywords: Benchmarking, clean audit, internal budgetary control system, local government, municipality, service delivery, Tlokwe City Council

In 2009 Operation Clean Audit was launched with the objective that all municipalities must achieve a clean audit by the 2014 financial year. A clean audit is an audit opinion when the financial statements are unqualified; no adverse findings were identified on compliance with laws and regulations as well as on predetermined objectives. The overall aim of the programme is to clean up the governance of municipalities and to enhance service delivery.

In both the public and the private sector internal control is crucial. It is seen as one of the key elements of good governance, it provides assurance of the rendering of reliable financial statements, of compliance with legislation and it also indicates how the organisation performs against its objectives. Budgetary control in local government can be used as an effective internal control method by legally limiting the authorised expenditure and to monitor the actual service delivery against the budgeted targets. If variances are identified in the budget or with regard to service delivery objectives, remedial action can be taken. If municipalities do not provide services to communities in a sustainable manner, it contravenes its constitutional mandate as stipulated in section 152(1)(b) of the Constitution of South Africa.

The qualitative research method, in the format of a case study of the Tlokwe City Council, a local municipality in the North West Province, was chosen for this research.

In the 2010 financial year, the Auditor General reflected that the Tlokwe City Council experienced deficiencies in the key fundamentals of internal control: leadership, financial and performance management, and governance which could directly be linked to the basis of the qualification of the financial statements, findings on predetermined objectives and compliance with legislation. The material underspending of the capital budget was also found to be affecting service delivery negatively.

The purpose of this study is to benchmark the internal budgetary control systems of municipalities in South Africa, which have already achieved clean audit reports for

consecutive years, to improve the internal budgetary control system of the Tlokwe City Council. This research was formulated in such a way that — through the findings obtained in the literature study with regard to the legislative framework regulating the budget formulation, internal and budgetary control of the local government sphere in South Africa, analysis of the internal budgetary control deficiencies at the Tlokwe City Council and the benchmarking exercise with the Swartland and Steve Tshwete local municipalities — a strategy can be developed to provide for effective budgeting and to improve the internal control system of the Tlokwe City Council.

Potential benefits that can arise from the implementation of the recommended strategy to improve the internal budgetary control system of the Tlokwe City Council are the attainment of a clean audit opinion by the Auditor General and subsequently the enhancement of service delivery to the community.

OPSOMMING

Normering van die interne begrotingskontrolestelsel van die Tlokwe Stadsraad

Trefwoorde: Dienslewering, interne begrotingskontrolestelsel, munisipaliteit, normering, plaaslike regering, skoon oudit, Tlokwe Stadsraad

In 2009 is Operasie Skoon Oudit van stapel gestuur met die oogmerk dat alle munisipaliteite teen die 2014 finansiële jaar 'n skoon ouditverslag moet behaal. 'n Skoon ouditverslag is 'n ouditverslag waar die finansiële state ongekwalifiseerd is, geen ongunstige bevindinge oor voldoening aan wette en regulasies en oor voorafbepaalde doelwitte gemaak is nie. Die oorkoepelende doel van die program is dat die bestuur van munisipaliteite verantwoordbaar gehou word en dienslewering verbeter word.

In sowel die openbare as die privaatsektor is interne kontrole noodsaaklik. Dit word gesien as een van die kernbeginsels van goeie bestuur, dit verseker dat die ingediende finansiële state as geloofwaardig beskou word, dat aan wetgewing voldoen word en dit dui ook aan hoe die organisasie sy doelwitte bereik. Begrotingskontrole in plaaslike regering kan as 'n doeltreffende interne beheermeganisme gebruik word deur gemagtigde uitgawes wetlik te beperk en werklike dienslewering teenoor begrote teikens te monitor. Indien afwykings in die begroting of met betrekking tot diensleweringdoelstellinge aangetoon word, kan regstellend en voorkomend opgetree word. Indien munisipaliteite nie op 'n volhoubare wyse dienste aan gemeenskappe lewer nie, is hulle in stryd met hul grondwetlike mandaat soos bepaal in artikel 152(1)(b) van die Grondwet van Suid-Afrika.

In hierdie navorsing is die kwalitatiewe navorsingsmetode gebruik. 'n Gevallestudie van die Tlokwe Stadsraad, 'n plaaslike munisipaliteit in die Noordwesprovinsie, is gedoen.

In die 2010 finansiële jaar het die ouditeur-generaal bevind dat die Tlokwe Stadsraad leemtes in belangrike fundamentele faktore van interne beheer ervaar, naamlik in leierskap, finansiële en prestasiebestuur. Hierdie leemtes in bestuur kan direk gekoppel word aan die grondslag van kwalifikasie van die finansiële state, bevindinge oor voorafbepaalde doelwitte en voldoening aan wetgewing. Daar is ook bevind dat wesenlike onderbesteding van die kapitale begroting dienslewering nadelig beïnvloed.

Die doel van hierdie studie is om — met behulp van normering van die interne begrotingskontrolestelsels van munisipaliteite in Suid-Afrika wat alreeds skoon oudit-

opinies vir opeenvolgende jare ontvang het — die interne begrotingskontrolestelsel van die Tlokwe Stadsraad te verbeter. Die navorsing is sodanig geformuleer dat 'n strategie ontwikkel kan word om voorsiening te maak om doeltreffend te begroot en om die interne begrotingskontrolestelsel van die Tlokwe Stadsraad te verbeter; met behulp van bevindinge verkry in die literatuurstudie met betrekking tot die wetgewende raamwerk wat die formulering van die begroting bepaal, deur gebreke in die interne begrotingskontrole te ontleed, en die beste praktyke van die Swartland en Steve Tshwete plaaslike munisipaliteite as norm te gebruik.

Moontlike voordele van die toepassing van die aanbevole strategie om die interne begrotingskontrolestelsel van die Tlokwe Stadsraad te verbeter is die verkryging van 'n skoon ouditverslag van die ouditeur-generaal en gevolglike verbetering van dienslewering aan die gemeenskap.

LIST OF ABBREVIATIONS AND ACRONYMS

AFS	:	Annual Financial Statements
CIDB	:	Construction Industry Development Board
EFT	:	Electronic Financial Transfer
GAMAP	:	Generally Accepted Municipal Accounting Practice
GRAP	:	General Recognized Accounting Practice
IAS	:	International Accounting Standards
ICANN	:	Internet Corporation for Assigned Names and Numbers
IDP	:	Integrated Development Plan
IMATU	:	Independent Municipal and Allied Trade Union
IMFO	:	Institute of Municipal Finance Officers
INTOSAI	:	International Organisation of Supreme Audit Institutions
MEC		Member of the Executive Council
MFMA	:	Local Government: Municipal Finance Management Act
MFSI	:	Municipal Financial Sustainability Index
MPAC	:	Municipal Public Accounts Committee
MSA	:	Local Government: Municipal Systems Act
MTREF	:	Medium Term Revenue and Expenditure Framework
PFMA	:	Public Finance Management Act
PPE	:	Property, Plant and Equipment
PPPF	:	Preferential Procurement Policy Framework
SALGBC	:	South African Local Government Bargaining Council
SALGA	:	South African Local Government Association
SAMWU	:	South African Municipal Workers Union
SARS	:	South African Revenue Service
SCM	:	Supply Chain Management
SDBIP	:	Service Delivery and Budget Implementation Plan
VAT	:	Value-added Tax

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CHAPTER 1

1. INTRODUCTION

1.1 BACKGROUND

In the State of the Nation address in 2010, the President of the Republic of South Africa has identified the need to modernise all three spheres of Government (National Treasury, 2011b:4). The key to this is that service delivery must be achieved in an effective and efficient manner as well as that the desired results and outcomes must be attained. In his above-mentioned address the President concluded that one of the government objectives is to focus on achieving a public service which is efficient, effective and oriented to development.

Government formulated in the *Budget Review 2010*, based on the above-mentioned address, the objectives that more services must be rendered by changing the way of working of government (National Treasury, 2010a:2). The budget has to be reprioritised in order to move allocated funds from low-priority programmes to high priority programmes. A culture need to be developed where people must be held accountable for their actions with clear measurable outcomes linked to key development priorities. The main challenge for every municipality is to obtain these objectives within its existing limited resource base.

The new democratic dispensation in 1994 brought in a collective need from national government to dispense effective measures in the provision of service delivery to local governments. Prior to 1994 local government was seen as a subservient sphere of government and were forced to implement developmental plans of both provincial and central government (Gunter, 2005:32). The Constitution of Republic South Africa (1996) established three distinctive, interdependent and interrelated spheres of government, namely national, provincial and local government but the national government is still the dominant sphere (Ababio *et al.*, 2008:5). Section 151 of the Constitution (1996) stipulates that local government must deliver goods and services to their respective communities on behalf of the other spheres of government. In section 152(1)(b) as one of the constitutional objectives of municipalities, the provision of services to communities in a sustainable manner is stipulated.

A municipality must also, as stipulated in section 152(2) of the Constitution, within its financial and administrative capacity strive to reach these objectives. In schedule 4(b)

the shared competencies and in schedule 5(b) the exclusive competencies of local government are listed. The Local Government: Municipal Systems Act 32 of 2000, (MSA), section 73(2) in chapter 8 elaborated on the constitutional objective that municipalities must deliver services which are equitable and accessible to all and that these services must be provided in a manner that is conducive to the prudent, economic, efficient and effective use of available resources.

With the commencement of the Local Government: Municipal Demarcation Government Act (Act 27 of 1998) on 1 February 1999 South Africa had undergone a structural reform process which resulted in the creation of nine provinces and 284 municipalities. On the 5th of December 2000 a new local government system based on the new physical aspects of the communities was inaugurated and started the transformation of the municipalities (Mlaba, 2006:25). Section 151(1) of the Constitution created the idea of "wall-to-wall" municipalities (Malherbe, 2011:5). Owing to the new geographic demarcations, municipalities began to find themselves effectively servicing bigger geographical areas. The surrounding areas of towns and cities, mostly rural areas with little or no rates base, were incorporated into the budgets of local municipalities.

The financial implication of these "wall-to-wall" municipalities was that municipalities had to sustain themselves within their budgets without compromising the effectiveness in the delivery of municipal services. A financial strain was placed on the municipalities and without a strict internal budgetary control system; the objectives of government cannot be obtained.

As all other municipalities in terms of section 155 of the Constitution, the Tlokwe City Council (previously the Potchefstroom City Council) was established on the 5th of December 2000 (Tlokwe City Council, 2011e:6). The area of jurisdiction of the municipality was increased to incorporate Potchefstroom Town, Mohadin, Promosa, Ikageng, Matlwang Village, Lindequesdrift and the rural hinterland. The jurisdiction area has increased from 250 km² to approximately 2 675 km², bordering Vanderbijlpark in the east, the Vaal River in the south, Fochville and Carletonville in the north and Klerksdorp/Stilfontein in the west. The N12 between Johannesburg and Cape Town divides the area in two parts. The N12 is one of the main designated development corridors in South Africa (Tlokwe City Council, 2011b:39). According to the 2011 census (Statistics South Africa, 2013), the jurisdiction area of the Tlokwe City Council

has a total population of 162 762 compared with its neighbour, the City of Matlosana Local Municipality, with a population of 398 676.

The budget of the Tlokwe City Council increased from R261,51 million for the 2000 financial year (R194,51 million for operating expenditure and R67 million for capital projects) to R939,32 million for the 2012 financial year (R798,81 million for operating budget and R140,51 million for capital budget), an average increase of R56,48 million per annum. Although the area of jurisdiction increased substantially with severe backlogs in service delivery and infrastructure in previous neglected areas, the City Council refrained from increasing its rates, tariffs and other charges above the headline inflation forecasts, as annually determined by National Treasury.

1.2 BUDGET FORMULATION IN LOCAL GOVERNMENT

Budgeting is a very important tool to achieve financial success by individuals and organisations, as it is a financial plan of the revenues and resources needed to carry out their activities and to meet their financial goals (Lanen *et al.*, 2011:12). Ehlers and Lazenby (2010:337) describe a budget as a resource allocation plan in which the different resources are allocated and prioritised to achieve the strategies formulated by the organisation. According to Adams *et al.* (2003:329) planning is a very important management function and it is a prerequisite for management control. The larger the organisation, the more important budgeting becomes and without planning effective control or performance measurement cannot be done.

Additional to the legal framework regarding the budget process, National Treasury also annually issues a Municipal Budget Circular providing guidance to municipalities for the preparation of their next Budget and Medium Term Revenue and Expenditure Framework (MTREF). The national priorities, headline inflation forecasts, as well as guidance regarding to relevant key issues for the specific year, as budgeting for free basic services, discretionary budget allocations, electricity tariffs, et cetera are contained in these circulars. Unfortunately, although the budgeting process of local government is legally prescribed in the Local Government: Municipal Finance Management Act, Act 56 of 2003 (MFMA) and the annual National Treasury Circulars are serving as a guideline, the processes are not always followed and the need of the community for effective, efficient service delivery is not always addressed in the Budget.

1.3 INTERNAL CONTROL

According to the International Accounting Standards (IAS) internal control is defined as the process designed by management to provide assurance that the objectives of organisations are achieved by the submission of reliable financial information, that the activities are done effectively and efficiently and in accordance with applicable laws and regulations (Gray & Manson, 2008:169). Internal financial control, efficient and effective operations as well as financially sustainable service delivery are some of the categories of objectives that the municipal internal control process needs to assess (PricewaterhouseCoopers, 2009:1).

The Auditor General's report for the Tlokwe City Council for the 2010 financial year, as contained in the Annual Report (Tlokwe City Council, 2011c:162), revealed numerous shortcomings resulting in a qualified audit opinion. The Auditor General based the qualified opinion on four aspects on which he was unable to obtain sufficient appropriate audit evidence, namely, for the accumulated surplus of the prior year, the cash flow statement of the prior year, an amount of R7,3 million in general expenditure as well as adjustments of R121 million in property, plant and equipment. In the Emphasis of Matters section of the Audit Report, the Auditor General highlighted overspending of the budget of R45,96 million, irregular expenditure of R95,2 million owing to non-compliance with the Municipal Supply Chain Management Regulations, fruitless and wasteful expenditure of R1,1 million as well as material underspending of R17,3 million in departments that negatively affected service delivery.

The Auditor General did not express a separate opinion on the effectiveness of internal control but did mention that the internal control deficiencies could directly be linked to the basis of the qualification on the financial statements, the findings on predetermined objectives and the compliance with applicable legislation. As drivers of the audit outcome, significant deficiencies were noted in leadership, financial and performance management as well as governance at the Tlokwe City Council (Tlokwe City Council, 2011c:166). Although the Tlokwe City Council received an unqualified audit opinion in the 2012 financial year, the Auditor General emphasised that significant deficiencies in internal control resulted in findings on the annual performance report and compliance with laws and regulations (Tlokwe City Council, 2013a:152).

Although no opinion was expressed on the effectiveness of the internal control system of the Tlokwe City Council, it is clear that deficiencies do exist and that these deficiencies need to be identified and corrected before a clean audit can be achieved.

Municipalities in the North West Province were also warned by the Auditor General (2011b:52) that their audit opinions will not improve if the necessary internal controls are not implemented. Council and senior management must ensure that even the most basic of controls, for example monthly reconciliations, are implemented as these internal controls are designed to ensure an environment of sound financial management. The Auditor General concluded in his report (2011b:77) that good leadership, quality financial and performance management as well as strong governance are the three crucial elements that can ensure that municipalities can obtain a clean audit and a sustained clean administration by 2014. The municipalities must therefore implement the basic financial and performance reporting controls as a matter of urgency.

1.4 BUDGETARY CONTROL

Both the planning and control functions of management are essentially founded in the accounting field and are closely related (Adams *et al.*, 2003:329).

Budgetary control is the use of budgets to control company operations. As part of the core function of management, budget control consists of various steps to establish whether the planned objectives are met (Weygandt *et al.*, 2005:393). Chadwick (2000:106) observes that it is common practice for the budget to be blamed, should there be any organisational problems or variances identified with the comparison between actual and budgeted figures. Weygandt *et al.* (2005:418) summarised that the concept of budgetary control consists of the following four phase process: Firstly reports need to be prepared to compare the actual results with the planned objectives, secondly the variances must be compared to determine the causes for the differences, thirdly appropriate corrective actions need to be implemented and in the final phase future plans need to be adjusted if it seems necessary.

According to section 28 of the MFMA, an adjustment budget is submitted annually at the end of January to the Tlokwe City Council for approval but, as indicated in the Audit Report (Tlokwe City Council, 2011c), the budget for the 2010 financial year was overspent with R45,96 million and the budget of departments that affected service

delivery was underspent by R17,3 million. These findings of the Auditor General indicate that the budgetary control system is not effective enough to implement remedial action when variances between the budget and the actual results are reported to management.

1.5. LEGISLATIVE FRAMEWORK

From 1994 to 2001 far-reaching changes were made to the political decision-making and the public policy-making processes, including a redirection of the priorities of the new policies. Policies were adopted at national level and provinces and local government were only given little policy-making powers and were restricted to the implementation of national policies (Booyesen, 2001:125, 138). A policy framework — consisting of legislation and policies — was also developed for municipal finance. This framework contains the government intentions with regard to municipal financial management and administration (Khalo, 2007:191). These legislation and policy documents were enacted and phased in over a period of time. The core of local government law in South Africa is the Constitution and all existing local government laws are based on the constitutional framework. According to Cele (2013:16) the aim of the local government legislation *inter alia* is to enable effective local governance and to provide services to the communities in an equitable and sustainable manner.

In local government, should any changes occur in the municipal environment or applicable legislation, policies and procedures — as part of the internal control system — need to be reviewed. Internal controls can only be effective if policies and procedures are documented, are approved by Council and are communicated to all relevant staff.

All existing internal controls must be evaluated if they are still appropriate and the risks facing the municipality may necessitate changes to the internal control system.

1.6 PROBLEM STATEMENT

On 14 July 2009 the Minister for Co-operative Governance and Traditional Affairs, Minister Sicelo Shiceka, launched Operation Clean Audit 2014. The objective of this project is that by the 2014 financial year the then 283 municipalities in the country should have achieved clean audits on their annual financial statements and by the 2011 financial year all municipalities must have improved from a disclaimer or adverse audit opinion (Van der Walt, 2012:30). Minister Shiceka categorised Operation Clean Audit

as a programme to clean up governance as well as to enhance service delivery at both the second and third tier of government. Thus the challenge for all municipalities, including the Tlokwe City Council, is to achieve a clean audit by 2014 as well as to enhance service delivery.

The Auditor General mentioned in a newspaper interview (*Kempton Park News*, 30 July 2012) that a clean audit is a concept unique to the public sector and is neither defined in accounting nor in auditing standards. A clean audit is a report by an auditor without any findings on financial statements, predetermined objectives or findings on compliance with laws and regulations.

The Tlokwe City Council does experience challenges in internal budgetary control as well as with service delivery, as indicated in the Annual Report (Tlokwe City Council 2010a:95). It has now become necessary to investigate the internal budgetary control system and a solution needs to be sought in order to transform the internal budgetary control system to achieve a clean audit by 2014.

The focus of this research is on the internal budgetary control system at the Tlokwe City Council. If necessary, amendments shall be proposed to expedite and to enhance service delivery as a municipality is constitutionally tasked to. Therefore the research question for this study is defined as follows:

Will the proposed amendments of the current internal budgetary control system at the Tlokwe City Council enhance service delivery?

1.7 RESEARCH OBJECTIVES

1.7.1 Main objective

The main objective of this mini-dissertation is to investigate and to evaluate the current internal budgetary control system of the Tlokwe City Council and to suggest improvements to the control system to enhance service delivery.

1.7.2 Secondary objective

The secondary objectives of this mini-dissertation are to

- evaluate the compliance with the legal requirements of the current budgetary control system of the Tlokwe City Council;

- gain a better understanding about the current existing literature and legislation on budget formulation, internal control and budgetary control in the local government sphere;
- compare the internal budgetary control system of the Tlokwe City Council with the internal budgetary control systems of municipalities which are of similar size (the City of Matlosana Local Municipality, the Rustenburg Local Municipality) or which already have achieved a clean audit, such as the Steve Tshwete Local Municipality (Middelburg); and to
- formulate a strategy for effective budgeting as well as to improve the internal control system of the Tlokwe City Council. This includes recommendations to improve the system of delegations, organisational structure and internal control policies.

1.8 SCOPE OF STUDY

The proposed study will be limited to the Tlokwe City Council. Comparisons to municipalities of similar size such as the City of Matlosana Local Municipality (Klerksdorp), the Rustenburg Local Municipality and municipalities which already have achieved a clean audit, such as the Steve Tshwete and the Swartland local municipalities will be highlighted in the study.

1.9 IMPORTANCE AND BENEFITS OF THE STUDY

In the light of the negative audit reports that the Tlokwe City Council has received the last few years and because a clean financial audit needs to be achieved by 2014, the Tlokwe City Council needs to investigate and to rectify the areas which resulted in findings of the Auditor General, as contained in the report of the Auditor General to the North West Provincial Legislature and to Council. The improvement in the audit report from an adverse finding in the 2009 financial year to a qualified report in the 2010 financial year was mainly owing to the appointment of consultants to address the issues related to the General Recognised Accounting Practice (GRAP), such as the unbundling of the assets register, impairment of debtors and post-retirement medical benefits, as well as the processes and procedures in compiling financial statements (Auditor General, 2011b:8).

The four findings contained in the Emphasis of Matter section of the report from the Auditor General (Tlokwe City Council, 2011C:162–5) and the ten findings regarding the

non-compliance with laws and regulations can be contributed to inadequate internal control systems. Three of the findings can directly be linked to non-adherence to the approved budget of Council, thereby clearly indicating that an improved budgetary control system must be put in place. Lack of such a budgetary control system will lead to future audit findings and if such an audit finding is repeated in consequent financial years, it may lead to a qualification.

This study provides an insight in the shortcomings of the internal budgetary control system and will assist the Tlokwe City Council to develop and to amend financial control systems. The primary objective for conducting this study is to improve the internal budgetary control system that will enable Council to enhance service delivery to the greater Potchefstroom demarcated area.

1.10 RESEARCH METHODOLOGY

Based on the researcher's understanding of the problem existing at the Tlokwe City Council, an in-depth cross-departmental investigative case study will be undertaken in separate phases, with each phase resulting in identified deliverables. There is no control group although references will be made to the best practices followed at the City of Matlosana, the Rustenburg and the Steve Tshwete local municipalities in South Africa.

The research technique involves a literature review of the core elements of an internal budgetary control system, taking in consideration the legislative framework as well as a qualitative study of the budget and the internal control system at the municipality; and benchmarking it with the local municipalities, which received a clean audit report for the 2010, 2011 and 2012 financial years.

Phase 1: Data collection, literature review and needs review: to

- analyse the budget formulation process at the Tlokwe City Council;
- understand the existing organisational structure and whether it is in line with the core functions;
- obtain all relevant existing internal financial control policies;
- investigate the budget formulation process at the municipality;
- examine the current system of delegations; and to
- obtain printed reports from the current expenditure system.



Phase 2: Analysis and assessment of data and policies: to

- identify effectiveness in the budget process and the internal budgetary control process;
- determine the relevance and effectiveness of financial policies;
- analyse internal control measures of other municipalities;
- legal and/or regulatory issues; and
- human resources implication.



Phase 3: Documentation and presenting recommendations and strategy: to

- compile a report; and to
- summarise key recommendations in the format of a strategy and proposed policy amendment

1.11 DATA COLLECTION

Primary sources of data used, but not limited to:

- reports from the Auditor General;
- MFMA Circulars from National Treasury;
- financial control policies from the Tlokwe City Council and other municipalities; and
- interviews with senior managers of the Tlokwe City Council and benchmarked municipalities.

Secondary sources of data used, but not limited to:

- academic peer-reviewed journals such as the *IMFO*, official journal of the Institute of Municipal Finance Officers;
- published academic literature;
- other journals such as the *Journal for Public Administration*;
- applicable legislation;
- searching the World Wide Web for information; and
- internal policies and procedures of municipalities.

1.12 CLARIFICATION OF TERMS

For purposes of this study, the following definitions are taken as correct and applicable.

- **Accountability:** Accountability means an obligation of a person to account for his/her activities and to disclose the results of his/her activities in a transparent manner (National Treasury, 2011b:3). Section 195(1)(f) of the Constitution stipulates that the public sector administration must be accountable. According to Pauw *et al.* (2009:28) "accountability is central to the management of public money" and two kinds of accountability — internal accountability to the direct supervisor and external accountability to the owners, stakeholders or shareholders — are identified.
- **Accounting officer:** An accounting officer is the head of a national or provincial department, the municipal manager of a municipality or the chief executive officer of an institution established in chapter 9 of the Constitution. The accounting officer is held accountable for all outputs required by the entity, must manage the entity according to relevant legislation (Public Finance Management Act [PFMA] or MFMA) and may delegate certain powers and duties to other officials (Pauw *et al.*, 2009:47).
- **Auditor General:** The Office of the Auditor General is enshrined in the Constitution by section 188 and the Auditor General is accountable to the National Assembly. Its functions are "to audit and to report on the accounts, financial statements and management of all institutions" supported by public money. Section 181(4) of the Constitution prohibits any interference in the functioning of the Auditor General (Pauw *et al.*, 2009:44).
- **Authority:** Clear lines of authority are required in a sound budgeting system. Authority needs to be delegated *inter alia* for budget preparation, for the taking of

remedial action to remedy an adverse situation revealed in a budget and in actual budget reporting (Chadwick, 1998:107).

- **Benchmarking:** Strydom (as quoted by Naidoo & Reddy, 2008:38) described the purpose of benchmarking as the identification of the best practices of other departments, sections or organisations and by using qualitative measures, making comparisons between the costs, quality or processes of the best practices of the other organisations with the own organisation to enable the own organisation to learn and to improve. Based on this assessment between the "best practice" processes and the own processes, performance targets can be set to improve the processes of organisations to decrease the gap identified (Naidoo & Reddy, 2008:38). Naidoo and Reddy (2008:51) elaborate that benchmarking can be used as a technique to compare the own municipality to the best municipality to realise what can be achieved.
- **Budget:** Ehlers and Lazenby (2010:337) describe a budget as a resource allocation plan in which the different resources are allocated and prioritised to achieve the strategies formulated by the organisation. The budgeting of public funds indicates the allocation of financial resources to each programme, subprogramme and activity. The funds are divided into standard expenditure items to indicate the costs relating to — for example — personnel, administration, repair and maintenance, inventories, and professional services (Pauw *et al.*, 2009:59).
- **Budgetary control:** Budgetary control is the use of budgets to control company operations and — as part of the core function of management — budget control consists of various steps to establish whether the planned objectives are met (Weygandt *et al.*, 2005:393). A budgetary control system is defined as a system in which actual results are compared with budgeted goals (Brock *et al.*, 2007:482).
- **Chief Financial Officer:** The duties of the Chief Financial Officer, as included in the PFMA and the MFMA, consist of advising the accounting officer on all financial matters including financial policies, control and financial management. Relevant financial information has to be provided to the accounting officer to make informed decisions (Pauw *et al.*, 2009:48).
- **Clean Audit:** A clean audit is an audit opinion that is financially unqualified, has no adverse findings on compliance with laws and regulations and also has no adverse findings on predetermined objections (Van Schalkwyk, 2013:6).

- **Control:** Control is any means or approach utilised to mitigate risk and to ensure that objectives are achieved (Cohen, 2007:168). According to Fourie and Opperman (2011:438) control is a conscious action or set of actions taken by management, and is the end result of proper planning, organising and leadership by the management.
- **Delegation:** National Treasury defines delegation as the assignment to another person of authority, function and responsibility to carry out specific activities and tasks (National Treasury, 2011b:3, 4).
- **Effectiveness:** Effectiveness means the degree to which the objectives are achieved and the extent to which targeted problems are resolved (National Treasury, 2011b:3). Effectiveness is made obligatory by law in the PFMA as accounting officers must commit themselves and their governmental or provincial departments to reach specified goals as specified in the departmental budget. In managing public funds effectiveness, economy and efficiency must be promoted and funds must be spent appropriately (Pauw *et al.*, 2009:2, 23).
- **Efficiency:** Efficiency means that the maximum output must be achieved from the provided limited resources to carry out the activity. Efficiency is thus the relationship between the output of services, goods or any other results, and the resources used to produce the output (Pauw *et al.*, 2009:123).
- **Financial control:** Financial control is the "overall system of organisations, controls, rules, procedures and regulations" established to ensure the efficient, effective and economic use of available funds (Cohen, 2007:168).
- **Financial year:** In local government *financial year* means a year ending on 30 June as described in section 1 of the MFMA.
- **Fruitless and wasteful expenditure:** Fruitless and wasteful expenditure is expenditure "which was made in vain and would have been avoided had reasonable care been exercised" (Pauw *et al.*, 2009:24).
- **Governance:** Governance, according to Cohen (2007:168) is "the framework of structures, functions, powers and duties underpinning financial management and control systems". The aim of governance is to ensure that the best possible system of controls is in place, "based on the objectives and risk exposure of the organisation". In the public sector audit governance means "the organisation of an administrative unit and defines the duties, responsibilities and delegations of authority of management".

- **Internal control:** According to the International Accounting Standards internal control is defined as the process designed by management to provide assurance that the objectives of organisations are achieved by the submission of reliable financial information, that the activities are done effectively and efficiently and in accordance with applicable laws and regulations (Gray & Manson, 2008:169, 289).
- **Irregular expenditure:** Irregular expenditure is defined as expenditure other than unauthorised expenditure which is incurred in contravention or not in compliance with a requirement of any applicable laws and regulations (Pauw *et al.*, 2009:43).
- **Line-item budgeting:** A line-item means "an item of expenditure classified according to its type, irrespective of the purpose" of the expenditure. The line-item classifications are standardised for government and examples are salaries, printing, fuel and purchase of bulk electricity. Budgeting is done per line-item and consists of preparing the estimates of expenditure for the new financial year by only adjusting the estimates of the previous year with the National Treasury approved growth percentages (Pauw *et al.*, 2009:56; Van Schalkwyk, 2012:8–10). Every year National Treasury provides detailed guidelines and instructions regarding the preparation of the budgets of the following year (Maphiri, 2011:35).
- **Local government:** A local government, or municipality, is the third sphere of government, an institution created by law by the central government for the residents in a particular demarcated area. This local government is an autonomous body with legislative and executive powers in the area. These services are rendered directly to the community at grassroots level (Van der Waldt, 2007:4).
- **Municipality and municipal council:** According to the South African Local Government Association (SALGA) (2011:5) a distinction must be made between a municipality and its municipal council. A municipality is the core institution within the sphere of local government. It is an organ of state that consists of the political structure and administration of the municipality and the community within its municipal area. A municipal council is a political body consisting of directly and indirectly elected councillors/members. A municipality is therefore a much broader concept and does include more institutions or structures. A municipality and its council are not synonymous.
- **Organisational structure:** An organisational structure is an "arrangement of lines of authority and responsibility within the organisation" (Horngren *et al.*, 2009:223).

The roles, responsibilities and authority of each individual and organisational unit as well as the lines of communication and delegation are defined in an organisational structure (Fourie & Opperman, 2011:440).

- **Segregation of duties:** Segregation of duties occurs when the duties and responsibilities of individuals are allocated in such a way that no individual may be involved in the recording and payment of transactions from the beginning to the end. The tasks of authorisation, recording and execution of transactions as well as custody of the assets must be separated (Gray & Manson, 2008:261, 278). Segregation of duties will prevent a person from committing fraud or misusing resources or the position of a municipality, "in such a way that it can be concealed in the normal course of duties" (Hogan, 2003).
- **Service delivery:** The main purpose of the public sector is to render services and the activities of the public sector and public sector institutions are justified as they render service to the public. Service to the population is the main measure of success (Pauw *et al.*, 2009:1).
- **Tlokwe City Council:** The *Provincial Gazette* No. 6419 dated 7 August 2007 amended the expression "Potchefstroom City Council" with the expression "Tlokwe City Council". The *Provincial Gazette* determined that any reference in any other notice or document to the "Potchefstroom City Council" or the "NW 402 Local Municipality" has to be read as a reference to the "Tlokwe City Council".
- **Unauthorised expenditure:** Unauthorised expenditure is either expenditure incurred for a purpose not provided for in the budget or expenditure incurred which exceeds the budgeted amount for that purpose or item (Pauw *et al.*, 2009:41).
- **Virement:** French term meaning: commerce transfer, an authorised transfer of funds from one use to another. In the United States of America, departments can also transfer expenditure funds during a year to meet changing needs as long as the expenditure stays within the approved budget (Bradley, 2002:1).
- **Vote:** Section 1 of the MFMA defines a vote as one of the main segments into which a budget of a municipality is divided. Funds are thus appropriated to the different departments or functional areas of a municipality. The municipality must define its departments around key functions or subfunctions (National Treasury, 2005a:1, 2).

1.13 CHAPTER OVERVIEW

Chapter 1 includes the introduction, the motivation of the actuality of the topic, preliminary literature review, the problem statement, the research objectives as well as the research methodology.

Chapter 2 consists of an explanation of the different methods of research, research methodology, research ethics, the source of the data for this case study and the use of this data in the research study.

Chapter 3 consists of the literature review, including the legislative framework. The importance of the field researched for the Tlokwe City Council will be addressed.

Chapter 4 consists of the analysis of the current policies, system of delegations, organisational structure and internal budgetary control system. The entire process of the budget with its legal requirements, the adjustment budget, internal budgetary reporting practices and the internal budgetary control system is investigated and is reported on in this chapter.

Chapter 5 contains the findings of the analysis of the current internal budgetary control system compared with the best practices of the chosen municipalities of similar size and of the municipality which already has achieved a clean audit.

Chapter 6 contains the recommendations for improvement of the internal budgetary control system and the conclusion.

In chapter 2 the manner how the data of the literature review in chapter 3 and the empirical data in chapters 4 and 5 were obtained, is discussed. The various research methodologies, advantages of the case study research method and the research ethics are also discussed.

CHAPTER 2

2. RESEARCH METHODOLOGY

2.1 INTRODUCTION

The purpose of this chapter is to describe the research methodology used to obtain data for the literature review and the empirical case study and the use of the data in the research study.

2.2 BACKGROUND

Kumar (2011:5) quotes Grinnell (1993) with the analysis of the word "research". The word *research* is composed of two syllables, *re-* meaning "again" or "over again" and *search* meaning "to examine closely and carefully". The two syllables together form a noun that describes a careful, systematic study and investigation in some field of knowledge to establish facts or principles. *The Reader's Digest Oxford Complete Wordfinder* (1993:1306) describes research as a systematic, orderly investigation into, and a study of, sources and material with the purpose to establish facts and to reach new conclusions regarding the study matter. Bordens and Abbott (2011:7) explain that research is the primary method to gather information and to determine the reasons for specific behaviour. Firstly the problem is identified by the researcher and then s/he collects the information with regard to the problem finally to develop rationalisations why this problem occurred. Graziano and Raulin (2010:26–7) found that research is "a process of inquiry" but defined scientific research as an inquiring method in which rational and empirical processes are integrated.

According to Brynard and Hanekom (2008:3) research is a procedure in which answers to specific questions are obtained and identified; problems are solved in a methodical manner with the provision of confirmable facts. Birley and Moreland (1998:9–10) indicate that research questions can come from either published books or articles, the wealth of experience gained by managers and professionals or questions raised from own experience or "common sense".

Kumar (2011:5) expands on the definition of research by stating that a specific process has to be followed to find answers to the research questions. This process implies that

- the research must be done within a framework of a set of viewpoints;

- procedures, methods and the techniques used must have been tested for their reliability and validity; and
- the process must be unbiased and objective.

Leedy and Ormrod (2010:2–7) identify eight different characteristics in research:

- a specific question or an identified problem initiates research;
- a clear description of the goal of the research is required;
- a specific process plan including the chosen research design and research methods is needed;
- the principal research problem must be broken down into smaller subproblems;
- the research must be guided by a specific identified research problem, hypothesis or a question;
- research accepts certain assumptions which must be valid;
- research requires the collection, analysis and the interpretation of data which will provide a solution to the initial problem or an answer to the question that initiated the research; and
- research is a cyclical process which follows logical steps from the initially raised question until the data were interpreted to provide a solution or answer to the problem or question.

Kumar (2011:9–10) differentiates between two types of research based on the applications of the findings of the research study. Pure research, which may not have any practical applications, comprises developing and testing hypotheses. However, the knowledge gained from pure research adds to the existing body of knowledge of research methods. In applied research the information collected can be used to enhance the understanding of a problem or to formulate policies. According to Bordens and Abbott (2011:4–5) the difference between applied and basic or pure research is that basic research is conducted to test a specific theoretical or empirical issue and applied research is done to investigate and to generate information regarding a specific identified problem in the "real world". Graziano and Raulin (2010:53–4) explain applied research as the study to find solutions to practical problems and basic research as the study to increase the knowledge and understanding of an aspect or occurrence without a specific objective in mind while doing the study. The findings of basic research are often used as the basis of applied research. Basic research is also known as pure research or fundamental research.

Brynard and Hanekom (2008:7) quote Bailey (1978), Huysamen (1994) and Smit (1995) in distinguishing between applied and basic research, which are not mutually exclusive. The purpose for which the research is used is the distinction between these two types of research. The difference between the aims of basic research and applied research is that in basic research theories are to be developed by testing hypotheses that have been deduced from the hypotheses, in contrast to the aim in applied research which is to find solutions for a specific identified problem. Although in basic research the researcher does not normally have an immediate application of the solution of the hypotheses in mind, the possible future application of the solution or the results of the research is not excluded. In applied research the research problem is identified according to the practical value the research would have in a specific situation, as the results of the research can be used immediately to solve the identified problem.

This research study can be classified as applied research as the aim of the study is to evaluate the current internal budgetary control system of the Tlokwe City Council, to benchmark the internal budgetary control system with similar municipalities and to recommend improvements to the internal control system.

In this chapter a review is done to indicate how a research study is designed, the research methods which can be used — including the advantages and disadvantages of a case study — and the differences between a quantitative and qualitative research methodology are discussed. The study regarding research ethics developed for the different research and professional bodies and the data collection, collection methods, analysis and interpretation of the research data are also described in this chapter. In each section of this chapter, the link to this research study is made.

2.3 RESEARCH DESIGN

Research design is, according to Kumar (2011:396), a process plan implemented by the researcher to answer the questions raised regarding the identified problem in a valid, economical, accurate and objective manner.

Bordens and Abbot (2011:235–6) describe two approaches which can be followed in data collection. The quantitative research approach is when the data are expressed in a numerical manner and the behaviour is counted. The advantage of this method is that several statistical tests are available to analyse the data. However, the disadvantage of the quantitative data collection approach is that it cannot be used in all research

situations. The qualitative research approach is when data are collected and expressed in written records of the behaviour witnessed. As the behaviour is neither counted nor captured in any statistical rating scales, the data cannot be statistically tested and thus the analysis of qualitative data is made difficult. A researcher mostly uses either the qualitative or the quantitative research approach but a combination of the two research approaches can be used.

Kumar (2011:11–13) classifies the quantitative research as a structured approach as everything that forms part of the research process, such as the objectives of the research, the design, the sample and the questions that are asked of respondents are all predetermined. The qualitative research is seen as an unstructured approach as it allows flexibility in all aspects of the research process. In the structured approach the extent of a problem is determined in contrast to the unstructured approach which explores the nature of the problem.

2.4 RESEARCH METHOD

2.4.1 Background

The different research methods include specific strategies and procedures for the implementation of research design. These methods can include sampling, data collection, data analysis and the final interpretation of these findings (Teddlie & Tashakkori, 2009:339). Hesse-Biber and Leavy (2011:5) define research methods as the tools researchers use to collect data.

According to Willis (2007:231–3) the most popular research methods are the established qualitative research methods which consist of the ethnography or observation (case studies included) method, the structured, semi-structured and open interviewing method, and the history and historiography method.

Leedy and Ormrod (2010:94–5) also differentiate between the qualitative and the quantitative research method. In the quantitative research methodology the findings of the study are reported in a statistical analysis in contrast to the qualitative research methodology where the findings are reported in an in-depth description and interpretation of the patterns identified in the analyses of the data.

The case study approach, as part of the ethnography qualitative research method, is a study of a specific phenomenon such as an event, an institution, a programme, a person or a process (Merriam, 1988 as quoted by Willis, 2007:238). Trochim and

Donnelly (2008:147) identify case studies as a commonly used method of qualitative measurement. A case study is identified as an in-depth "study of a specific individual or specific context". The information required for case-study analysis can be obtained through different methods or a combination of methods such as direct observation, unstructured interviewing or written documents. Saldaña (2011:8–9) observes that, as a case study focuses on the analysis of a single unit, it allows for an in-depth examination. The case study of a single unit may be chosen either deliberately owing to the unique character of the unit, strategically as the case may represent the most typical of its kind or it may be chosen for convenience as the researcher may be familiar with the study unit.

In this research study the case study research method is used. In the first phase of this research study a literature study is done to establish the link between internal controls, budgets and budgetary internal control. The legal framework local government has to comply with, is also analysed in the third chapter. In the second phase of the case study research, the budgetary internal control system of the Tlokwe City Council is analysed, the best practises of similar local municipalities are identified and in chapter 6 recommendations are made to improve the internal budgetary control system of the Tlokwe City Council.

2.4.2 Case study research

In this research study, an in-depth cross-departmental investigative case study method was chosen and the Tlokwe City Council was selected owing to the researcher's understanding of a problem of internal control deficiencies existing at the Tlokwe City Council. Kumar (2011:126, 379) assumes that the case identified being studied in a case study is atypical of cases of a certain type and a single case can thus provide a better understanding of situations predominant in a group from which the case was chosen. According to Teddlie and Tashakkori (2009:25) case study research is the thorough analysis of a single case or several cases identified for the study and it is popular amongst qualitative researchers in various study fields such as business and law. The case study research design is one of the different research methods utilised by qualitative researchers (Hesse-Biber & Leavy, 2006:190; Kumar, 2011:379; Trochim & Donnelly, 2008:147; Willis, 2007:238). Hesse-Biber and Leavy (2011:255) argue that a case study is not a research method or methodology but more an expansive field of research within qualitative research. A case study is seen as being both the process

and the product of the research. According to Katz (2009:114–16), in scientific research either best cases or representative cases are acceptable categories of case studies to present raw examples with all the complexities and difficulties of the real world. Best cases show the extreme of actual results. These results can but does not usually occur in comparison to representative cases which are the most common examples in the data set of results.

Willis (2007:240) defines case studies as the most used and criticised forms of social research. According to Willis (2007:239) case studies are:

- Case studies are focused on a particular context as on one phenomenon, one company or entity.
- Most of the data collection occur in real environments and are about real people or real situations.
- Case study data consist of descriptive data emanating from different sources as, for example, from observations, interviews, historical data and journals.
- From the examination of the data generalisations, concepts or hypotheses can emerge. The hypotheses at the outset of the study may also be reformulated and amended as the study proceeds.
- Case studies can also discover a new meaning, confirm what is known or extend the reader's experience regarding the phenomenon studied.

According to Hesse-Biber and Leavy (2011:256) both qualitative and quantitative research methods can be used in case studies and the data can be obtained from pre-existing sources or can be original. Different data sources such as documentation, interviews, archival records, direct observation, participant observation or even physical artefacts can be used.

2.4.3 Advantages of a case study

Willis (2007:240) lists three advantages of the case study research method over the experimental research methodology, namely, that detailed information can be obtained in a real authentic setting, the study can be done without predetermined goals and hypotheses and a case study is holistic as human behaviour is best understood as lived experience in the social context. Kumar (2011:126) explains that the case study design is very useful to carry out research in a little-known area or when the researcher wishes to obtain a holistic understanding of a specific situation or phenomenon. A case study

research can provide an in-depth understanding of a specific case but it cannot make any generalisations to a population beyond cases similar to the identified researched case. According to Hesse-Biber and Leavy (2011:256) a case study research allows for a more complex understanding of the research subject.

2.4.4 Disadvantages of a case study

Willis (2007:239) describes the case study as one of the most used but also the most criticised forms of research. Case studies, as part of the qualitative research methodology, are very time-consuming and take much longer to complete than quantitative research studies, as it involves the collection, analysis and interpretation of large amounts of qualitative data (Hesse-Biber & Leavy, 2011:265; Willis, 2007:241). During the study the researcher may also change the initial plans of what data will be collected (Willis, 2007:239). The researcher's own feelings about the topic also influence the type of data collected as well as the approach to analysis and interpretation (Hesse-Biber & Leavy, 2011:256). According to Kumar (2011:126) judgemental or information-oriented sampling techniques are used in selecting a single case which is assumed to be atypical of similar cases in a group or population.

2.5 RESEARCH METHODOLOGY

The focus of research methodology is on the research process and the decisions the researcher needs to make to achieve a research project. The questions which must be answered are, *inter alia*, the method of data collection to be used and the identification of the factors which play a role in the design (Brynard & Hanekom, 2008:36). The research methodology can be seen as the strategy for research. The strategy must determine if the qualitative or quantitative methods of data collection will be used. The researcher must clearly indicate which of the two methods will be used as a properly defined hypothesis should be part of a quantitative study. In a qualitative research study a clearly formulated research question must be included in the proposal (Brynard & Hanekom, 2008:28).

The underlying philosophy, the methods, models and procedures used in qualitative and quantitative research methodology differ to some extent. The differentiation between the two methods is in terms of the purpose of the research, the nature of the research process, method of data collection and format of data, the procedures used for data analysis as well as the style of communication of the research's findings (Kumar,

2011:18; Leedy & Ormrod, 2010:96). Willis describes the major difference between the quantitative and qualitative research approaches as not the type of data used but as the different opinions and beliefs "about the nature of the world" and how the world can be better understood, to the different positions regarding the relationship between professional practice and social science research (2007:22).

2.5.1 Quantitative research

The quantitative research methodology is the method used by researchers to assign numbers to observations. Quantitative research is also seen as a "hard" science. Data are produced through the process of counting and measuring "objects" or "things" (Brynard & Hanekom, 2008:37). This method requires experiments, questionnaires, quantitative analysis and surveys to obtain the data. Teddlie and Tashakkori (2009:343) define quantitative or statistical data analysis as the analysis of numerical data using techniques that include the description of a phenomenon of interest or searching for substantial differences between groups or relationships among variables. The quantitative researcher relies on numbers, rates and percentages to be presented in graphs, tables or charts to communicate its meaning (Hesse-Biber & Leavy, 2011:6). Kumar (2011:13) classifies a study as quantitative if the variations in a problem are quantified; information is gathered through quantitative variables and the aim of the study is to determine the magnitude of the problem. Leedy and Ormrod (2010:94) summarise quantitative research as a study looking at "quantities" of the identified study aspect.

2.5.2 Qualitative research

Brynard and Hanekom (2008:37) describe the qualitative research methodology as the method in which descriptive data is produced. The researcher's own experience or observations, normally without assigned numbers or counts, are contained in this research. A condition of qualitative research methodology is the commitment of the researcher to perceive the subject through the eyes of a participant. Qualitative research, according to Hesse-Biber and Leavy (2011:4), is an interdisciplinary field comprising different perspectives and practices for generating knowledge. The focus of the research is a "words and text" approach as opposed to a "numbers" approach as used in quantitative research. Qualitative research is a holistic process which integrates epistemology, methodology and the method in order to develop unique approaches to the study of the social world (Hesse-Biber & Leavy, 2011:353). The philosophical

(epistemology) foundation of the researcher influences every aspect of the research process from selection of the topic, formulation of the question, the sampling method to the research design. According to Teddlie and Tashakkori (2009:343) the techniques used in qualitative research are associated with the gathering, analysis, interpretation and presentation of data in a narrative form. The methods normally used are case studies, in-depth interviewing of informants and questionnaires.

According to Kumar (2011:13) qualitative research can be identified if the purpose of the study is to describe a problem; if the information is obtained through the use of variables measured on a nominal or ordinary scale; and if the variation in a situation is established without been quantified. Leedy and Ormrod (2010:94) summarise quantitative research as a study looking at "qualities" or "characteristics" of the study aspect identified.

This research study is a qualitative research as the problem of the budgetary internal control deficiencies at the Tlokwe City Council was identified by the Auditor General during his statutory audits for the financial years 2009 and 2010. After an analysis of the audit reports for the following two financial years, 2011 and 2012, and the internal control system of the municipality was concluded, the problem areas were identified and the benchmarking exercise with other municipalities highlighted the best practises which could be implemented to rectify the internal control deficiencies at the Tlokwe City Council.

2.6 RESEARCH ETHICS

The *Reader's Digest Oxford Complete Wordfinder* (1993:505) describes *ethics* as the science of morals in human conduct as well as a set of moral principles and rules of conduct. According to Rossouw *et al.* (2008:3) the words *ethics* and *morality* are interchangeable as the origin of the word *ethics* is from the Greek word *ethikos* which was later translated into the Latin *moralis*. Hesse-Biber and Leavy (2011:59) also explain that the term *ethics* developed from the Greek word *ethos* meaning "character". They further make it clear that the researcher must ensure that the research process and the research findings are trustworthy and valid. The selection of the research problem, the conduct of the research, the publication of the research findings and the consent of the participated research subjects are a few of the pertinent aspects a researcher needs to analyse within the code of ethics.

Different research and professional bodies developed codes of ethics specifically for research and researchers do need to abide by the relevant code of conduct when they carry out their research (Kumar, 2011:241). According to Hesse-Biber and Leavy (2011:85) these research codes of conducts, based on moral principles, were established in order to protect the research subjects and their settings and they may not be harmed by the research process. The Nuremberg Code, a code of ethics which stipulated that all research participation must be voluntary, was developed after the Second World War.

According to Brynard and Hanekom (2008:6) honesty and confidentiality are the two overarching ethical requirements for researchers. The researcher must at all times report the truth of his study in an unbiased manner and no confidential data may be revealed.

Kumar (2011:244) identifies various stakeholders in the research process, such as the research subjects or participants, the researcher and the funding body of the research. Each of these stakeholders has his or her personal ethical issues. The relationship between these stakeholders has ethical aspects which must be considered. The ethical issues regarding participants are the requirement to obtain consent to information, to provide incentives for information, to obtain sensitive information, the possibility of causing harm to participants and to maintain confidentiality. The researcher must be unbiased in his research. Provision or deprivation of treatment can pose an ethical dilemma for the medical researcher. The researcher may not use inappropriate research methodology, report the findings incorrectly or use the information inappropriately. The research sponsoring organisation may interfere in the research by imposing restrictions on the research that may include the misuse of the information or the prohibition of reporting the findings.

In this research study the previous municipal manager of the Tlokwe City Council gave consent that the researcher may research the internal control deficiencies at the Tlokwe City Council identified by the Auditor General. Only published audit reports or reports and policies approved by Council were used in the analysis of the problem identified. The chief financial officers of various municipalities were informed of the benchmarking exercise and their assistance to provide information were requested in writing. Documentation providing information regarding policies, audit reports and also

organisational structures of various municipalities were also retrieved from official websites of these municipalities.

In the next chapter a comprehensive literature review regarding the legislative framework of local government in South Africa, budgeting, budget and internal control is undertaken. The importance of the field researched is addressed.

2.7 DATA COLLECTION, COLLECTION METHODS, ANALYSIS AND INTERPRETATION

According to Willis (2007:203) several data sources have to be used in research owing to the data collection methods used as well as the participants selected, which have an impact on the meaning and understanding of the research. Kumar (2011:138) indicates two major approaches to gather information about a problem, person or situation. Either the researcher needs to collect data personally or the information is readily available and must only be extracted. In the first approach data are gathered from primary sources — such as gathering information at first hand by interview — in comparison with the second approach in which data are collected from secondary sources such as government documents, articles, earlier research and other documentation available on the subject. Brynard and Hanekom (2008:36) define "primary data" as data collected by the researchers themselves and "secondary data" as data collected by other researchers.

Brynard and Hanekom (2008:35) state that data collection is the most time-consuming part of research. They also divide the data collection methodology in quantitative and qualitative methods. Literature reviews, direct observation, questionnaires and interviews are some of the data collection techniques used by both methods.

In contrast to the quantitative research method in which the researcher must strictly adhere to the standardisation of questions and the reliability of data has to be verified, in the qualitative research method the researcher is allowed more flexibility and freedom to determine the structure and order of the research and the format of the questions is not standardised. In most qualitative research studies the method of data collection determines the design of the study (Kumar, 2011:159).

After the data were collected, the researcher must firstly filter the data to retain only that data relevant to the research project (Brynard & Hanekom, 2008:62).

According to Hesse-Biber and Leavy (2011:257) several data collection methods, such as document analysis, direct observation and interviews are used by researchers conducting case studies. The advantages of data gathered from documentation are that data cover a long span of time and many events. It is not established as a result of the case study and therefore is unobtrusive. Hesse-Biber and Leavy (2011:269, 273, 307) describe that the analysis and interpretation of the case study research data is done in an iterative way. It is an ongoing process of collection, analysis and interpretation of the data. The researcher must also validate the data by using different sources.

The goal of using tables, graphs and single representation of group of scores, as techniques used for summarising data, is to be able to understand data, to detect relationships and to communicate the results of data analyses to the reader (Teddlie and Tashakkori, 2009:258). Tables and figures are used in this research study to explain the relationship between internal budgetary control and the findings of the Auditor General.

In this research study the data for the literature study were sourced by the study of various books and articles as regards the identified study area. Numerous applicable articles were sourced through the internet and information regarding the legal requirements of the MFMA was requested from National Treasury or obtained from the internet.

With the use of tables comparing the audit findings, document analysis was done of audit reports by the Auditor General of the Tlokwe City Council and other municipalities. Direct observation by the researcher at the Tlokwe City Council identified various internal control deficiencies, which observations were also conveyed by the Auditor General in its audit findings.

2.8 SUMMARY

The aim of this chapter was to provide the background of the various research designs, research methods and research methodology. The quantitative and qualitative research approaches are discussed as well as the advantages and disadvantages of the case study method. Reasons are provided for the decision to use the case study method to conduct research. The process followed to obtain data for the literature study in chapter

2 and for analysis of data regarding the status of the internal budgetary control system of the Tlokwe City Council, is explained.

The importance of ethics in research is emphasised in this chapter. The purpose of the research study must be explained to all participants in the study and participation must be voluntarily. In this research study all ethical processes and requirements were adhered to and consent to the benchmarking process was obtained from the municipalities identified, whose publicly available audit reports were analysed.

In chapter 3 a literature review of internal budgetary control is done.

CHAPTER 3

3. LITERATURE REVIEW ON INTERNAL BUDGET CONTROL

3.1 INTRODUCTION

The aim of this chapter is to give a theoretical overview of the internal budget control function. Firstly, a literature review is provided regarding the legislative framework in which local government has to operate and, secondly, an overview regarding budget formulation, budget control and internal control processes in both the private and public sectors is given. A brief description of what benchmarking and service delivery in local government entail is also provided. An important aspect of this chapter is to establish the link between budgetary and internal control.

Managers are responsible to achieve the targets set out in the budget and if variances occur, they have to take action to get the organisation, department or section back on track. The actual resources used are compared with the budgeted resources and the calculated variances are used to measure the performance of the manager as well as the responsibility centre. The variance analysis can help managers either to change their activities to reach the budget or to revise their goals or plans (Lanen *et al.*, 2011:12, 13).

Fourie and Opperman (2011:122) stated that the budget is the most important mechanism to give effect to a municipality's service delivery strategies. The annual budget provides the tool for implementing the Integrated Development Plan (IDP), which is the strategic plan of the municipality. The annual budget must therefore be output driven and the intended outcomes must be in line with the service delivery objectives defined in the IDP. The Service Delivery and Budget Implementation Plan (SDBIP) is the most important budget management tool as it is a detailed plan for implementing the municipality's delivery of municipal services and the annual budget over the next 12 months. It measures the compliance with the intended utilisation of allocated resources and the extent to which performance targets for each revenue source and expenditure votes are met (Fourie & Opperman, 2011:185). No municipality can thus provide sustainable effective services to the community residing in its jurisdiction area if it does not have a clear understanding of the importance of drafting an economically sound budget based on the IDP, and to implement an internal budget control function as part of

financial administration to measure and report variances between the budgeted and actual performance outputs and financial results.

According to Fourie and Opperman (2011:492) the annual budget has to be designed in such a way so as to assist management in the planning, co-ordination and control of the various functions and activities of the municipality. Budget control is seen as "the watchdog" to make certain that what is budgeted for a specific activity or function actually is achieved within the context and timeframe planned. If variances are identified which are so substantial that future service delivery could be negatively affected, corrective actions immediately should be implemented.

3.2 LEGISLATIVE FRAMEWORK

3.2.1 Background

A policy framework — consisting of legislation and policies — was developed for municipal finance. This framework contains the government intentions with regard to municipal financial management and administration (Khalo, 2007:191). These legislation and policy documents were enacted and phased in over a period. The South African Constitution established the foundational provisions of local government and the subsequent acts regulate the activities and overall functions of local government. The core of local government law in South Africa is the Constitution and all existing local government laws are based on the constitutional framework.

Substantial changes to the institutional and legislative frameworks in existence prior to the 2000 local elections were needed to transform the local government system. New local government legislation replaced the previous provincial fragmented legislation for each step in the transformation process. A new framework for municipal finance management was also developed to address the various causes of financial problems at municipalities (Fourie & Opperman, 2011:2).

The local government system, as enshrined in the Constitution, is also supported by further state-of-the-art legislation, primarily in the form of the Local Government: Municipal Structures Act, the MSA, the MFMA and the Local Government: Property Rates Act. According to Ababio (2007:3) these acts also set out the objectives and financial management framework of municipalities, from which municipalities should develop sustainable financial stability and exercise its constitutional mandate.

3.2.2 Constitution

Section 40 of the Constitution of the Republic of South Africa, Act 108 of 1996, created the national, provincial and municipal spheres of government as three distinctive, interrelated and interdependent levels in a system of co-operative government (Pauw *et al.*, 2009:34). All municipalities, the Tlokwe City Council included, are established in terms of section 155 of the Constitution. In section 151 it is stipulated that local government must deliver goods and services to their respective communities on behalf of the other spheres of government. National and provincial government may not negate the right of municipalities to employ their powers and fulfil their functions. Section 152(1)(b) stipulates the sustainable provision of services to communities as one of the constitutional objectives of municipalities.

Section 152 cautions local government to strive, within its financial and administrative capacity, to provide services to the communities in a sustainable manner and to reach its objectives. A democratic and accountable government must be provided for the local communities (Ababio, 2007:7).

Municipalities have executive and legislative authority in their demarcated areas and have the right, to administer local government matters listed in schedule 4(b) as shared competencies and in schedule 5(b) as exclusive competencies of local government; as well as any other matter assigned to it by national or provincial legislation. The municipality's mandate to fulfil its developmental duties is entrenched in the Constitution. To attain this mandate administration, budgeting and planning must be structured in such a way so as to give priority to the basic needs of the community and to promote social and economic development (Fourie & Opperman, 2011:5).

Various aspects of municipal finance are also dealt with in the Constitution, including the principles of municipal financial management and administration in section 195(1) and the municipal budget, revenue and expenditure in sections 160(2), 215 and 227 (Khalo, 2007:191).

The Constitution is the basis for the municipal finance framework and when dealing with disputes between the different spheres of government or within the municipality between different stakeholders regarding municipal financial management issues, the provisions and the principles of the Constitution will provide guidance (Pauw *et al.*, 2009:256).

3.2.3 Local Government: Municipal Structures Act

The Local Government: Municipal Structures Act, 1998 (Act 117 of 1998) indirectly affects municipal finances as it stipulates that the executive committee must recommend the direction, strategies, programmes and services the municipality must adhere to, to address the needs of the community via the integrated development plan. It also recommends the estimated revenue and expenditure for the Medium Term Revenue and Expenditure Framework (MTREF) (Ababio, 2007:7). The Local Government: Municipal Structures Act also stipulates that a system of delegations must be developed to maximise administrative and operational efficiency (Van der Walt, 2007:56).

According to Pauw *et al.* (2009: 258) the different types of municipalities provided for in the Constitution as well as in the Local Government: Municipal Structures Act determine the context and the environment within which the municipalities must manage their finances. An appropriate division of powers and functions between the different categories of municipalities is also addressed in the Local Government: Municipal Structures Act (Fourie & Opperman, 2011:6).

Section 155 of the Constitution establishes the following three distinct categories of municipalities:

- a Category A municipality is a metropolitan municipality with exclusive authority to make by-laws for its areas of jurisdiction;
- a Category B municipality is a local municipality which shares authority with the district municipality within whose area it falls; and
- a Category C municipality is a district municipality with authority to administer and to make by-laws in its demarcated area, which includes more than one local municipality, and it shares authority with the local municipality within its area (SALGA, 2011:6). According to schedule 4b of the Constitution a district municipality assists the local municipalities in its area with the performance of shared competencies.

Currently, from 19 May 2011, there are in total 278 municipalities; 8 Category A metropolitan municipalities, 44 Category C district municipalities and 226 Category B local municipalities (Municipal Demarcation Board, 2013).

The Tlokwe City Council is a Category B local municipality which shares municipal, executive and legislative authority with the Dr Kenneth Kaunda District Municipality (Category C), within whose demarcated area it falls.

The Dr Kenneth Kaunda District Municipality consists of the following four local municipalities: Tlokwe City Council, City of Matlosana (Klerksdorp, Stilfontein, Orkney and Hartbeesfontein), Ventersdorp, and Maquassie Hills (Makwassie and Wolmaransstad).

3.2.4 White Paper on Local Government

In 1998 the White Paper on Local Government directed how municipalities should integrate development planning with community-based goals and needs. This White Paper prepared the way for legislation for long-term financial management solutions for the various financial challenges municipalities were experiencing. According to Pauw *et al.*, as quoted by Ababio (2007:7), the indicated planned legislation was needed to restore financial discipline, to eliminate the ever-increasing consumer debt and to generate the necessary cash flow to implement the developmental projects of municipalities.

3.2.5 Local Government: Municipal Systems Act

The Local Government: Municipal Systems Act, 2000 (Act 32 of 2000) can be seen as the foundation on which the new local government system is built. This Act stipulates the processes and principles of the internal systems as well as the duties of the administration of a local government to give meaning to developmental local government, to empower municipalities to provide basic services and to work towards social and economic upliftment of the community (Van der Walt, 2007:58; Fourie & Opperman, 2011:6).

Section 73(2) of the MSA (chapter 8) elaborates on the constitutional objective that municipalities must deliver services which are equitable and accessible to all and that these services must be provided in a manner conducive to the prudent, economic, efficient and effective use of available resources.

Sections 74 and 75 of the MSA determine the requirement for a tariff policy for levying of fees for municipal services and section 96 stipulates that municipalities must collect all

monies due and payable to them and a credit control and debt collection policy needs to be approved by Council and be promulgated as a municipal by-law.

Close linkages exists between the MSA and other legislation, especially the MFMA. The planning and budget process, supply chain management and roles and responsibilities of stakeholders are contained in both acts and are complimentary to each other. These sections must be read together to get a clear understanding of the intent and application of the acts (Fourie & Opperman, 2011:8).

Figure 3.1 indicates the various pieces of local government legislation which emanated from the Constitution.

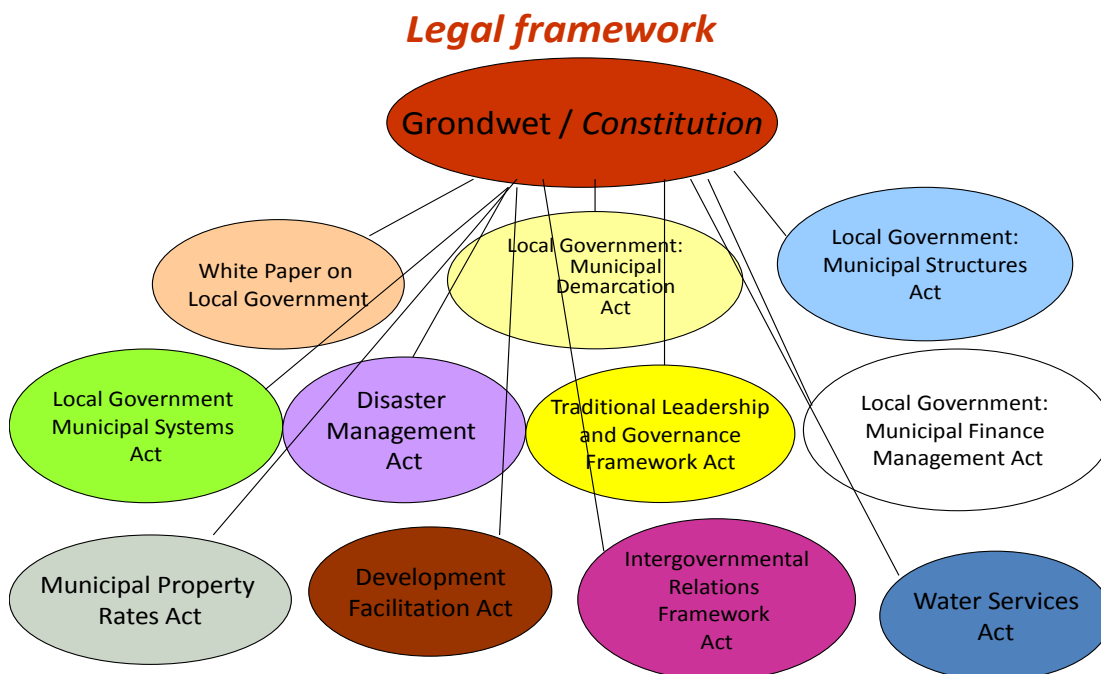


Figure 3.1 Legal framework

Source: Presentation given in 2009 to law students of the North-West University (Potchefstroom campus) by Mr BHG Groenewald, Manager: Office of the Speaker of the Tlokwe City Council.

3.2.6 Local Government: Municipal Finance Management Act

The Local Government: Municipal Finance Management Act, Act 56 of 2003 is a critical component of the legislative reforms and transformation framework as contained in the White Paper on Local Government in 1998. The MFMA provides the foundation for

sound financial management principles, practices, norms and standards in the local government sphere (Ababio, 2007:8; Khalo, 2007:192).

According to Van der Walt (2007:61) the vision or aim of the MFMA is to modernise the budget and financial management practices in municipalities in order to maximise the financial capacity of municipalities to deliver services to the community and to give effect to the principle of transparency. The MFMA, together with the Local Government: Municipal Structures Act and the MSA, aims to transform local government to become more participatory, transparent and accountable.

The five underlying principles of the MFMA, which form the basis of the key financial reforms envisaged in the Act, are as follows (Van der Walt, 2007:62; Fourie & Opperman, 2011:9):

- Promoting sound financial governance by clarifying roles;
- strategic approach to budgeting and financial management;
- modernisation of financial management;
- promoting co-operative government; and
- promoting sustainability.

According to Khalo (2007:192) and Fourie and Opperman (2011:11) the main purpose of the Act is to regulate and to secure sound and sustainable municipal financial management by means of establishment of rules and standards for appropriate lines of responsibilities, municipal budgets, financial statements and management of revenues, expenditures, assets and liabilities and the handling of all financial dealings of municipalities and municipal entities. The MFMA took effect on 1 July 2004 (National Treasury, 2004:1).

3.2.6.1 Contents of the Local Government: Municipal Finance Management Act

The MFMA consists of 16 chapters of which chapters 4, 7 and 8 are the most relevant for the purpose of this study.

- Chapter 4 determines all issues relating to budgets, including their content, funding and approval, responsibilities, capital projects, adjustment budgets and unauthorised, irregular or fruitless and wasteful expenditure.

- Section 53 and section 54 in chapter 7 contain the responsibilities of the mayor with regard to the budget processes and budgetary control as well as early identification of financial problems.
- In terms of chapter 8, sections 62 and 65 of the MFMA, the Chief Financial Officer has an important functional responsibility to assist the municipal manager to carry out his/her financial management responsibilities that include budget formulation and preparation, in-year reporting and the design, implementation and ongoing maintenance of the internal control procedures. (According to section 1 of the MFMA the municipal manager is defined as the accounting officer.)

In sections 62–70 the MFMA requires that the accounting officer takes responsibility for managing revenue and expenditure, cash and banking, investments, borrowings, assets and liabilities, including the establishment of appropriate internal controls and financial management systems, subject to certain delegations of responsibility. The responsibility of the Chief Financial Officer for internal control arises from the delegated authority received from the accounting officer. The Chief Financial Officer must provide direction and guidance to achieve sound financial management practices by implementing relevant policies and procedures. Monitoring systems to ensure compliance to such guidelines and policies must also be implemented.

3.2.6.2 Local Government: Municipal Finance Management Act: regulations and circulars

In addition to the MFMA, certain regulations and circulars are issued to supplement the provisions of Act. The regulations carry the same authority as the MFMA but the circulars are only intended as guidance until the municipalities adopt these circulars by council resolution (PricewaterhouseCoopers, 2009). From 2005 until the middle of 2013 68 MFMA circulars were issued by National Treasury dealing with various aspects of the MFMA, for example guidelines regarding the budget key focus areas, economic and headline inflation forecasts, restrictions on percentage tariff increases, new formats and tables for budgets and annual reports, clarifying descriptions of various sections of the Act as well as guidelines and format of financial statements of the General Recognised Accounting Practice (GRAP).

Several regulations were gazetted prescribing the processes to be followed in supply chain management, investments, debt disclosure, minimum competency levels of

financial officials and senior personnel, asset transfer, property rates, and budget and reporting.

The Municipal Budget and Reporting Regulations were gazetted on 17 April 2009 with effect from 1 July 2009. These regulations stipulate the budget and adjustment processes and the budget reporting process. Section 7 also determines that the municipal manager must ensure that 26 budget-related policies must be prepared and amended on an annual basis, in accordance with legislation applicable to those policies.

Internal controls can only be effective if these policies and procedures are documented, approved by Council and communicated to all relevant staff. If any changes occur in the municipal environment or applicable legislation, these policies and procedures, as part of the internal control system need to be reviewed.

Existing internal controls must be evaluated if they are still appropriate and the risks facing the municipality may necessitate changes to the internal control system.

3.2.7 Effect of legislation on audit opinions

Every municipality is required to operate within legal parameters, which include relevant legislation applicable to the various departments or services rendered by the municipality, by-laws, financial and other pieces of legislation. Although the municipality must comply with all the applicable legislation, in 2011 senior management of the Tlokwe City Council has revealed in a situational analysis session that the application of certain laws is not co-ordinated and in certain instances an overregulation of the activities of the municipality hampers service delivery (Tlokwe City Council, 2011e:8).

In the Audit Report for the Tlokwe City Council regarding the 2010 financial year the Auditor General listed eight findings in non-compliance of the MFMA and six findings of non-compliance with regulatory requirements with regard to his audit of predetermined objectives.

3.3 BUDGET FORMULATION

3.3.1 Importance of budgeting

Budgets are defined by Vanderbeck (2010:337) as planning instruments used by companies to assist in setting goals and to be utilised as a device against which actual results can be measured. Brock *et al.* (2007:482) extends the definition of the budget

by including a specified period of time to the quantified plan and the CIMA study guide (2009:228) compares a budget for a forthcoming accounting period to a forecast which is seen as an estimate of what is likely to happen in the undefined future. Coombs *et al.* (2005:90) describe a budget as a financial plan but expand it by including non-financial quantitative terms such as units of sales and labour hours. These quantitative units have a direct effect on the financial budget and can thus be seen as a subset of the budget. The budget is also seen as a road map that indicates the way to managers as well as cautioning them when they deviate from the planned route (Vanderbeck, 2010:338). Brock *et al.* (2007:497) refer to the budgeting process as the most important aspect of cost accounting to management.

Coombs *et al.* (2005:90) see the planning process taking place on different levels, namely, on strategic, tactical and operational levels. The financial part of each planning process is known as budgets although at the strategic and tactical levels the term financial planning is preferred.

Budgeting is seen as one of the most important business activities and requires the necessary attention of managers in both the private and the public sectors. In the private sector a master budget is seen as part of the overall organisational plan for the next financial year consisting of organisational goals, a strategic long-range profit plan and the actual tactical short-range profit plan (Lanen *et al.*, 2011:474). The overall budget and planning process in local government is similar as it also consists of a five-year plan, the IDP, a three-year MTREF budget and the actual one-year SDBIP.

Organisations prepare budgets for various reasons of which co-ordination of activities, communication of top management objectives to staff, motivation of staff to reach the continuous improved standards, allocation of resources to departments or sections of the organisation and performance measurement are seen as the most important reasons for budgeting (Adams *et al.*, 2003:329-31).

3.3.2 Budgeting process in local government

Pauw *et al.* define a budget in the public section as

"a financial plan for work to be done in the public interest with public money for a specific period estimating the revenue to be earned and expenditure to be spent as well as authorising certain expenditures" (2009:55).

In the government sphere, the budget serves as an expression of the voters' desires and as such, when approved, is a legally binding spending authorisation. Furthermore, especially in the local government sphere, the budget communicates the goals of the ordinary citizen by identifying the programmes that need to be funded. It also sets the limit to spending for the different activities and cost centres (Lanen *et al.*, 2011:493). As the public sector is "publicly owned" the goals and objectives of the public must be contained in the budget. Profit maximisation is not the aim of municipalities but the optimum provision of quality services within the limited resources available (Coombs *et al.*, 2005:107, 108). The budgets of local government have to be designed in such a manner that it supports management with the planning, co-ordination and control of the different activities (Fourie & Opperman, 2007:492).

According to Pauw *et al.* (2009:294) a distinction must be made between the budgeting process and the budget cycle in local government. The budgeting process deals with procedures and processes, as determined by legislation, to prepare the budget and to get it approved in council. All the aspects involved in budgeting, from the initial planning phase until the final reporting stage, are included in the budget cycle.

The municipal budgeting process at large is similar to the principles applied in the budget process in the national and provincial sphere of government but are in some aspects unique owing to the distinctive nature of local government. The budget and planning process needs to be integrated by ensuring that the capital and operational budget is linked to the outputs and outcomes as contained in the IDP. The IDP is a five-year strategic development plan that guides all planning and development in a municipality and all decisions regarding planning, development and management must be based on the IDP (Pauw *et al.*, 2009:278–9).

Maphiri (2011:36) explains that, following a world-wide trend, in the last two decades South Africa has embarked on a reform of the budgeting system of government. The overall aim is to improve efficiency and effectiveness in service delivery. Government initially started with line-item budgeting to ensure control over inputs as well as reforms to enhance fiscal discipline and controls to force expenditure to remain within the budget. In the next step in the budgeting reforms government departments had to submit strategic plans, which entailed the priorities they wanted to address in the next strategic planning cycle. These plans had to be aligned to the governments overall strategic plan. The last reform is the introduction of performance budgets where the

emphasis is placed on output and outcome-based measures and less focus on input-based measures. The last budget reform phase is not fully adopted in South Africa as non-financial performance is presented as a supplement to financial information and the audits done by the Auditor General are also predominately done on financial inputs and less on the service delivery outputs and outcomes. From the 2006 financial year the Auditor General commenced phasing in performance audits.

National Treasury establishes the financial targets to support planning in all three spheres of government (Pauw *et al.*, 2009:46). The budget reform process was introduced to local government through the guidelines provided by and the budget formats prescribed by National Treasury in MFMA Circular 28, dated 2005. The Municipal Budget and Reporting Regulations, 2009 also contain the format and tables in which the budget information regarding the annual and adjustments budget must be completed (Fourie & Opperman, 2011:175).

According to the MFMA, the executive mayor must guide and co-ordinate the budget process and must ensure that the budget complies with the budget requirements and be submitted to council for approval according to a scheduled time-table approved by council. The budget must be presented in a format prescribed by the National Treasury, consisting of an operating budget that sets out the revenue by source and expenditure for a three year period (MTREF) and a capital budget, which is in line with the IDP (Van der Walt, 2007:63). The community and all stakeholders affected by the budget and imposed tariffs on services need to be consulted before the budget is approved by council. The community participation process, for which resources must be made available, must also cater for capacity building for the community. Special needs of women, people who are illiterate or disabled and other disadvantaged groups must also be addressed (Fourie & Opperman, 2011:177).

Additional to the legal framework regarding the budget process, National Treasury also annually issues a Municipal Budget Circular providing guidance to municipalities for the preparation of their next Budget and MTREF. The national priorities, headline inflation forecasts, as well as guidance regarding to relevant key issues for the specific year, such as budgeting for free basic services, discretionary budget allocations, electricity tariffs, et cetera, are contained in these circulars. Tariff increases of municipalities higher than the headline inflation forecasts must be explained in detail to National Treasury, although its approval for the budget is not required.

Coombs *et al.* (2005:108) also observe that governments worldwide impose "top-down caps" on expenditure owing to their need to control costs within a framework of their long-term social and economic objectives. This approach may lead to a short-term, year-to-year approach towards the budget of the public sector. The incrementalism method used involves the practice of just increasing the budget of the previous year with the allowed increase percentage.

Overformalisation of the planning system, mainly in the public sector, may lead to a high degree of bureaucracy. This leads to expenditure which may not be committed to a project if it was not approved in the budget, over-rigid rules which are in place before a budget can be reallocated to another project or service, and it is much easier to obtain authorisation for smaller-scope capital projects than for more meaningful or strategic projects (Coombs *et al.*, 2005:108).

Unfortunately, in South Africa similar problems do exist with the local government budgeting process. Although the budgeting process of local government is legally prescribed in the MFMA and the annual MFMA circulars are serving as a guideline, the budget processes are not always followed diligently and the community's need for effective, efficient service delivery is not always addressed in the budget.

The Auditor General stated in his Audit Reports for several years for the Tlokwe City Council, as contained in appendix C, various findings of non-compliance to the MFMA legislation with regard to the budget process.

3.3.3 Budget cycle in local government

The budget cycle, according to Pauw *et al.* (2009:294), encompasses most of the financial management activities at local government; from the initial planning stage (IDP and budget) to the reporting stages — which include the monthly in-year reporting — up to the final financial statements at the end of the financial year. The accountability or budget cycle in local government is scheduled as follows:

Accountability Cycle

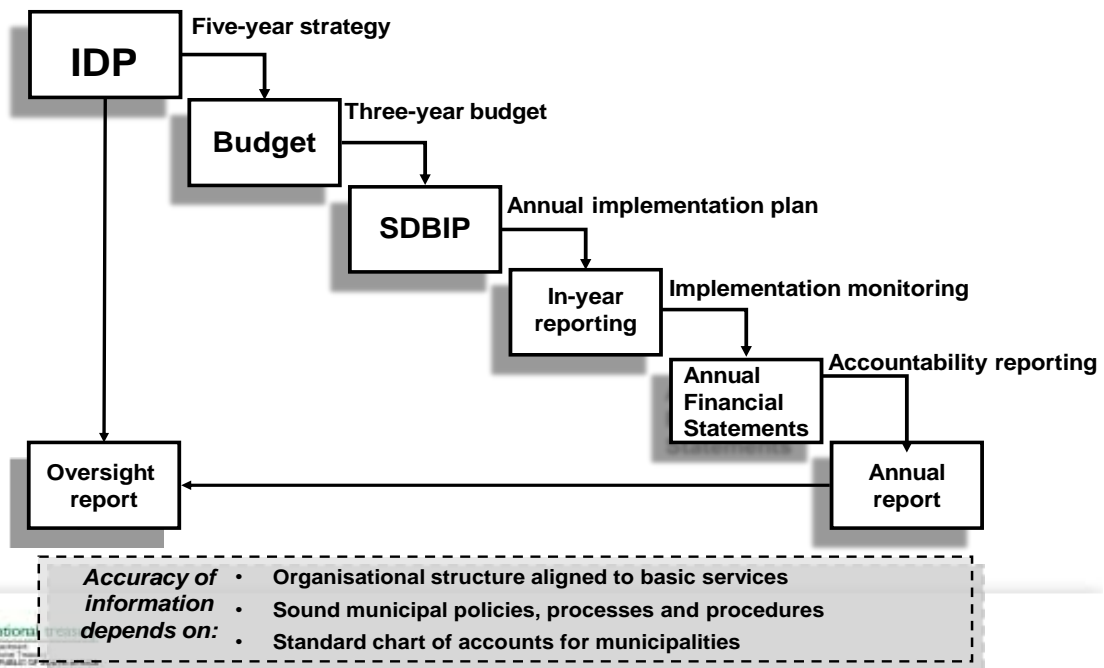


Figure 3.2 Accountability cycle in local government

Source: National Treasury (MFMA Circular 32, 2006:17)

The budget cycle consists of the following five stages (Pauw *et al.*, 2009:294–9):

- The budget preparation stage amounts to a period of eight months, from July–August when the mayor tables the time schedule with key deadlines for the budget process, the budget compilation, the review of the IDP and budget related policies until February–March when the draft budget is tabled in council.
- The second phase of the budget cycle is the adoption by council of the budget after the community was consulted regarding the budget and the associated municipal tariffs that will be enforced from the start of the new financial year.
- The budget implementation stage involves the publication of the budget in the printed media and on council's website, the submission of the budget schedules to National Treasury, the signing of performance contracts with senior managers, the submission of the SDBIP to the mayor and the recording of the budget allocations per vote and line item on the financial accounting system.
- The fourth stage in the budget cycle is budget control and this stage extends over the full twelve-month period of the financial year. Budget control consists of

variance analysis to ensure that actual expenditure does not exceed budgeted expenditure and its aim is to ensure accountability. Monthly, quarterly and mid-year reports must be submitted to the mayor.

- The last stage in the budget cycle consists of the drafting of the financial statements as well as performance reports at the end of the financial year to be submitted to the Auditor General for the statutory audit. In January the annual report, that includes various documents as the audited financial statements, the Auditor General's audit report and the performance report, must be tabled in council. After the oversight committee has scrutinised the annual report, it recommends to council whether to adopt the annual report with or without recommendations for actions to be taken to ensure an improved audit report in the future.

3.4 BUDGETARY CONTROL

3.4.1 Importance of budgetary control

The budget is seen as the foundation of a company's financial control system as well as a control device. The budgetary control system is the actual results compared to the budgeted goals and corrective actions taken to rectify the variations (Brock *et al.*, 2007:482, 494). After actual results are compared with the budget, managers can change their activities to reach the budget or they can even revise their plans or goals (Lanen *et al.*, 2011:13). Otley (1995:30) sees budgetary control as very important in the establishment of effective organisational control and the sole formal control mechanism at senior management level. Even in Japan the importance of the use of budgeting for cost planning and control is acknowledged and is seen to control costs and is crucial in the planning process (Sakurai & Scarbrough, 1997:27).

Budgetary control, according to Leitch (2003:2), is any approach management undertakes to set targets, to measure these targets against the actual outcomes and to motivate the staff to reduce these variances. Budgets, but also a combination of financial and non-financial targets, can be used in this control mechanism. Ababio *et al.* (2008:8) also observe that no financial control system can be used more effectively than the budget.

3.4.2 Process of budgetary control

In local government, after the budget allocations were implemented, managers must exercise control over their allocated budgets as they are accountable for the revenue and expenditure. The budget control stage of the budget cycle consists of monthly, quarterly, and mid-year reports and at the end of the financial year, the financial statements as contained in the annual report. For variances identified between the actual and budgeted figures, both in revenue and expenditure, reasons have to be provided. Managers must ensure that the actual expenditure does not exceed the budget and that they stay within the monthly cash flow provision. After the municipal manager submitted the mid-year report, the mayor will consider whether the budget is implemented according to the SDBIP and if needed, an adjustment budget and revisions to the SDBIP, in terms of section 28 of the MFMA, is recommended (Pauw *et al.*, 2009:297-8). According to Pauw *et al.* (2009:74) the control phase runs concurrently with all the phases in the budget cycle as the budget is an *ex ante* control measure, thus a control measure before the fact. The budgetary control phase in the government sphere is finally completed when the legislature or municipal council adopts the audit reports from the Auditor General.

3.4.3 Advantages and disadvantages of budgetary control

Several advantages and weaknesses were identified in budgeting and budgetary control. Ehlers and Lazenby (2010:337) mention that a budget does support strategy implementation if senior management is dedicated to budgeting. Budgets are based on the short-term goals of the organisation and a comparison between the operating results and the budget is made on a regular basis. The value of a budget as a resource allocation plan lies in its alignment with the organisation's strategic goals and objectives. According to Ehlers and Lazenby (2010:338), should too few resources be allocated in a budget, strategy implementation efforts will be hindered. On the other hand, allocation of too many resources will waste costly resources and will reduce financial performance.

Carter *et al.* (1997: chapter 4:2, 3) identify the following budgeting and budgetary control advantages:

- It compels management to think about the future and to formulate detailed plans to achieve the targets set out for the various departments or cost centres.

- By participating in the budget process, managers learn to plan ahead. This promotes co-ordination and communication between them. For example, the department of housing cannot plan for new housing projects if the department of infrastructure has not included provision for services for the area where the houses are supposed to be built in its budget.
- Budgeting clearly defines areas of responsibility and managers are required to achieve the budget targets set for the operations or services under their control.
- Through budgetary control a performance appraisal method is established. Variances between the budget and actual results can be determined and the reasons provided for these differences can be separated between controllable and uncontrollable factors.
- Remedial action can be implemented when variances are identified.
- Budgeting also improve allocation of scarce resources. By setting targets for their budgets, personnel are motivated to reach the targets.
- Budgetary control has the additional benefit that it cuts down on management time by using the principle of management by exception. Only variances over a specific percentage, 5% or 10%, or a predetermined amount, are investigated.

A number of disadvantages of budgeting and budgetary control are also identified by Carter *et al.* (1997: chapter 4:3):

- In the field of marketing or sales, budgets can be seen as pressure measures used by management resulting in bad labour relations and incorrect record-keeping.
- Budgets cause friction between managers owing to disputes over the allocation of resources. "Empire building" does occur especially in the personnel budget. Managers inflate their budgets as they anticipate that it will be either decreased ("cut") by the budget committee or they will not be blamed for overspending at the end of the financial year. Pauw *et al.* (2009:84) describe the politics or competition in budgeting of public money as not only legitimate efforts to convert the policy of the ruling party into feasible programmes but also as a competition for power and resources as well as the power of the control over resources.
- On the other hand, at the end of a financial year waste of resources does arise as managers take the view that they should "spend it or lose it" or, alternatively, by spending their entire budget they prevent being blamed for underspending. "Fiscal

dumping" also occurs at the Tlokwe City Council as results of prior years clearly indicate that the expenditure payments (excluding purchase of bulk electricity) in June, the last month of the financial year, are substantially higher than payments done in the previous months.

- Budgetary control conflict also arises between departmental managers as accusations occur, should targets not be met and should costs be shared (for example electricity consumption in a building is allocated to various departments). The dilemma exists between responsibility versus control of a specific activity or cost item.

The following four fundamental weaknesses with budgetary control are identified by Leitch (2003:6):

- Action is only taken after a variance occurred.
- Often, owing to lack of time and resources, no action is taken to get the project or business back on track to reach the desired outcome.
- If the variance is better than expected owing to budgetary control, the normal reaction is to ease off and put more effort into projects or activities which show a negative variance.
- Budgetary control suppresses uncertainty as management is unwilling to discuss outcomes other than the planned outcomes.

3.4.4 Budgetary control in local municipalities

According to Fourie and Opperman (2010:492) budget control in municipalities is seen as a "watchdog" to ensure that what is planned and financially provided for, is actually done in that specific financial year. If variances between budgeted targets and actual results are identified, reasons have to be provided and if the variances are so significant that future service delivery can be affected, remedial action needs to be taken. Van der Walt (2007:62) maintains that, according to the MFMA, the executive mayor or the executive committee has to oversee the performance of the administration of a municipality in relation to the budget and the implementation plan for service delivery through monthly progress reports. The Council — as part of its responsibility — holds the mayor and senior managers accountable on the basis of quarterly performance and financial reports as well as the annual reports.

Maphiri (2011:37) formulates in-year management control as the management process of monitoring the actual service delivery against the budgeted activities and if material variances do occur, management must initiate corrective measures to ensure that the service delivery and expenditure realise as planned. An adjustment budget or adjusted service delivery plans can also be submitted for approval.

Van Wyk and Kroukamp (2007:266) observe that budgetary control in government departments is extremely difficult to exercise without a cost-benefit analysis for all services to determine which services are delivered in a more cost-effective manner and which services are not, and without knowledge of the relationship between activities and costs.

In the United States of America, according to Bradley (2002:1), budget director of Maricopa County, a budget serves as an internal control method by establishing legal limits to authorised expenditures and as a plan to meet the objectives of the organisation. Similar to South Africa (section 32 of the MFMA), legislation in the United States of America prohibits expenditures to exceed the total budget. With the approval of the budget by the County Board, a maximum amount is set for all spending as well as for the amounts on items within the overall budget.

3.4.5 Causes of budget deviations

The main objective of budgetary control is to compare the actual results with the budgeted goals and then to identify the reasons why these deviations have occurred.

National Treasury (2000) as quoted by Maphiri (2011:37) recognised four main reasons for the occurrence of deviations. Two of the causes — error in capturing of transactions into the accounting system and transactions that still have to be captured into the system at the end of the specific monitoring period — are related to the integrity of the financial system. These causes can be solved by realignment of the data capturing process and better audit of the correctness of the data to be captured.

The other two important causes for deviation are unforeseen events that have occurred during the financial year as well as incorrect anticipation of events at the beginning of the year. Unforeseen events are out of the control of management as they are mostly external to the organisation but incorrect anticipation of realised revenue and expenditure is a managerial and political problem, according to Maphiri (2011:37, 38). He explains that this incorrect anticipation of events at the beginning of the year can be

eliminated if managers co-ordinate and communicate their plans and activities with other departments during the budget process. Results of internal co-ordination and communication deficiencies are overexpenditure or underexpenditure of the budget, as contained in audit findings.

To determine how effectively the budget is utilised as an internal control technique, management needs to investigate the following: whether the budget is correctly allocated and all the transactions are captured accurately in the correct financial period; whether the revenue and expenditure figures are projected for the rest of the financial year; and, should problems be identified, whether action is taken to rectify the situation. Any variances identified are made the responsibility of key individuals — such as departmental or section managers — who either can exercise control or can request additional funds in the Adjustment Budget or transferring funds (virement) between various accounts.

According to section 28 of the MFMA an Adjustment Budget is submitted annually at the end of January to the Tlokwe City Council for approval. As indicated in the 2009–10 Audit Report (Tlokwe City Council, 2011c:163), the budget for the 2010 financial year was overspent with R45,96 million and the budget of departments that affected service delivery was underspent by R17,3 million. These findings of the Auditor General indicate that the budgetary control system is not effective enough to implement remedial action when variances between the budget and the actual results are reported to management.

3.5 INTERNAL CONTROL

3.5.1 Background

Internal control, according to Gray and Manson (2008:289), is the process designed by management to provide reasonable assurance that the organisation performs against its objectives, that reliable financial reporting is provided, that effective and efficient operations are provided as well as that the organisation complies with applicable laws and regulations. Internal control is thus a key foundation of good governance.

Internal control is not limited to the financial field but also includes information technology, human resources, et cetera (PricewaterhouseCoopers, 2009:2). Smith (2005:190) extends the internal control process from policy and procedure manuals and internal audit also to embrace the organisational goals as well as all the employees,

irrespective of level, who are tasked to achieve these goals. As the organisational goals must be achieved, internal control is seen as a strategic process. The King II report indicates that internal controls and risk management must be practised by all personnel and it should be part of the day-to-day activities. Internal control has to change to be effective as the environment and the needs of local government change (Fourie & Opperman., 2011:437). Brock *et al.* (2007:483) refer to control as the way managers can ensure that all activities in the company are functioning properly and that the objectives, as identified in the planning stage and contained in the budget, are met. The description of control of public money by Pauw *et al.* (2009:42) includes measure of actions against standard prescriptions for behaviour. These prescriptions for behaviour can be in the form of legislation such as the PFMA and MFMA, policies or in procedural manuals.

The purpose of the system of internal control is to provide reliable financial information, data and reports. Internal controls must also promote operational efficiency and effectiveness, safeguarding assets and records, ensure compliance with relevant laws and regulations, guard against the misuse of resources as well as encourage staff to adhere to prescribed, council-approved policies (Fourie & Opperman, 2011:438).

3.5.2 Elements of internal control

Internal control has five interrelated components, consisting of the control environment, the risk assessment process, the information system, control activities and the monitoring of controls. The control environment relates mainly to governance and management functions, management style and organisational structure, the system of delegation, and policies and practices of human resources. The control environment sets the tone of an organisation and lays the foundation for all other components of internal control, providing discipline and structure (Vanstapel, 2004:13–14; PricewaterhouseCoopers, 2009:2–3).

The risk assessment process is first to identify and analyse business risks relevant to the achievement of financial and other reporting objectives and then to form a basis of how these risks must be managed. The information and communication component relates to the procedures and records used by the municipality to process and to record transactions. Included in the information system are all the related business processes relevant to financial reporting and communication.

Control activities are policies and procedures which ensure complete and accurate financial reporting and that controls are in place to achieve internal control objectives and to address the risks identified. These controls include performance reviews, physical controls, procedures of authorisation and segregation of duties, security of assets as well as reconciliation of accounts. Control activities can be preventive and/or detective. The monitoring of controls assesses the effectiveness and the performance of the current internal controls over time and the internal or external audit can be tasked to perform this function (DiNapoli, 2007:4, 19; Gray & Manson, 2008:289; PricewaterhouseCoopers, 2009:2–3). Section 165 of the MFMA regulates the function of internal audit in municipalities.

3.5.3 Internal control in local government

Gyüre (2012:173) warns that the financial risks in local government have reached such a high level that it not only poses a threat to local government but also to the total national economy. Internal controls will assist in addressing these risks.

Internal financial control, efficient and effective operations as well as financially sustainable service delivery are some of the categories of objectives that municipal internal control processes need to assess (PricewaterhouseCoopers, 2009:1). According to Laubscher and Van Straaten (2009:93) statutory financial control in local governments consists of external and internal components, of which preparation of the budget resorts under the external component and internal auditing as part of the internal component. In order to be accountable to the public, municipalities must implement an effective internal financial control system (Laubscher & Van Straaten, 2009:97). The public sector has to rely on an efficient and an effective internal financial control system to account to the public with regard to utilisation of public resources and the progress of service delivery (Ababio, 2007:4, Ababio *et al*, 2008:4). The control function in the public sector is necessary to ensure that, *inter alia*, the limited human and material resources are effectively used and that wastage is eliminated. The requirements for accountability to the public are complied with by the activities of the internal control function (Kakumba & Fourie, 2008:122).

The implementation of an effective and efficient internal financial control system for both the private and the public sectors is very important as internal financial control is seen as one of the key elements of good governance. As the community demands enhanced service delivery, an internal financial control system will provide the required information

for governance and accountability in the public sector (Fourie, 2007:733). According to Van der Nest *et al.* (2008:545) an effective internal control system and sound governance need to be applied by managers in the public sector in their respective responsibility areas, as an increase in accountability is clearly essential for good democracy as well as for improved service delivery.

Internal control, according to Fourie and Opperman (2011:438), is a process implemented by the management of the municipality to provide reasonable assurance of the achievement of the following categories of objectives:

- internal financial control;
- accountability and corporate governance;
- reliability of financial reporting;
- effectiveness and efficiency of operations; and
- compliance with applicable legislation and regulations.

Internal control is thus the plan of the organisation with all the co-ordinated systems implemented by management to achieve the above-mentioned objectives.

In her letter to the Mayor and Council of the City of Berkeley in California (2003:1) Hogan highlighted that the council and the city manager are responsible for maintaining a system of internal control to prevent unreasonable loss or misuse of assets, loss of public confidence in the City of Berkeley as well as failure effectively and efficiently to deliver mandated services to the community. The oversight of the council is part of the internal control system.

3.5.4 Failures in internal control

Smith (2005:193) quotes Cullen *et al.* (1994) that internal control failures are mainly owing to the following five eventualities: lack of integrity of top management, a weak control environment, inconsistent or unrealistic objectives, communication breakdown and the inability or inflexibility to react appropriately. Huefner (2011:1) reports that inadequate monitoring leads to internal control weaknesses which can lead, *inter alia*, to fraud, waste, loss or inefficient use of municipal resources and can thus increase the tax burden of the community. According to Agu (2002:2) the implementation of internal control measures will prevent fraud in local government.

The Auditor General did not express a separate opinion on the effectiveness of internal control in the 2009–10 Audit Report of the Tlokwe City Council, but did mention that internal control deficiencies can be directly linked to the basis of the qualification on the financial statements, the findings on predetermined objectives and the compliance with applicable legislation (Tlokwe City Council, 2011c:166).

Although no opinion was expressed over the effectiveness of the internal control system of the Tlokwe City Council, it is clear that deficiencies do exist and that these deficiencies need to be identified and to be corrected before a clean audit can be achieved.

Municipalities in the North West Province were also warned by the Auditor General (2011b:52) that their audit opinions will not improve if the necessary internal controls are not implemented. The Council and senior management must ensure that even the most basic of controls, as for example monthly reconciliations, are implemented as these internal controls are designed to ensure an environment of sound financial management. In his report the Auditor General concluded (2011b:77) that good leadership, quality financial and performance management as well as strong governance are the three crucial elements that could ensure that municipalities can obtain a clean audit and a sustained clean administration by 2014. The municipalities must therefore implement the basic financial and performance reporting controls as a matter of urgency.

3.6 BENCHMARKING

3.6.1 Background

Nick Griffin, General Manager of New Zealand Registry Services, addressed the Internet Corporation for Assigned Names and Numbers (ICANN) Congress in Wellington, New Zealand in March 2006 (2006:4) with regard to the benefits of benchmarking. According to him, benchmarking is the process of identifying, sharing and using knowledge and best practices as well as the measurement of the organisation's own processes and practices against defined standards. Naidoo and Reddy (2008:39) state that benchmarking is an effective mechanism for continuous improvement. Through the process of benchmarking an organisation can identify what needs to be changed, how can it be changed and what the benefits for the organisation will be if the changes are made. According to Schwalbe (2010:299) benchmarking

generates quality improvement ideas through the process of comparing specific characteristics of a project or product with other projects or products within or outside the organisation.

Ehlers and Lazenby (2010:369) stress that an organisation can only achieve strategic success over the long term if the organisation continuously improve its strategic management activities. This continuous improvement can only be done by adopting several practices such as re-engineering and benchmarking. According to the Centre for Municipal Research and Advice (Centre for Municipal Research & Advice, 2010:38) benchmarking in local government in South Africa is a new management tool which involves a self-assessment process; which leads to comparing the municipality's own management processes and achievements in the provision of service delivery with that of other municipalities — especially those with good practices — to identify ways to improve its own performance. It has specific benefits in the implementation of policies in local government. This self-assessment is seen as an effective method to identify gaps and challenges in the performance of the municipality and then to recognise solutions to attend to the challenges.

3.6.2 Benefits of benchmarking for local government

Amongst the various benefits of benchmarking for municipalities identified by the Centre for Municipal Research and Advice (2010:39), the most important benefits acknowledged for this study are that benchmarking with other municipalities will encourage the Tlokwe City Council to identify gaps in know-how and opportunities to learn, to identify gaps in performance, strengths and weaknesses and to encourage the Tlokwe City Council to become open to new ideas, policies, processes and practices to improve effectiveness, efficiency and better performance; ultimately to reach the objective of a clean audit report by 2014.

Benchmarking as a management tool can only be successful if it has the support and commitment of senior management, if the municipality understands and knows its own policies and practices, if benchmarking is part of teamwork and if it is done periodically and not just the once (Naidoo & Reddy, 2008:39; Centre for Municipal Research & Advice, 2010:39).

3.7 SERVICE DELIVERY OF LOCAL GOVERNMENT

Laubscher and Van Straaten (2009:93) link the success or failure of local government in South Africa to the financial management, control and responsibility in the municipality. According to Ababio *et al.* (2008:4–6) municipalities in developing countries experience the same challenges as municipalities in South Africa. One of the challenges is that the ability of municipalities to deliver services is dependent on the management of revenue and expenditure. As many municipalities are experiencing financial difficulties, owing to poor revenue collection, ever-increasing debt and lack of financial management skills, the provision of services, poverty alleviation and economic development is constrained (PricewaterhouseCoopers, 2009:32). Van Dijk and Croucamp (2007:664) acknowledge that the large-scale protests actions against the inability of municipalities to render services can be addressed by better management.

Another challenge is that the public sector worldwide, be it central government or municipalities, has to deliver services with fewer resources owing to political pressure to keep tariffs and costs low. The example of central government in the United States of America, which is transferring some of their responsibilities to municipalities without the provision of adequate resources, is also used by Cokins (2008:59). This "unfunded mandate" is also a challenge that local government in South Africa has to face. Maphiri (2011:36) emphasises that, should government want to improve the life of its citizens it has to deliver efficient, effective service.

Ababio (2007:4) goes so far to state that municipalities in South Africa are in a state of paralysis regarding service delivery and internal control compliance.

The Auditor General reported at a National Treasury meeting in September 2011 that for the 2010 financial year, 46% of municipalities had received audit findings in financial matters, 92% of municipalities in performance aspects and 95% of municipalities had received audit findings regarding compliance with laws and regulations. The statement of Ababio (2007:4) is thus still applicable, if the 2009–10 audit reports of municipalities are taken in consideration.

Regarding the performance of the Tlokwe City Council for the 2010 financial year, on predetermined objectives the Auditor General found non-compliance with regulatory requirements as well as useless or unreliable reported information. Eight findings were mentioned in the report of non-compliance with the MFMA.

3.8 SUMMARY

The aim of this chapter was to give a theoretical overview of the internal budget control function. Firstly, a literature review is provided regarding the legislative framework in which local government has to operate and, secondly, an overview is given regarding budget formulation, budget control and internal control processes in both the private and the public sectors. A brief description of what benchmarking and service delivery in local government entail is also provided. An important aspect of this chapter is to establish the link between budgetary and internal control.

Unfortunately, although the intention of the various local government acts that followed the White Paper on Local Government of 1998, such as the MSA and the MFMA, was to restore financial discipline and to eliminate or to decrease the growing consumer debt position, owing to the non-compliance of municipalities with the above-mentioned acts these needs were not met. Non-compliance with these acts is raised by the Auditor General as one of the major concerns. National Treasury also indicated — in its fourth quarterly report of the financial position of local governments in the 2011 financial year — that 66 municipalities are in financial distress and 167 municipalities reported a growth in debtors in that financial year. The total consumer debt figure for 278 municipalities on 30 June 2011 amounted to a staggering R64,6 billion (National Treasury, 2011a:13, 19).

It can be concluded from the literature review of internal control that internal control is an ongoing process and it is affected by people. People at all levels of an organisation, whether in the private or the public sectors, are involved in the internal control process, not only in the drafting and adjusting of the policies and procedure manuals but also in the adherence and monitoring of these control measures. If internal controls are not in place and the personnel do not adhere to it, no reasonable assurance can be given that the financial information provided is reliable, that legislation is adhered to and that the predetermined objectives are met. Without an effective internal control system, the endeavours to obtain a clean audit in 2014 will be futile.

It is clear from the literature review that direct links do exist between budget formulation, internal control, and budgetary control. Ababio (2007:4), Maphiri (2011:42), Fourie (2007:733) as well as Van der Nest *et al.* (2008:545) make the link between good internal control, accountability and the enhancement of service delivery. Ababio *et al.*

(2008:4) also stress that the internal control system of the public sector must be efficient and effective.

The aim of the MFMA and the budgeting reforms is to improve financial discipline and to ensure more efficient use of public funds. As the Tlokwe City Council has to adhere to the Clean Audit 2014 objective, it can only be achieved through the formulation and application of various budgetary and internal control policies. Budget control is more preventative in nature as it should prevent unauthorised expenditure and it should ensure that expenditure is spent on the correct projects, votes or departments. As indicated in the literature review, internal control is both preventative and/or detective. The current internal budgetary control systems, budget process, applicable policies, organisational structure, and system of delegations of the Tlokwe City Council need to be analysed and the shortcomings identified. As part of the analysis, the Auditor General's audit reports for the last five years also are scrutinised to determine which internal control deficiencies the Auditor General has identified and if any internal control policies implemented after the statutory audit have improved the audit finding in the following year.

In building on the subject matter, chapter 4 consists of the analysis of the audit findings on internal control weaknesses as well as audit findings on non-compliance with legislation at the Tlokwe City Council. The entire process of the budget with its legal requirements, the adjustment budget, internal budgetary reporting practices, the approved budget-related policies, system of delegations, organisational structure, and the internal budgetary control system of the Tlokwe City Council are investigated and are reported on in chapter 4.

CHAPTER 4

4. ANALYSIS OF THE INTERNAL BUDGETARY CONTROL SYSTEM

This purpose of this chapter is to discuss the internal budgetary control system of the Tlokwe City Council. The current policies, system of delegations, organisational structure and budget process of the Tlokwe City Council are investigated and are compared to the internal control weaknesses identified by the Auditor General in the final audit and management reports of the past three years. The audit findings relating to internal control deficiencies are investigated to categorise the shortcomings in the policies; the system of delegations; the organisational structure; internal budgetary reporting; the budget process; and budgetary control.

4.1 INTRODUCTION

Horn gren *et al.* (2009:36, 207) describe a budget as the most important planning tool of management and it quantifies the action plan in financial figures. A budget is also used as a tool to co-ordinate the actions which must be implemented to reach the plan. A budget is also used as a control tool as the actual performance can be compared with the budget (Horn gren *et al.*, 2009:36). According to Pauw *et al.* (2009:117) budgets are seen as vital components in the planning and controlling of activities of any public sector organisation. Budgets provide the necessary authority to national and provincial departmental managers as well as municipal managers to incur expenditure and to provide targets which must be achieved.

Maphiri (2011:37) emphasises that the in-year management of a budget and performance plans is a process of monitoring service delivery against the plans and to exercise control by taking remedial action to ensure that the planned service delivery and expenditure occur as planned or if variances realised, to adjust the budget or the performance plans.

The Auditing Standards of the International Organisation of Supreme Audit Institution (INTOSAI), as quoted by Cohen (2007:169), define internal control as the

"entire system of financial and other controls, including the organisational structure, methods, procedures, and internal audit established by the management to conduct the business of the entity in a regular, effective, efficient and economic manner" (2007:169).

According to Pauw *et al.* (2009:262), several organisational structures are relevant and needed when municipal financial management is involved. The political structures as the municipal council are involved with the formulation of all the policies of the municipality, including the financially-related policies and they have to oversee and ensure that these financial-related policies are implemented and complied with and the finance portfolio committee (Budget Committee) assist council with decision-making in all financial matters. Each municipality must also have organisational structures on the administrative level in place, as for example the Budget and Treasury office (Finance department), an internal audit section and an Audit Committee.

4.2 AUDIT FINDINGS IN INTERNAL CONTROL

4.2.1 History of audit outcomes at the Tlokwe City Council

The Constitution establishes the Office of the Auditor General as an independent state institution with the responsibility to be the external auditor of all three government spheres as well as government institutions. The Public Audit Act (Act 25 of 2004) stipulates the functions of the Auditor General, including the function to prepare a report in respect of each audit of a municipality performed. The Auditor General must give an opinion on the following:

- whether the annual financial statement fairly reflects the financial position of the municipality at year-end, the results of operations and cash flow for the period ended on that date,
- compliance with applicable legislation relating to financial matters, financial management and other related matters,
- reported information relating to the performance of the municipality measured against predetermined objectives, and
- the Auditor General may report if the resources of the municipality were procured economically and utilised efficiently and effectively (Fourie & Opperman, 2011:13).

The history of the audit outcomes for the past 12 years of the Tlokwe City Council, as indicated in Table 4.1, reflects the major impact implementation of Generally Accepted Municipal Accounting Practices (GAMAP) in the 2004 financial year and from then on the incremental implementation of GRAP had on the audit outcomes. Prior to the 2004 financial year the then Potchefstroom City Council always had achieved a clean audit with the Institute of Municipal Finance Officers fund accounting system. The Tlokwe

City Council has opted to implement the GAMAP and GRAP standards earlier than the effective dates gazetted by the Minister of Finance. For the 50 high capacity municipalities such as the Tlokwe City Council, the gazetted implementation date of the GAMAP/GRAP standards was the 2006 financial year (National Treasury, 2005c:4).

Table 4.1 History of audit opinions and audit findings for the Tlokwe City Council

Financial year	Audit opinion	Qualification findings	Emphasis of matter	Other matters	Non-compliance with legislation
2001	Unqualified	–	3	–	–
2002	Unqualified	–	12	–	5
2003	Unqualified	–	17	–	3
2004	Qualification	2	9	–	4
2005	Disclaimer	14	3	–	5
2006	Adverse	17	5	4	18
2007	Adverse	15	–	4	7
2008	Disclaimer	20	–	6	9
2009	Disclaimer	17	–	7	4
2010	Qualified	4	4	1	10
2011	Qualified	8	5	1	25
2012	Unqualified	–	6	–	34

Source: Auditor General Audit Reports for the financial years 2001–12

The audit opinions as indicated in Table 4.1 are only applicable to the financial statements of the Tlokwe City Council and not on performance measurement, for which the Auditor General issued separately an opinion and findings.

The audit opinion of the Tlokwe City Council's financial statements had regressed from an unqualified audit opinion in the 2003 financial year to the worst possible audit outcomes of disclaimer and adverse audit opinions which were received for the financial years 2005 to 2009. According to the Auditor General an adverse opinion is expressed when the effect of the disagreement with management regarding departures from the financial reporting framework is so material to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements. A disclaimer of opinion is expressed when the possible effect of a limitation of scope is so material that the auditor has not been able to obtain appropriate audit evidence to form an opinion and accordingly is unable to express an opinion on the financial statements (Auditor General, 2012h:4).

Improvements in the audit opinions of the Tlokwe City Council did realise in the 2010 and 2011 financial years as qualified audit opinions were received. A qualified audit opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management regarding departures from the financial reporting framework, or the limitation of scope, is not so material as to require an adverse opinion or a disclaimer of opinion (Auditor General, 2012h:4). One of the objectives of the Operation Clean Audit programme is that by the 2010 financial year, no municipality and provincial department may achieve an adverse and disclaimer audit opinion. This objective was reached by the Tlokwe City Council in 2010. The next objective of the Operation Clean Audit programme is that by 2012 at least 60% of provincial and the 283 (now 278) municipalities achieve an unqualified audit opinion. This objective was also reached by the Tlokwe City Council by achieving an unqualified audit opinion on its financial statements in the 2012 financial year. An unqualified audit opinion means that these statements are a true reflection of the financial statements but findings have been raised on predetermined objectives and/or compliance on laws and regulations (Auditor General, 2012h:4). Significant deficiencies in internal control were however again mentioned in the 2012 Audit Report (Auditor General, 2012d:7–8).

4.2.2 Findings on internal control weaknesses

In the audit report of the year ended 30 June 2002, the first findings on internal control weaknesses were issued. In the 2003 audit report, shortcomings in budgetary control were identified and three findings regarding non-compliance with applicable legislation

were included. The existence of 27 vacancies in the Finance department, according to the Auditor General, seriously affected the functioning of the department and resulted in a lack of segregation of duties. In the 2004 audit report the issue of lack of segregation of duties owing to the then 32 vacancies was raised again. In the 2005 financial year the Tlokwe City Council received a disclaimer audit opinion owing to the implementation of the GAMAP/GRAP accounting practices. The financial system was changed from the fund accounting system to the new accounting standards as recommended from the Accounting Standards Board and National Treasury. At the 2005 year-end 51 vacancies existed in the Finance department.

At the end of the 2006 financial year the number of vacancies in the Finance department slightly decreased to only 48 vacancies out of existing 101 positions. Senior positions were however only filled by acting personnel. The following severe internal control weaknesses: lack of monitoring of reviewing; inadequate financial accounting and control systems; personnel not adequately trained in new accounting standards and no adherence to accounting policies and standards were highlighted as reasons for the adverse audit opinion. In the 2006 audit report the lack of a formal fraud prevention plan and measures to detect and correct fraud and error was identified.

In the 2007 to 2011 Audit Reports the root causes of the findings that lead to negative audit opinions as they relate to the five components of internal control were discussed and are abridged in Table 4.2.

Table 4.2 Audit findings as they relate to internal control components

Financial year	Basis for audit opinion	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
2007	Basis for adverse	8		8	2	11
2008	Basis for disclaimer	10	4	10	3	10
2009	Basis for disclaimer	8	4	3	2	
2010	Basis for qualification	20		6		9
2011	Basis for qualification	4	4	1		10

Source: Auditor General Audit Reports for the financial years 2007; 2008; 2009; 2010 and 2011

Section 62(1)(c)(1) of the MFMA clearly states that the municipal manager must ensure that the municipality has and maintains an effective, efficient and transparent financial and risk management system as well as an internal control system. In sections 64(2)(f) and 65(2)(c) of the MFMA the accounting officer is tasked to implement and to maintain systems of internal control of debtors and revenue and of creditors and payments specifically and section 78(1)(a) stipulates that each senior manager must ensure that the established system of financial management and internal control is carried out diligently (2003).

The Auditor General (2011b) concluded in his report on the audit outcomes of the municipalities of the North West Province for the 2010 financial year that — if internal controls are not implemented to address the findings that relate to the three

fundamentals of internal controls such as leadership, financial and performance management and strong governance — an improvement in the audit opinion will not be realised.

Appendix A indicates the assessment of the achievement of control objectives at the Tlokwe City Council. This assessment is based on significant deficiencies relating to the fair presentation of the financial statements, material misstatements corrected as a result of the audit, findings on the predetermined objectives and findings on non-compliance with laws and regulations for the 2011 and 2012 financial years. Significant deficiencies occur when internal controls do not exist, are not appropriately designed to address the risk or are not implemented and which either had or could cause the financial statements or report on predetermined objectives to be materially misstated and material non-compliance with laws and legislation to occur (Auditor General, 2011b). (The assessment for the Swartland Local Municipality is also included in appendix A, as discussed in chapter 5.)

In appendix B all the findings relating to internal control deficiencies for the 2012 financial year are listed. An analysis was made if these findings were also issued in the prior three financial years. In the 2012 financial year, nine of the twenty-one findings in internal control deficiencies were identical findings of the previous financial year and six findings were repeated in the 2010, 2011 and 2012 financial years. Of the 23 findings on internal control deficiencies in the 2011 financial year, 11 identical findings were reported in the 2010 and 2 identical findings were reported in the 2009 financial years respectively.

The Auditor General reported in his Draft Management Report (2011a) that internal control shortcomings also lead to the various qualifications of misstatement in the financial statements. These misstatements were not prevented nor detected by the internal control system. The shortcomings can be summarised as the lack of reconciliations; lack of proper record keeping; lack of sufficiently skilled staff and the annual review of policies are urgently needed. In the 2012 financial year the audit also revealed that the internal control processes of management were not able to prevent material misstatements in the financial statements, which necessitated material corrections that were made to the statements during the audit.

4.2.3 Findings on non-compliance with legislation

Twenty-six and fifteen findings of non-compliance with laws and regulations were reported in the 2012 and 2011 financial years respectively, of which nine findings have been rated as affecting the auditor's report in the 2011 financial year. Three of the findings of non-compliance with procurement legislation which affected the 2011 auditor's report, have been raised in the 2009 report and findings of unauthorised, irregular, fruitless and wasteful expenditure were reported on in each of the four respective financial years.

The findings for non-compliance with laws and regulations in the 2012 financial year are listed in appendix C. Of the 26 audit findings on non-compliance with laws and regulations in the 2012 financial year, four identical or similar findings were reported in the previous three financial years.

Of the 22 findings in the Management Report from the Auditor General (2011a), which are rated as matters affecting the report from the auditor regarding the financial statements, nine findings were for non-compliance with laws and regulations and the balance were for material misstatements in the financial statements which, according to the Auditor General, could have been prevented by the internal control system of the Tlokwe City Council.

4.3 BUDGET REPORTING AND MONITORING

The municipal manager — as the accounting officer — is responsible for all income and expenditure, all assets and liabilities of the municipality as well as compliance with the municipal finance management legislation. According to section 61 of the MFMA he must act with integrity and in the best interest of the municipality in managing its financial affairs (SALGA, 2011:52).

With regard to the budget process, the municipal manager must assist the mayor in performing the legislated budgetary functions (section 68, MFMA); must ensure public participation in the budget process (section 22, MFMA); must submit the draft budget to relevant institutions (section 22, MFMA) and must report once a month on the state of the budget to provincial treasury (section 71, MFMA).

4.3.1 Budget-related and financial policies

The object of the Municipal Budget and Reporting Regulations, 2008 (National Treasury, 2009), made in terms of section 168 of the MFMA and published on 17 April 2009, is described in regulation 2: "to secure sound and sustainable management of the budgeting and reporting practices" of local government and to set norms and standards for ensuring accountability, transparency and the correct lines of responsibility in the budgeting and reporting processes. Guidelines issued according to section 168 of the MFMA are however not binding on a municipality unless the council adopts it by way of a policy or a council resolution.

According to Fourie and Opperman (2011:438) a system of internal control is the policies developed by management to ensure that the objectives of the municipality are achieved. This internal control system contains various subsystems and uses people, budgets and rules as means of control.

Regulation 7(1) of the Municipal Budget and Reporting Regulations stipulates that the municipal manager must ensure that budget-related policies are prepared or amended according to legislation and tabled in council for adoption.

Appendix D indicates all the budget-related policies which are required by above-mentioned regulations as well as the adoption or amendment dates of these policies by council. Of the required 26 policies, 14 policies were approved by Council, a new overtime policy was drafted in 2004 but was never approved and 11 of the required policies are still outstanding. None of the 11 policies, as for example the funding and reserves policy as well as the long-term financial plan of the Tlokwe City Council, which is required in terms of regulations 7 and 8 of the Municipal Budget and Reporting Regulations, have been drafted and submitted to Council for approval by the end of the 2012 financial year. Regulation 7(1) of the Municipal Budget and Reporting Regulations stipulates that all these budget-related policies need to be prepared and tabled to council for adoption or to be reviewed on an annual basis to be in accordance with the applicable legislation. Municipalities had to comply fully with these regulations as from 1 July 2010.

According to section 73 of the MFMA the accounting officer must report to provincial treasury should any of these budget-related policies not be implemented or adopted by Council, as well as any non-compliance with any of these policies by an official or political structure. Although only 14 of the required 26 budget-related policies are in

place and the policies are not adhered to on a regular basis, no reporting was done to provincial treasury in this regard.

The Auditor General included three audit findings regarding policies in his 2011 Draft Management Report (2011a). Deficiencies in the Supply Chain Management Policy, an incomplete Cash Management and Investment Policy and the lack of an inventory management policy were identified and have been included in the internal control deficiency classification. In the 2012 financial year the Auditor General repeated the findings regarding deficiencies in the Supply Chain Management Policy and the lack of an inventory management policy (2012c).

4.3.2 Budget reporting and budget process

4.3.2.1 Budget and budget reporting

As indicated in the previous paragraphs, the MFMA stipulates the delegated authorities regarding the budget and the budget reporting process. The budget control stage of the budget cycle starts on 1 July, the first day of the financial year, until 30 June of the next calendar year and is aimed at ensuring accountability from senior management. The budget control stage consists of monthly and quarterly reports, the mid-year report and at the end of the financial year the financial statements as contained in the annual report (Pauw *et al.*, 2009:297–8). For variances identified between the actual and budgeted figures, both in revenue and expenditure, reasons has to be provided in the monthly, quarterly and mid-year reports. The mayor will, based on the variances identified in the mid-year report, consider whether the budget is implemented according to the SDBIP and if needed, an adjustment budget and revisions to the SDBIP is recommended.

The Auditor General (2012a) did not report any audit findings in his 2011 statutory audit of the annual budget process or the monthly budget reporting. Shortcomings do however exist as the monthly budget statements, as prescribed in section 71 of the MFMA, which must be submitted to the mayor, provincial treasury and National Treasury were often not submitted within ten working days after the end of a month as prescribed. Delayed month-end financial closure as well as absence of key personnel at month-end owing to various reasons still negatively affect compliance with legislated reporting due dates, but limited improvements did realise in the past two financial years.

4.3.2.2 Budget process

The annual budget process of the Tlokwe City Council is completed according to legislation. The time schedule of the budget is tabled to Council in August, the mid-year report and the adjustment budget are tabled in January, the draft budget is tabled in March and the final budget, proposed tariff increases and the IDP is submitted in May to Council for adoption. Shortcomings do however exist in the formulation of the budget, as the Auditor General found in the 2011 and 2012 statutory audits of the predetermined objectives. Contrary to the requirements of regulation 6 of the Local Government: Municipal Planning and Performance Management Regulations (2011), the annual budget of the Tlokwe City Council is not based on the development priorities and objectives as well as the performance targets as contained in the IDP. According to the Budget By-law the Chief Financial Officer must ensure that the annual budget reflects the budget priorities determined by Council and the budgeted capital projects must be aligned with the IDP.

Another shortcoming of the annual budget preparation at the Tlokwe City Council is the use of the traditional line-item budgeting approach. In all municipalities the organisational structure consists of various line and support departments and these are allocated cost centres. The MFMA Circular 12 (National Treasury, 2005a:1) defines these departments as votes. These votes are subdivided into separate cost elements or line-items. The combination of the line-items is referred to as the General Ledger.

In a traditional line-item budget approach, according to Van Schalkwyk (2012:8–10), the budget is compiled with the votes and line-items as the primary cost allocation method. In this method used by departmental managers, a percentage increase is generally added to the prior year's trend of expenditure per line-item. This incremental budgeting method works well for personnel expenditure, remuneration of councillors and typical administrative costs such as stationary and general stock items. A disadvantage of the incremental budgeting approach is that past inefficiencies and waste in the current way of doing things do remain part of the baseline costs of a department and no reprioritisation of expenditure programmes or emphasis on key performance areas in departments are done. Mkhize and Ajam (2006:763) stress that, although line-item budgeting is relative easy to implement and has the potential for control of excess expenditure through comparisons and trends, the system fails to provide sufficient information on what the funds were actually spent on. Line-item budgeting is also seen

to contribute to "an environment of risk of corruption". Pauw *et al.* (2009:56) also mention that the old traditional approach of line-item budgeting or the incremental budgeting approach is not conducive to calculate the quality or quantity of performance or service delivery. This budget approach does not consider the value that should be added through the use of resources.

Although Horngren *et al.* (2009:209) list the promotion of co-ordination with and communication between different units, the motivation of managers and employees, and the provision of a performance management and control tool as the advantages of budgets, the opposite often occurred at the Tlokwe City Council. During deliberations with the managers of departments regarding their share of the budget, managers are not willing to integrate their department's objectives with the overall strategy of the municipality and political intervention is required to balance the budget. The performance of the municipal manager and departmental managers are measured against the percentage spent on the capital and operating budget but no measurement exists if the funds were spent effectively and efficiently.

Budgetary slack, described by Horngren *et al.* (2009:225), is the practice used by management to underestimate the revenue budget or to overestimate the expenditure budget to make targets more easily achievable. This practice is usually applied when the budget variations are used for performance evaluation of managers. When the actual traffic fines revenue exceeded the underestimated budgeted revenue, the departmental manager also requested Council to allocate the excess revenue earned to his specific department's capital budget which is contrary to the Municipal Budget and Reporting Regulations and the MFMA. Managers also overestimate their expenditure budget. They plan to use this overestimation as a hedge if across-the-board budget reductions are requested to balance the budget.

4.3.3 Budgetary control

Van Schalkwyk (2012:9) mentions that budgeting plays a major role in controlling operations effectively and efficiently in the public sector owing to many processes that have to be followed before a budget is approved. The municipal manager, as accounting officer, must take the necessary steps to ensure that budgetary control is practised (section 69, MFMA); that all spending is in accordance with the budget (section 69, MFMA); that revenue and expenditure are monitored (section 69, MFMA); that spending is reduced if needed (section 69, MFMA) and that all undercollection,

shortfalls, overspending and steps to be taken to rectify the situation is reported to Council (section 70, MFMA). He must also ensure that unauthorised, irregular or fruitless and wasteful expenditure and other losses are prevented (section 62, MFMA).

Managers of departments must also exercise control over their allocated budgets as they are accountable for the revenue and expenditure in their departments (votes). Managers must ensure that the actual expenditure does not exceed the budget and that they stay within the monthly cash flow provision as presented in the SDBIP. The financial reports are provided to managers on a monthly basis and officials tasked with budgetary control in the departments have access to the financial management system. However, as indicated in the audit findings, budgetary control at the Tlokwe City Council have many deficiencies.

4.3.3.1 Underspending of the budget

In the 2010 financial year underspending to the value of R17,26 million was identified in the infrastructure, housing and public safety votes. In the 2011 audit, material underspending of the budget by R40,87 million in bulk purchases, repairs and maintenance and general expenditure are recognised. Underspending of the budget increased in 2012 to the value of R47,99 million, mainly on general expenses and maintenance, employment related costs and bulk purchases. Material underspending is seen by the Auditor General as negatively affecting service delivery.

National Treasury (2011a:18) acknowledges the following factors that contribute to underspending of capital budgets: poor capital budgeting and planning; shortage of professional engineers that can draft tender specifications; delays in procurement processes and political interference in the allocation of tenders. The first three factors mentioned above also cause underspending of the capital budgets at the Tlokwe City Council.

The reasons provided for the underspending of the operating budget in the 2011 financial year was mainly the lengthy procurement process for repairs and maintenance, insufficient skilled staff in the infrastructure department to compile tender documents and less electricity and water being consumed than provided for.

4.3.4 Unauthorised, irregular, fruitless and wasteful expenditure

4.3.4.1 Unauthorised expenditure

Section 1 of the MFMA stipulates that a municipality may only incur expenditure in terms of an approved budget and within the limits of the allocated amounts of the different votes in the approved budget. Unauthorised expenditure is seen as any expenditure incurred by the municipality other than the expenditure provided for within an approved budget; overspending of the total amount of the budget or overspending of a vote in the budget. Expenditure incurred unrelated to a department and the spending of funds or grants otherwise than according to the conditions of the grant or allocated for a specific purpose is also seen as unauthorised expenditure (South Africa, 2003). Pauw *et al.* (2009:41) describe unauthorised expenditure as both misdirected spending and overspending, which is in contravention of the law. According to Fourie and Opperman (2011:46) the municipal manager must inform the mayor, council, provincial department of local government and the Auditor General immediately should unauthorised, irregular or fruitless and wasteful expenditure be incurred. Section 32 of the MFMA stipulates that, after an investigation into the reasons why this expenditure was incurred, the municipality must recover unauthorised, irregular or fruitless and wasteful expenditure from the person liable for that expenditure unless the council authorised the unauthorised expenditure in an adjustment budget or certify the irregular, fruitless or wasteful expenditure as irrecoverable and written off by council (South Africa, 2003).

In the 2010 financial year unauthorised expenditure of R45,96 million was identified in the statutory audit, mainly owing to R24,80 million spend on the upgrading of the airport for the World Cup. In the 2011 financial year the municipality again received findings of unauthorised expenditure to the value of R22,3 million as overspending was incurred on employee costs, grants and subsidies paid, depreciation and impairment losses and on various capital projects. Unauthorised expenditure of R152,52 million, mainly owing to R127 million book entry for recalculation of depreciation as a result of the unbundling and revaluation of property, plant and equipment as well as a R22 million transfer of assets, was incurred in the 2012 financial year.

The Auditor General repeatedly found that, in contravention of section 15 of the MFMA, expenditure was incurred in excess of limits of the budgeted amounts for different votes. This non-compliance with legislation is either owing to departments having difficulties compiling credible operating budgets as it is based on the traditional line-item budgeting

approach or they are unable effectively to manage their operational expenditure according to their budgets. Capital budgets are also compiled without a detailed cost analysis of the capital projects by an engineer, resulting in an underestimation of the total costs and thus overexpenditure occurs. Although monthly reports comparing the expenditure with the operating and capital budgets are sent to the departments, managers have access to view their expenditure and budgets per line-item on the financial management system and a departmental overview is provided in the monthly financial report, expenditure still incur in excess of the budget. A clear internal control weakness does exist regarding budgetary control.

Just prior to financial year-end and submitting the annual financial statements to the Auditor General, the budget is realigned to actual spending in the various votes, according to the approved Virement policy. The Virement policy allows a department to shift expenditure from one use to another as long as the expenditure stays within the approved budget (Bradley, 2002:1). This practice hides to a large extent the over- and underspending within a department.

The implementation of the new GRAP standard 24 on 30 June 2013, which deals with the presentation of budget information in the financial statements, will curb the practice to realign the budget before year-end. As the budget is a key accountability tool on the public sector, the GRAP 24 accounting standard will require municipalities to present a comparison of the budget and actual amounts, for the current year, either as additional columns in the financial statements or as a separate statement. A comparison needs to be presented between the approved, adjustment and final budgets. The final budget, according to the Accounting Standards Board (2007:3), is the council approved budget adjusted for transfers, allocations, supplement appropriations and other changes. Material differences in the changes in the budget as well as between the budget and actual amounts must be explained in the notes to the financial statements (Accounting Standards Board, 2007:7–8).

4.3.4.2 Irregular expenditure

According to the definitions of the MFMA, irregular expenditure is any expenditure which is incurred in contravention with or is not compliant to either the MFMA, the MSA or the Remuneration of Public Office-Bearers Act, 1998 (Act 20 of 1998) as well as expenditure incurred in contravention of the supply chain management policy/by-law of the municipality. Irregular expenditure can also be incurred when an official spends

public money without the consent of the accounting officer or a delegated authorised officer, although the expenditure does not need to be seen as unauthorised or fruitless and wasteful expenditure (Pauw *et al.*, 2009:43).

A finding, grouped in the emphasis of matter paragraph of the 2011 Draft Management letter (Auditor General, 2011a:Part B), disclosed that R32,50 million expenditure was incurred owing to non-compliance with the Municipal Supply Chain Management Regulations of the MFMA, 2005 (National Treasury, 2005b). In the 2010 financial year irregular expenditure to the amount of R95,24 million was also referred to in the audit report owing to non-compliance with the Municipal Supply Chain Management Regulations. The 12 findings in the 2012 audit report regarding non-compliance with the Municipal Supply Chain Management Regulations explain the irregular expenditure to the value of R147,74 million incurred in the past financial year (Auditor General, 2012c).

The Auditor General stated in his North West MFMA 2009–10 General Report (2011b:17) that — although supply chain management policies are in place — a lack of enforcement and monitoring of compliance with the supply chain management policy by management resulted in this irregular expenditure. Basic controls such as proper record keeping, risk assessment and internal monitoring are lacking and this lack of internal control leads to inefficient contract management and irregular contract amendments, extensions and renewals.

In the 2011 statutory audit of the Tlokwe City Council, nine procurement findings were classified as non-compliance to legislation and two findings were for internal control deficiencies. The first finding of internal control deficiency is that the supply chain management policy of the Tlokwe City Council was not updated with the Municipal Supply Chain Management Regulations. The second finding indicated both the lack of reporting on procurement activities and the lack of control of the vendor master file. In all the procurement findings the lack of control of reporting and non-compliance to legislation and internal control by the accounting officer is identified (Auditor General, 2011a).

4.3.4.3 Fruitless and wasteful expenditure

Pauw *et al.* (2009:23) observe that, according to the PFMA, ineffective activities that did not benefit the public, as defined in the budget, are seen as fruitless and wasteful

expenditure. Section 32 of the MFMA stipulates that all irregular, fruitless and wasteful expenditure must be investigated and steps must be taken to recover the expenditure or to prevent a recurrence of the expenditure.

Fruitless and wasteful expenditure was identified in 2010 and 2011 financial years to the value of R1 126 504 and R314 289 respectively. This expenditure was mainly owing to penalties and interest paid on late payments of amounts due to the South African Revenue Service (SARS) and other creditors.

4.3.5 Summary on findings of the Auditor General

The above findings of the Auditor General listed — regarding excess and underexpenditure as well as unauthorised, fruitless and wasteful expenditure — clearly indicate that severe weaknesses do exist in budgetary control. Appendices A, B and C highlight the many internal control deficiencies such as lack of control; no reconciliations or control of reconciliations; shortcomings in policies; lack of segregation of duties and a lack of a clear system of delegated responsibility and authority. The 15 findings of non-compliance to laws and regulations in the audit of the 2011 financial year also indicate that the employees of the Tlokwe City Council do not adhere to or understand the policies implemented or are unwilling to comply with the new set of rules and regulations, as determined by the MFMA.

At the Auditor General MFMA road show held on 15 March 2012 in Rustenburg, Ms M. Mabe, the MEC (Member of the Executive Council) for Finance in the North West Province, mentioned that municipalities are still struggling to comply with the MFMA, nine years after its promulgation. Mr Van Schalkwyk of the Office of the Auditor General explained at above-mentioned meeting that the main reasons for the adverse, disclaimer or qualified audit opinions for municipalities in the North West Province are lack of supportive documentation, no reconciliations of accounts, poor recording of transactions, inadequate debt control and non-compliance with legislation. According to Van Schalkwyk poor leadership, unqualified senior managers and political interference is at the core of most municipalities' financial constraints.

4.4 SEGREGATION OF DUTIES AND SYSTEM OF DELEGATION

4.4.1 Segregation of duties (authorising, processing, recording and reviewing)

Segregation of duties is needed in all organisations to reduce the risk of error, fraud or misuse or abuse of resources or position. Therefore no single individual or team may control all key stages of a transaction. Thus no person should initiate the transaction, approve the transaction, record the transaction, reconcile balances, handle the assets and review the reports (Vanstapel, 2004:29; University of California, s.a.:13; Fourie & Opperman, 2011:441). According to PricewaterhouseCoopers (2009:10) duties and responsibilities should be assigned to a number of individuals to ensure that effective checks and balances do exist. Normally the responsibilities for authorising transactions, recording transactions and the handling of the related assets are divided. The duties and responsibilities of employees of a municipality should be so divided that no official can control all phases or functions of any task or transaction (Fourie & Opperman, 2011:441).

Fourie and Opperman (2011:53, 73, 439) emphasise that the municipal manager must develop a system of delegations that provide "adequate checks and balances in the municipality's financial administration". This system of delegation must maximise administrative and operational efficiency. Control activities are the policies and procedures that ensure completeness and accuracy of accounting transactions include segregation of duties and authorisation controls. These control activities also limit exposure to loss of assets or fraud and ensure compliance with applicable legislation.

The Tlokwe City Council risks misappropriation of funds or fraud when the Finance department has a shortage of staff. The control activity of segregation of duties can therefore not be implemented in full. In the past decade, the Auditor General found inadequate segregation of duties to be a recurring finding owing to the high vacancy rate in the Finance department. Segregation of duties is an issue in each department where cash is handled; employees are authorised to sign for requisitions; requesting direct payments; signing for overtime and so on. In the Finance department segregation of duties are more critical in the creditors, petty cash, and revenue, procurement and salaries sections. The information technology system of the Tlokwe City Council is separately audited by the Auditor General and the lack of segregation of duties in the information technology section was stated as a finding in several years audit reports.

Control measures were implemented in the Finance department to prevent any collusion in the salary and creditor sections with the implementation of electronic financial transfer (EFT) for salaries and creditor payments but with direct payments, shortcomings in segregation of duties still exist.

Lolwane (2009:18) emphasises that all institutions must take steps to discourage an environment that creates the opportunity for people to commit fraudulent activities. In 2009 the 8th Global Annual Fraud Survey conducted by Ernst & Young provided the following interesting statistics of who commits fraud: 55% of management; 30% of employees; 6% of organised crime syndicates; 5% of clients and only 4% of suppliers. Lolwane (2009:18) also provides recent statistics which indicate that 25% of employees will definitely not steal owing to their value system; 25% of employees will definitely steal owing to their inclination and 50% of employees will possibly steal if the opportunity arises and they are unlikely to get caught.

The Institute of Certified Fraud Examiners in the United States of America estimated that 2% of the typical entity's annual budget is lost to fraud each year (Hogan, 2003:2). If the same percentage is used for example at the Tlokwe City Council, 2% of all the payments done in 2011 to the value of R620 688 519 is R12 413 770 and 2% of cash handled of nearly R680 443 586 million is R13 608 872. The question can be raised if the Tlokwe City Council can afford not to fill the vacant posts at Finance or improve its internal control system.

The Internal Control Standards Committee of INTOSAI, under the chairmanship of F. Vanstapel, published in 2004 updated Guidelines for Internal Control Standards for the Public Sector. In this document the importance of ethical behaviour as well as the prevention of fraud and corruption in the public sector has been emphasised (Vanstapel, 2004:3). Policies and procedures have to be developed and adopted for authorisation and approval procedures; segregation of duties; controls over access to resources and records; verifications; reconciliations; reviews of operating performance; reviews of operations, processes and activities as well as supervision (Vanstapel, 2004:29-31).

In August 2006 Council approved the authorisation and signing authority of officials for cheques, orders, requisitions and Council documents but although several reports were submitted to Council from 2007 to 2011 to amend the authorised signing authority, no amendments to the powers were approved to date. As signing authority was allocated

to individual persons and not to posts, resignations or retirements of the officials listed did occur and new appointments, which do not appear on the list of authorised signatures, were done. These new officials signed various documents. Signing authority is currently an internal control weakness as nobody really knows who has signing authority and to what amount. The approved 2006 report was also silent on the signing authority of officials acting in higher posts. A list of the specimen signatures of the delegated officials with signing authority does not exist and as several of the signatures are illegible, risks do exist that wasteful incorrect transactions made by officials without signing authority can occur.

In November 2011 the municipal manager did approve an amended list of 65 officials with authorised signing authority for various amounts but after discussion in February 2012 of this report, the Executive Mayor, as chairperson of the mayoral committee, instructed the municipal manager to conduct an investigation into senior officials and officials in middle management to be authorised to sign municipal documents, payments and requisitions to a certain amount. A comprehensive recommendation on signing authority should be formulated and resubmitted to the mayoral committee for approval and then to Council for final adoption once the investigation is completed.

As indicated in prior paragraphs, major internal control weaknesses do exist regarding the signing authority of officials and segregation of duties at the Tlokwe City Council.

4.4.2 Authorisation and approval procedures

According to the INTOSAI Guidelines for Internal Control the authorisation and the execution of transactions and events may only be done by persons acting within the scope of their authority (Vanstapel, 2004:29). Authorisation is the method to ensure that only valid transactions and events are initiated as intended by management and authorisation procedures should be documented and clearly communicated to all staff. These procedures should include the conditions and terms under which authorisations are to be made and if all staff and managers abide with these procedures, the directives of management and applicable legislation such as the MFMA and its regulations will be complied with.

Every transaction in a municipality needs authorisation and important control measures should be considered with regard to authorisation:

- Segregation of duties. The official requesting the authorisation of a payment may not be the same official granting the authorisation.
- Multi-authorisation. For transactions higher than a predetermined amount, the manager must recommend to a higher management level for authorisation.
- Authorisation must be in writing.
- Supporting documentation must be attached to the document or payment voucher requesting authorisation.
- Supporting documentation should be cancelled after being processed to prevent resubmission and double payment (Fourie & Opperman, 2011:442).

In 2004, when a system of delegations was approved by Council, an authorisation procedure manual with regard to the requesting and signing of cheque vouchers was drafted by the previous Internal Auditor to improve the internal control system of the Tlokwe City Council. This draft procedure manual was, although implemented in the Finance department, never approved by Council nor adhered to by the other departments. The manual included the procedure to prepare cheque vouchers, checking of payment vouchers, requests for direct payments, important checks to be performed when preparing a cheque voucher as well as approval of cheque payments. A list of names of officials authorised to check the vouchers for the issuing of cheques relevant to their tasks within financial amounts restraints, was also provided in the procedure manual. Four of the listed thirteen officials have resigned in the period from 2004 to date and new appointments were made in vacant or new positions, but the names of these appointees, who as part of their duties check and approve payment vouchers, were never submitted to Council for approval.

Procedures for expenditure management were adopted by Council in 2004 and amendments to this policy were adopted in 2009. This procedure manual does not include the approval procedures for the electronic financial transfer payments system implemented in the Tlokwe City Council in the 2012 financial year. Part of the internal control deficiencies findings of the Auditor General regarding procurement was that no properly implemented controls for adding, deleting or changing the vendor master file exist. There are no properly implemented controls for vendor acceptance to prevent and to detect fictitious suppliers and banking details of vendors can be changed on the master file without the approval of senior officials, causing a risk of incorrect or fraudulent electronic payments. This deficiency was reported to the information

technology service provider and they were requested to implement the necessary amendments to the vendor master file.

Powell (2009:24) reports that EFT fraud is not a bank problem but most of the time is committed by officials. Illegitimate payments can be loaded onto the payment system and payments can be done to whatever account was loaded in the vendor master file prior to authorisation. According to Powell, EFT fraud has reached near-epidemic proportions in the local government sphere. Another internal control deficiency identified is that password abuse amongst financial officers does occur.

An urgent need does thus exist to amend and to implement the procedure manual for cheque and electronic payments to improve the internal control system.

4.4.3 System of delegations

A system of delegation in local government has a major effect on service delivery as it emphasises strategic planning and decision-making with budgetary and financial management implications, and on the service delivery implementation plan. The system of delegations, including the procedures and processes, has to be results driven as well as performance driven and as such contributes towards effective and efficient service delivery (National Treasury, 2011b:4).

According to Pauw *et al.* (2009:276) the municipal manager must develop a system of financial delegations that will improve operational efficiency and will provide the necessary "checks and balances" in the financial administration. These delegations must be reviewed on a regular basis and, when needed, amended. Fourie and Opperman (2011:41) also mention that the municipal manager must submit a report to council when it becomes necessary to review the existing delegations with the recommended changes to the delegations. The system of delegations is based on two principles; firstly, no delegation is absolute, thus it can be revoked or reviewed and, secondly, the delegation does not absolve the delegator from the responsibility for the performance of the duty or power delegated. The delegations must be in writing and subject to financial limitations imposed by council. Each time a new council is elected and appointed, the system of delegations has to be reviewed (Fourie & Opperman, 2011:105).

A system of delegated powers of the Tlokwe City Council was approved by Council in November 2004 and amended in July 2005. Although various workshops were held in

the following years to update the system of delegations to be compliant with the new and amended legislation, such as the MFMA regulations which were promulgated after 2005, the system of delegation is still outdated and not compliant to the latest legislation. The current system of delegation does not delegate powers and functions to a specific individual or to the holder of a specific post. Neither does the official to whom powers, responsibilities or functions were delegated to, sign a form accepting the delegations. Accountability for the effective and efficient performance of the tasks is not attached to the position nor does the system allow sub-delegation. The system also does not specify the conditions and limitations of the delegated authority nor does it specify the delegated powers and responsibilities for officials acting in higher positions. According to National Treasury (2011b:7) all delegations must be reviewed annually to determine its effectiveness and to entrench the system of accountability and responsibility to complete tasks assigned to an official of a municipality. As the system of delegations of the Tlokwe City Council was approved in 2005, several internal control weaknesses and non-compliance to applicable legislation can be identified.

The City of Matlosana Local Municipality (Klerksdorp) was earmarked by National Treasury in 2011 as a pilot municipality to amend their system of delegations in order to improve service delivery. The author of this mini-dissertation was requested to amend the system of delegations of the Tlokwe City Council to be more compliant to legislation. A page of the amended system of delegations, as benchmarked by the City of Matlosana Local Municipality, is hereby attached as Appendix K. This document contains 150 pages of delegated powers as prescribed in the MSA, the Local Government: Municipal Structures Act, the MFMA, the Property Rates Act, the Expropriation Act, the Division of Revenue Act, the Promotion of Administrative Justice Act and other acts influencing the activities of a municipality.

4.4.4 Organisational structure

According to Ehlers and Lazenby (2010:320) organisational design provides the backbone of an organisational formal reporting relationship, its systems and decision-making, controls and authority processes. The organisational structure is defined as the framework in which the strategic processes "must operate to achieve the goals and objectives of an organisation". The structure specifies who is responsible for specific tasks in an organisation. Ehlers and Lazenby (2010:320) emphasise that "structure follows strategy" and when the organisation's chosen strategy changes, the structure

also needs to be changed. In the absence of a close fit between structure and strategy, administrative and resource allocation problems will ensue and the overall performance of an organisation will decline.

DiNapoli (2007:7) acknowledges that every member of an organisation has a role in the system of internal control as internal control is people dependent. Internal control systems are developed by people, it shows people how to perform their duties and it provides the means of accountability. The individual roles of members of an organisation differ in the system of internal control depending on the member's position in the organisational structure.

According to DiNapoli (2007:7) the strength of an internal control system depends on the employees' attitude towards and attention to internal control. If the top management does not support internal control, the whole organisation will also not practice good internal control. Managers can override control activities owing to time constraints or two or more employees can act together to evade internal control and beat the system. In terms of the MSA the municipal manager is responsible for the financial administration of a municipality and appointment of staff, and has the power to delegate responsibility to the most effective level within the organisation (Fourie & Opperman, 2011:40).

At the Tlokwe City Council an amended functional organisational structure was approved in 2007. In a functional structure, units and tasks within the units are grouped together according to functional areas, as finance, human resources and technical departments. The authority and decision-making on functional matters are decentralised but the overall authority and decision-making rests with the Chief Executive Officer (Ehlers & Lazenby, 2010:325–6). The structure of the Tlokwe City Council is designed according to functional departments similar to the departments at central and provincial government (Figure 4.1).

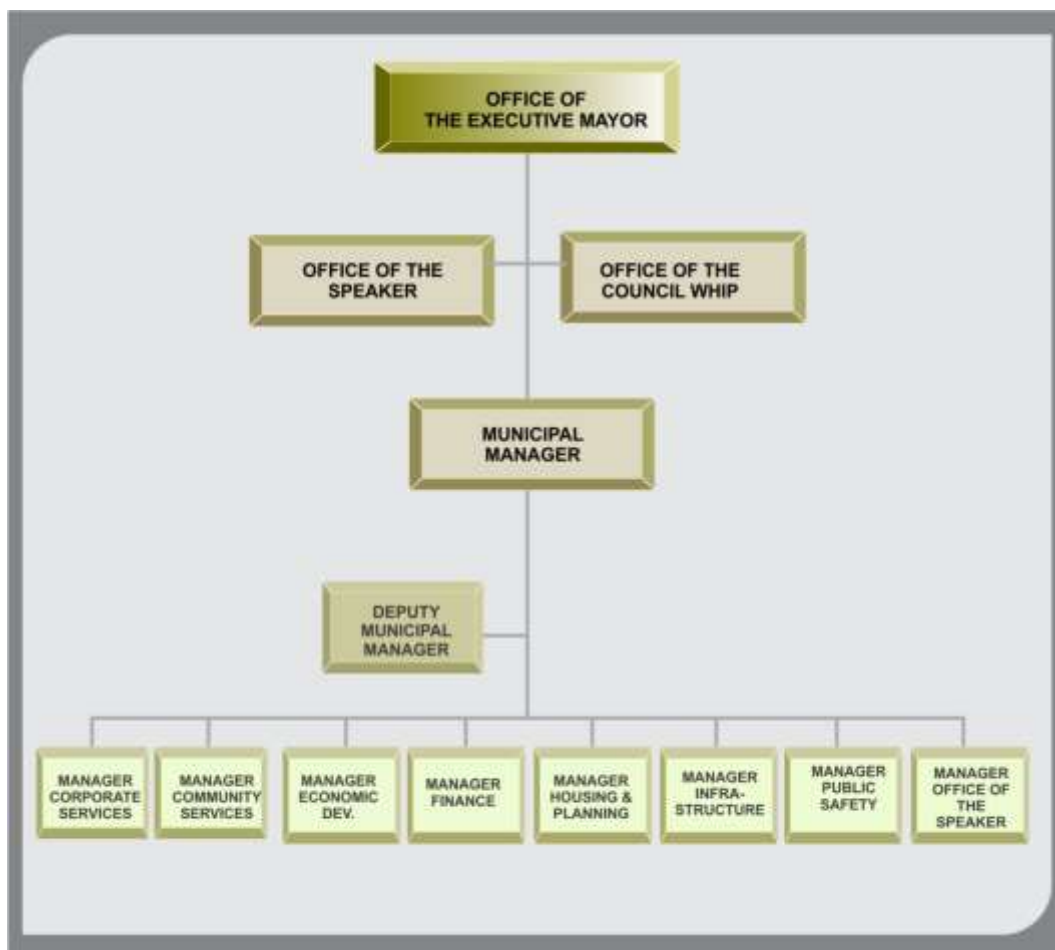


Figure 4.1 Institutional structure of the Tlokwe City Council

Source: IDP document (Tlokwe City Council, 2013b)

In 2008 a new organisational structure was approved with newly created posts and some of the current posts were placed at a higher salary level. A cost analysis of the 2008 structure revealed the structure as being too expensive whereafter Council rescinded this structure and reinstated the 2007 approved organisational structure. Several amended organisational structures were submitted to Council between 2008 and 2012 for approval but to date the structure is not finalised.

The Chairperson of the Audit Committee informed Council on 27 March 2012 that, as an effective organisational structure for placing appropriately skilled persons is not in place, service providers are appointed to perform several financial functions such as the completion of the GRAP compliant financial statements and value-added tax (VAT) reconciliations (Bredenkamp, 2012:6).

The approved organisational structure of the Finance department is indicated in appendix H.

The Auditor General reported in numerous audit reports that discrepancies exist between the posts that appear on the payroll system, the posts budgeted for in the personnel budget and the existing posts structure as provided by the Human Resource department. In 2007 new job descriptions were drafted for all existing posts and sent to the South African Local Government Bargaining Council for benchmarking with similar posts at other municipalities. A new wage curve with grading of posts was promised for local government but this process as well as the benchmarking of job descriptions were never completed owing to legal actions initiated by the two largest trade unions, IMATU (Independent Municipal and Allied Trade Union) and SAMWU (South African Municipal Workers Union), against the employer association SALGA (South African Local Government Association) regarding the wage curve agreement. A service provider was appointed by the Tlokwe City Council in 2013 to analyse all the job descriptions, to grade all the posts and to submit to Council a holistic report regarding a proposed organisational structure.

Although everyone in an organisation has the responsibility to ensure that internal control is effective, the managers and the municipal manager have the ultimate responsibility to ensure that officials do their work and that an effective internal control system is in place (DiNapoli, 2007:7). As mentioned in paragraph 3.2.6.1 (page 36), the MFMA compels the municipal manager to implement an internal control system and senior managers must ensure that this internal control system is carried out diligently.

Owing to the absence of formally approved job descriptions and the organisational structure being seen as a "soft structure", the compliance requirements of the MFMA and its regulations are placing additional work on personnel in the Finance department and are also causing internal control deficiencies.

4.5 INTERNAL AUDIT AND AUDIT COMMITTEE

Section 165 of the MFMA compels a municipality to establish an internal audit section or to outsource the internal audit function if the municipality does not have the internal capacity. One of the tasks of the internal audit section is to advise the accounting officer and the audit committee on internal control matters. Internal Audit is primarily responsible for preparing an internal audit plan, for assisting management in their control and operating responsibilities through independent audits and consultations designed to evaluate the internal control systems (University of California, s.a.:2). Although the internal audit section does not have the line responsibility for risk

assessment or internal control, it should assist in identifying, evaluating and monitoring organisational risks and provide independent assurance to management, if the internal controls and risk management process are adequate and effective (PricewaterhouseCoopers, 2009:7). As the internal audit unit is part of the municipality, they must ensure that management receives independent feedback on how the implementation of policies and procedures are effected throughout the institution (Grove, 2009:21). Badara (2012:58) describes the function of internal audit as to safeguard financial control in the public sector.

The third strategic objective of the Operation Clean Audit 2014 entailed that by the 2010 financial year all accounting officers had to sign performance contracts which included audit management (both internal and external audits), integrated risk management, and the audit committees and internal audit units had to be functional (Van der Walt, 2012:30).

The Auditor General stated in the audit reports of the 2009, 2010, 2011 and 2012 financial years that no reliance is placed on the work of the internal audit section as the unit is not adequately resourced to be able to identify internal control deficiencies and to recommend corrective actions effectively. Owing to the internal audit section of the Tlokwe City Council being understaffed, with only two internal auditors and two interns employed at the end of the 2013 financial year, no sufficient time is available for internal control investigations. The Audit Committee recommended to Council on 27 March 2012, for a municipality of the size of the Tlokwe City Council with all the financial control challenges experienced, that an enlarged internal audit section of at least five internal auditors and one clerical support official is required (Bredenkamp, 2012:5).

According to section 166 of the MFMA each municipality must have an audit committee and section 166(2)(a)(i), (ii) and (iv) of the MFMA requires that the audit committee has to advise the council, the municipal manager and the management staff on effective government, internal financial control, risk management and the adequacy and reliability of financial reporting and information. An internal control deficiency and non-compliance finding was made by the Auditor General in the 2009 audit report and repeated in the 2011 Management Report, owing to the lack of appointment of an audit and performance audit committee.

A new audit committee was established for the Tlokwe City Council on 28 August 2011 and the Audit Committee Charter was tabled in Council in April 2012 for approval. The

Charter stipulates that, *inter alia*, the audit committee shall evaluate the policies and procedures implemented by management to ensure that the accounting and information systems as well as the related controls are adequate and effective. The audit committee will also satisfy itself that it has appropriately addressed internal financial control areas (Audit Committee, 2012:7).

In the 2012 Auditor General Report (2012d) the Auditor General acknowledged that the Audit Committee is functional but ineffective in the internal control environment with regard to performance reporting and compliance with laws and regulations as the Tlokwe City Council did not respond to the concerns raised.

4.6 SUMMARY

The aim of this chapter was to analyse the internal budgetary control system of the Tlokwe City Council. The analysis indicates several deficiencies in the internal budgetary control system that need to be addressed before a clean audit regarding the financial management of the Tlokwe City Council can be achieved.

Kalashe (2007:24) recognises an important disadvantage in the line-item budgeting system as departmental managers are in complete control of their operational budget. This allows them to spend the money allocated as they think fit as long as they are within the budgeted items within their vote. Funds are transferred between line-items in a vote, without concurrence of the political leadership, with the result that officials can determine the objectives and targets to be realised. This challenge can be surmounted if the finance department is given the authority to reallocate funds from departments that are underspending to departments that are experiencing financial challenges. To a large extent the audit findings of underspending and unauthorised expenditure — owing to overspending of votes — can then be eliminated.

The internal control deficiencies identified in irregular, wasteful and fruitless expenditure and non-compliance with legislation can partly be addressed through the establishment, amendment of and adherence to the policies and procedure manuals as required by the MFMA and its Regulations. The current organisational structure needs to be aligned to the functions of a municipality, according to the constitutional mandate of local government, but also in line of the Council Budget By-law that stipulates that personnel expenditure may not exceed 30% of the operational budget. The system of delegations and signing authority of officials must be updated to include the requirements of the

relevant legislation and segregation of duties has to be adhered to at all times. Controls need to be implemented for the monthly reconciliation of accounts and action plans must be developed to address the identified audit findings and internal control deficiencies.

The Auditor General (2010d:66) concluded in his Consolidated Report on local government audit outcomes for the 2009 financial year that every municipality can reach the objective of a clean audit opinion of the financial statements within a short period of time if the leadership of the municipality follows a structured and systematic approach to monitor the implementation of an action plan to address the internal control deficiencies and audit findings. The municipalities must focus on the leadership, financial management and governance fundamentals of internal control. The executive mayor and the municipal manager need to identify the key controls that will drive clean audit opinions and monitor these controls on an ongoing basis. Corrective measures must be taken if variances or shortcomings in the internal controls are identified and the effectiveness of the finance and internal audit structures, the audit committee and risk management must be assessed. Regarding the financial management aspect the finance department must adhere to internal financial controls such as strict segregation of duties, proper filing of documentation, monthly reconciliations of accounts and monthly reporting to management to enable quality decision-making as service delivery must be achieved. To enhance the governance fundamental of internal control the internal audit unit and the audit committee must be empowered and strengthened to perform their tasks effectively.

As indicated in the literature review in chapter 3 section 3.6, benchmarking is the process of identifying, sharing and using knowledge and best practices of peer institutions to be used as an effective method to improve the institution's own effectiveness, efficiency and performance.

In chapter 5 the policies and best practices used by several municipalities to improve their budgetary internal control system to enable them to achieve clean audits, are discussed. The Auditor General Reports for the past three years, the approved policies as required by legislation, the system of delegated authorities, the approved signing authority as well as best practices used in the budgetary internal control systems of the municipalities identified, which can be utilised to eliminate the identified internal control deficiencies at the Tlokwe City Council, are analysed.

CHAPTER 5

5. BENCHMARKING OF MUNICIPALITIES

5.1 INTRODUCTION

The purpose of this chapter is to identify best practices in the internal control systems of other municipalities. Naidoo and Reddy (2008:37) state that it is crucial for local government to adopt management tools and practises to ensure that it stays at the forefront of innovations and to improve in terms of best practices. Through benchmarking, best practices from other organisations and departments can be drawn to achieve business excellence. Although any procedure, practice or process which can be identified can be benchmarked, the focus should be to benchmark those activities which impact on customer satisfaction and/or on either financial or non-financial business results (Naidoo & Reddy, 2008:39). *The Reader's Digest Oxford Complete Wordfinder* (1993:128) describes a benchmark as "a standard or point of reference".

Naidoo and Reddy (2008:41) referred to Koehler and Pankowski (1996) in stating that benchmarking is not often done by teams of government because of various given reasons which mostly originate from a fear of benchmarking, including the concern that weaknesses in their own organisation will be exposed when comparing it with an outstanding functional organisation. Naidoo and Reddy (2008:41) quotes McKenzie (2003) that peer reviews — comparing the municipality to the benchmark of an "ideal" local authority, which has all the qualities of a highly effective local council — emanates from the United Kingdom where local government uses peer review as part of its on-going process constantly to improve itself and the service it delivers to the community.

Naidoo and Reddy (2008:42) mention that, because of the introduction of new legislation governing local government, the benchmark must seek to determine to which extend the identified municipality has been able to implement the Constitution, new legislation applicable to local government as well as government policies.

In this study of benchmarking the best practises of municipalities that had received clean audits or even unqualified audit opinions without findings had to be identified, to analyse the policies and best practices used by several municipalities to improve their budgetary internal control system, to enable them to achieve clean audits. The reports for the last three years of the Auditor General for these municipalities identified, the

approved policies as required by legislation, the system of delegated authorities, the approved signing powers as well as best practices used in the budgetary internal control systems of the municipalities identified, which can be utilised to eliminate the identified internal control deficiencies at the Tlokwe City Council, are analysed.

5.2 IDENTIFICATION OF MUNICIPALITIES TO BENCHMARK

5.2.1 Auditor General audit reports

Every year the Auditor General tables a report to Parliament and in the provincial legislatures regarding the audit outcomes of municipalities and their entities. The audit outcomes of the 2011 financial year was tabled on 23 July 2012 in Parliament and the analyses of the report revealed that slight progress was made to obtain clean audits by 2014 (Auditor General, 2012g). In an address to a parliamentary committee meeting the Auditor General emphasised that South Africa aims for 100% clean audits by 2014. To obtain this outcome leadership needs to have the will to change the situation, competent staff must be appointed and there has to be accountability and consequences for non-performance at all levels of staff (Mawson, 2012:16).

The audit outcomes for the 2010 and 2011 financial years are summarised in Table 5.1.

Table 5.1 Summary of audit outcomes of municipalities

Audit outcomes	2011	2010
Financially unqualified with no findings on predetermined objectives or compliance with laws and regulations (clean audit outcome)	13	7
Financially unqualified with findings on predetermined objectives or compliance with laws and regulations	114	122
Financially unqualified financial statements	45%	46%
Qualified opinion	54	60
Adverse opinion	7	7
Disclaimer opinion	57	77
Number of audit reports not issued by 31 January 2012	38	10
Outstanding audits and financially qualified financial statements	55%	54%
Total number of audits	283	283

Source: Van der Walt (2012:30)

The clean audit outcomes improved from seven municipalities in the 2010 financial year to 13 municipalities in the 2011 financial year. Thus only 5% of the 283 municipalities received a clean audit with no findings on the financial statements, predetermined objectives or compliance with laws and regulations. According to Nombembe (2012:62) the three prominent reasons for the slow progress towards clean audits are:

- Of the municipalities 57% responded slowly to the advice of the Auditor General and slowly implemented key controls.
- Lack of minimum competency of officials, specifically at financial discipline, at 72% of audited municipalities.
- Lack of consequences for poor performance and transgressions at more than 70% of municipalities audited.

The audit analysis per province is also tabled by the Auditor General in the relevant provincial legislature. The 13 municipalities which had obtained a clean audit outcome per province in the 2011 financial year are indicated in Table 5.2. The audit outcomes per province for the 2011 and 2012 financial years are summarised in Appendix I.

Table 5.2 Municipalities with clean audits in the 2011 financial year

KwaZulu-Natal	Limpopo	Mpumalanga	Western Cape
Umzinyathi District Municipality	Waterberg District Municipality	Ehlanzeni District Municipality	Swartland Local Municipality
eMadlangeni Local Municipality	Fetakgomo Local Municipality	Gert Sibande District Municipality	West Coast District Municipality
Richmond Local Municipality		Steve Tshwete Local Municipality	
uMdoni Local Municipality		Victor Khanye Local Municipality	
Umtshezi Local Municipality			

Source: Auditor General (2012e:14)

On 1 September 2010 the Municipal Demarcation Board announced that the number of municipalities would be reduced from 283 municipalities to 278 municipalities (National Treasury, 2010b:4). In the 2012 financial year the overall municipal audit results regressed as only nine municipalities of 278 municipalities obtained a clean audit status.

The nine municipalities which had obtained a clean audit status per province in the 2012 financial year are indicated in Table 5.3.

Table 5.3 Municipalities with clean audits in the 2012 financial year

KwaZulu-Natal	Limpopo	Mpumalanga	Western Cape
Umtshezi Local Municipality	Waterberg District Municipality	Ehlanzeni District Municipality	West Coast District Municipality
		Steve Tshwete Local Municipality	Swartland Local Municipality
			George Local Municipality
			Langeberg Local Municipality
			Mossel Bay Local Municipality

Source: Auditor General (2013c)

Three local municipalities in the Western Cape — the George, Langeberg and Mossel Bay Local Municipalities — improved their audit results to achieve clean audit opinions, by making concerted efforts to address the audit matters raised in the audit reports of the previous year (Auditor General, 2013c:1). Only three local municipalities, the Steve Tshwete, Swartland and the Umtshezi Local Municipalities retained their clean audit status from the previous financial year.

The audit results of the 23 municipalities in the North West Province for the 2012 financial year compared with the previous financial year are indicated in Table 5.4.

Table 5.4 Detailed audit outcomes of the municipalities in the North West Province

Auditee	Audit Outcome 2012	Audit Outcome 2011	Audit Outcome Comparison
Bojanala District Municipality	Financial unqualified with findings	Financial unqualified with findings	Unchanged
Moretele Local Municipality	Disclaimer	Disclaimer	Unchanged
Madibeng Local Municipality	Disclaimer	Disclaimer	Unchanged
Rustenburg Local Municipality	Qualified	Disclaimer	Improved
Kgetleng River Local Municipality	Disclaimer	Disclaimer	Unchanged
Moses Kotane Local Municipality	Qualified	Disclaimer	Improved
Ngaka Modiri Molema District Municipality	Disclaimer	Disclaimer	Unchanged
Ratlou Local Municipality	Financial unqualified with findings	Financial unqualified with findings	Unchanged
Tswaing Local Municipality	Disclaimer	Disclaimer	Unchanged
Mafikeng Local Municipality	Disclaimer	Disclaimer	Unchanged
Ditsobotla Local Municipality	Disclaimer	Disclaimer	Unchanged
Ramotshere Moiloa Local Municipality	Disclaimer	Disclaimer	Unchanged
Dr Ruth Mopati District Municipality	Disclaimer	Disclaimer	Unchanged
Kagisano/Molopo Local Municipality	Disclaimer	Disclaimer	Unchanged

Table 5.4 Detailed audit outcomes of the municipalities in the North West Province (continued)

Auditee	Audit Outcome 2012	Audit Outcome 2011	Audit Outcome Comparison
Mamusa Local Municipality	Disclaimer	Disclaimer	Unchanged
Greater Taung Local Municipality	Disclaimer	Qualified	Regressed
Lekwa-Teemane Local Municipality	Disclaimer	Disclaimer	Unchanged
Dr Kenneth Kaunda District Municipality	Financial unqualified with findings	Qualified	Improved
Ventersdorp Local Municipality	Disclaimer	Disclaimer	Unchanged
Tlokwe City Council	Financial unqualified with findings	Qualified	Improved
City of Matlosana Local Municipality	Disclaimer	Disclaimer	Unchanged
Maquassi Hills Local Municipality	Disclaimer	Disclaimer	Unchanged

Source: Auditor General (2013a:6; 2013b:27–8)

As indicated in Table 5.4, none of the 23 municipalities in the North West Province had achieved a clean or an unqualified audit opinion without findings in either the 2011 or the 2012 financial years. As described in chapter 1 section 1.6 (p. 6) a clean audit is an report from the auditor without any findings on financial statements, predetermined objectives or findings in compliance with laws and regulations. A financial unqualified opinion with findings is an audit opinion where the financial statements are regarded as a true reflection of the financial status of the municipality, although there are still findings with regard to the financial statements which are not material to qualify the audit finding or with regard to the predetermined objectives or the compliance with laws and regulations.

In the 2011 financial year only two municipalities, the Ratlou Local Municipality and the Bojanala District Municipality, had achieved unqualified audit opinions with findings. Both the Tlokwe City Council and the Dr Kenneth Kaunda District Municipality had

improved from a qualified audit opinion in the 2011 financial year to achieve, together with above-mentioned two municipalities, unqualified audit opinions with findings in the 2012 financial year.

Although only four municipalities in the North West Province, the Tlokwe City Council included, had achieved an unqualified audit with findings in the 2012 financial year, the Tlokwe City Council can neither be compared with a small rural municipality such as the Ratlou Local Municipality (Stella) nor with a district municipality such as the Bojanala or the Dr Kenneth Kaunda district municipalities. As indicated in chapter 3 section 3.2.3 (p. 33) district municipalities have a different constitutional mandate to local municipalities and can thus not be compared with local municipalities. The Ratlou Local Municipality cannot be compared to the Tlokwe City Council as the revenue base of the municipality consists of 94% government grants and only 6% revenue is raised from service charges for municipal services.

5.2.2 Municipal Financial Sustainability Index

In August 2011 Ratings Africa had published a report regarding the expansion of the new Municipal Financial Sustainability Index (MFSI) and in February 2012 had updated the report to include the 2011 financial results of 102 municipalities. Ratings Africa is a governance ratings agency, one of only three in the world, that focuses on the measurement of sound corporate governance by public entities including municipalities and corporations (Ratings Africa, 2011:1–8).

Ratings Africa defines municipal financial sustainability as the financial ability to deliver services, to develop and to maintain the infrastructure required by its residents without unplanned increases in rates and taxes or a reduction in service delivery, and the capacity to absorb financial upsets caused by natural, economic and other adversities without external financial assistance. The MFSI focuses on four internal components (with different weightings for the calculation of the index) that can be influenced by management, namely:

- financial position — 8%
- operating performance — 24%
- debt governance — 28%
- liquidity management — 40%

The MFSI was initially calculated for 105 local and metropolitan municipalities with a score calculated for four years from 2007 to 2010. The report of February 2012 only included the 2011 financial results for 102 municipalities. In Table 5.5 the best-performing municipality per province as per the MFSI rating and the audit opinion of these municipalities for the 2011 and 2012 financial years are shown.

Table 5.5 Best-performing municipalities in 2011 by province

Province — municipality	2007	2008	2009	2010	2011	2011 audit opinion	2012 audit opinion
Eastern Cape — Amahlati (Stutterheim)	75	70	79	80	80	Qualified	Qualified
Free State — Metsimaholo (Sasolburg)	35	32	48	52	73	Disclaimer	Qualified
Gauteng — Midvaal (Meyerton)	56	38	31	38	50	Unqualified with findings	Unqualified with findings
KwaZulu-Natal — KwaDukuza (Stanger)	80	79	87	84	86	Unqualified with findings	Unqualified with findings
Limpopo — Mogalakwena (Mokopane — Potgietersrus)	83	75	74	79	80	Unqualified with findings	Unqualified with findings
Mpumalanga — Steve Tshwete (Middelburg)	90	88	84	78	74	Clean Audit	Clean Audit
Northern Cape — Emthanjeni (De Aar)	31	31	48	68	66	Qualified	Qualified
North West Province — Tlokwe (Potchefstroom)	80	79	79	80	82	Qualified	Unqualified with findings
Western Cape — Stellenbosch	86	84	71	80	85	Unqualified with findings	Unqualified with findings

Source: Ratings Africa (2012:4); 2011 and 2012 Annual Reports of individual municipalities and MFMA road shows of the Auditor General

On 21 February 2012 Leon Claassen of Ratings Africa mentioned in an interview with Cox (2012) that, although municipalities have to face many challenges, there are still a few well-managed municipalities in South Africa. According to him these municipalities adhere to good budgetary practices, strict financial control and good revenue collection. The City of Johannesburg was identified as the worst performing municipality financially

in this study with 26 points and Cape Town obtained the highest points as a metropolitan city, with 63 points. The Tlokwe City Council was also mentioned in this article as earning the third highest points for financial stability and financial sustainability in the country.

The Tlokwe City Council, with an overall score of 82, received the highest points in the North West Province. The other three larger municipalities in the North West Province — the City of Matlosana Local Municipality (Klerksdorp), the Rustenburg Local Municipality and the Madibeng Local Municipality (Brits) — obtained 68%, 65% and 16% respectively in the MFSI (*North West Independent*, 2012:1).

5.2.3 Identifying municipalities to benchmark the Tlokwe City Council

Although the City of Matlosana Local Municipality and the Rustenburg Local Municipality obtained more than 50 points in the MFSI study, the City of Matlosana Local Municipality received disclaimer audit opinions in the past four consecutive financial years and the Rustenburg Local Municipality received a qualified audit opinion in the 2010 financial year, a disclaimer in 2011 and improved in 2012 to obtain a qualified audit opinion (City of Matlosana Local Municipality, 2010, 2011a, 2012, 2013a; Rustenburg Local Municipality, 2012, 2013). The history of audit opinions and number of audit findings which are included in the respective audit reports for the Rustenburg Local Municipality and the City of Matlosana Local Municipality is indicated in Appendix J.

Although the City of Matlosana Local Municipality and the Rustenburg Local Municipality with populations of 398 676 and 549 575 citizens respectively, according to the 2011 census (Statistics South Africa, 2013), are much larger than the Tlokwe City Council, they are not found suitable to benchmark the Tlokwe City Council owing to their specific financial challenges, as indicated in their respective audit opinions.

As both the audit opinions of the Auditor General as well as the MFSI research done by Ratings Africa indicate that the Tlokwe City Council is rated as the best performing local municipality in the North West Province, municipalities in other provinces which received clean audits and/or obtained more than 50 points in the MFSI study are identified to be more suitable to compare the Tlokwe City Council with.

The researcher decided to use two municipalities — which had received clean audits in at least two consecutive financial years — to benchmark. The Steve Tshwete Local

Municipality (Middelburg) in Mpumalanga received clean audit opinions for three consecutive financial years (2010, 2011 and 2012) and was the best-performing municipality in the MFSI in Mpumalanga for the 2011 financial year.

Although the Swartland Local Municipality in the Western Cape is smaller than the Tlokwe City Council, with total assets amounting to R2,03 billion in comparison to the total assets of the Tlokwe City Council of R3,85 billion at 30 June 2012, the municipality was identified as benchmark as it had received unqualified audit opinions for the 2009 and 2010 financial years with findings but improved to receive clean audit opinions in both the 2011 and 2012 financial years.

5.3 ANALYSIS OF AUDIT REPORTS AND INTERNAL CONTROL SYSTEMS — SWARTLAND LOCAL MUNICIPALITY AND STEVE TSHWETE LOCAL MUNICIPALITY

5.3.1 Background

5.3.1.1 Swartland Local Municipality

The Swartland Local Municipality includes the towns in the Western Cape of Abbottsdale, Chatsworth, Darling, Kalbaskraal, Malmesbury, Moorreesburg, Riebeeck Kasteel, Riebeeck West, Riverlands and Yzerfontein. The head office and main infrastructure is based in Malmesbury. The total population of the Swartland demarcated area as per their own survey in 2011, was indicated in the Swartland Local Municipality Annual Report (2013a:5) as 94 804 persons, of which 83 217 are residing in the various towns and 11 587 in the rural areas. According to the 2011 census (Statistics South Africa, 2013) the population of the Swartland Local Municipality is indicated as 113 762 persons.

The Swartland Local Municipality has a mayoral executive system combined with a ward participatory system, whereby the executive leadership vests in the executive mayor, assisted by a deputy mayor and a mayoral committee of four full-time councillors. Twenty three councillors, twelve ward councillors and eleven proportionally elected councillors serve in the Swartland Local Municipality.

5.3.1.2 Steve Tshwete Local Municipality

In 1994 the towns of Middelburg, Mhluzi, Hendrina and Kwazamokuhle were amalgamated to form a Transitional Local Council. The Steve Tshwete Local

Municipality came into being on 5 December 2000 and it includes the following towns, villages and rural settlements in the Mpumalanga province: Blinkpan, Doornkop, Hendrina, Komati, Koorfontein, Kranspoort, Kwamakalane, Kwazamokuhle, Lesedi, Naledi, Presidentrus, Pullenshope, Rietkuil, Somaphepha, Sikululiwe and the biggest towns Middelburg and Mhluzi in which the majority of the estimated 229 831 citizens (Statistics South Africa, 2013) reside. The municipal area covers approximately 3933 km² in comparison with the Tlokwe City Council municipal area of approximately 2675 km².

The Council of Steve Tshwete Local Municipality comprises 58 councillors, 29 ward councillors and 29 proportional representatives and is headed by an executive mayor, assisted by six members of a mayoral committee, the Speaker and the Chief Whip.

5.3.2 Audit opinions

5.3.2.1 Swartland Local Municipality

The history of the audit opinions and number of audit findings for the Swartland Local Municipality for the financial years 2009 to 2012 are shown in Table 5.6.

Table 5.6 History of audit opinions and audit findings for the Swartland Local Municipality

Financial year	Audit opinion	Qualification findings	Emphasis of matter	Other/ additional matters	Non-compliance with legislation
2009	Unqualified	0	3	1	0
2010	Unqualified	0	0	0	1
2011	Clean audit	0	1	1	0
2012	Clean Audit	0	1	1	0

Source: Swartland Local Municipality (2009a, 2010a, 2011a, 2013a)

The three findings emphasised in the 2009 audit were for errors which occurred in the restatement of corresponding figures as the Swartland Local Municipality adopted the transitional provisions of GRAP Standards in the 2009 financial year as well as for material water losses which had occurred in that specific year. The only audit finding listed under other matters was for 18,34% underspending on the capital budget but the Auditor General resolved that it did not have a negative impact on service delivery. The

Auditor General warned in its report (Swartland Local Municipality, 2009b:10) that the municipality will experience greater challenges in future with the full implementation of the GRAP Standards and recommended the following action plan:

- a strategy must be developed to improve financial management controls relating to compliance with accounting standards and reconciliation, and maintenance of underlying records;
- a discipline of producing at a minimum monthly and quarterly financial accounts; and
- the financial statements must be subjected to a quality review before they are submitted for auditing. The internal audit unit and the audit committee could assist in this regard.

The Swartland Local Municipality did adhere to the above-mentioned recommendations of the Auditor General and did implement an action plan to address all the audit findings in the 2010 financial year. Although the municipality had implemented the full GRAP financial standards in the 2010 financial year, as per legislative requirements for medium-capacity municipalities, it received only one audit finding in the 2010 financial year. This audit finding was in respect of non-compliance with regulatory and reporting requirements owing to the submission of the financial statements to the Auditor General eight days late. This omission to submit the financial statements on 30 August 2010 was beyond the control of the municipality, as information regarding infrastructure assets was received late (Swartland Local Municipality, 2010b:16).

As indicated in appendices E and F, no repetitive findings in financial management and non-compliance of legislation were found in the 2010, 2011 and 2012 financial years except findings regarding governance of Information Technology. After each statutory audit was concluded, the management of the Swartland Local Municipality immediately implemented an action plan to rectify the audit findings and the financial internal controls were improved as recommended by the Auditor General (Swartland Local Municipality, 2010b:6, 2011b:10).

The Auditor General did not identify any significant deficiencies in internal control relevant to his audit of the financial statements, annual performance report and compliance with laws and regulations in the 2009, 2010, 2011 and 2012 financial years (Swartland Local Municipality, 2009b, 2010a, 2010b, 2011b, 2012c).

In appendix A, as referred to in chapter 4 section 4.2.2 (p. 61), the assessment of the achievement of control objectives at the Tlokwe City Council and the Swartland Local Municipality is analysed. These assessments are based on significant deficiencies relating to the fair presentation of the financial statements, material misstatements corrected as a result of the audit, findings on the predetermined objectives and findings on non-compliance with laws and regulations for the 2011 and 2012 financial years.

5.3.2.2 Steve Tshwete Local Municipality

In the 2009 financial year, three audit findings on performance information resulted in the Steve Tshwete Local Municipality receiving an unqualified audit opinion with findings. Corrective actions, which were immediately taken in response to the findings of the Auditor General, resulted in the municipality receiving clean audits in the following three consecutive financial years. During the 2012 financial year neither unauthorised nor irregular expenditure occurred but two reported cases to the value of R250 884 resulted in fruitless and wasteful expenditure (Steve Tshwete Local Municipality, 2013a: 55–6). In the prior two financial years, no fruitless or wasteful expenditure, unauthorised or irregular expenditure was reported in the financial statements.

The Auditor General did not find any deficiencies in internal control that was considered significant for inclusion in his audit report regarding the financial statements, predetermined objectives or non-compliance with laws and regulations for the 2010, 2011 and 2012 financial years (Steve Tshwete Local Municipality, 2010, 2011, 2012a, 2013a).

As contained in the mission statement of the Steve Tshwete Local Municipality, the municipality is dedicated to the total well-being of all citizens, *inter alia*, through striving to sustain the fiduciary position of the municipality towards achieving a clean audit (Steve Tshwete Local Municipality, 2013a).

5.3.2.3 Summary of the audit opinions

A summary of the audit opinions for the 2009, 2010, 2011 and 2012 financial years as well as several of the financial indicators and financial information of the Tlokwe City Council (as discussed in chapter 4) and both the Swartland and the Steve Tshwete local municipalities for the period ending 30 June 2012 is shown in Table 5.7.

Table 5.7 Summary of key financial indicators, financial position and audit findings of the Tlokwe City Council and both the Swartland and the Steve Tshwete local municipalities

	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Audit opinion — 2009	Disclaimer	Financial unqualified with findings	Financial unqualified with findings
Audit opinion — 2010	Qualified audit opinion	Financial unqualified with findings	Clean Audit
Audit opinion — 2011	Qualified audit opinion	Clean Audit	Clean Audit
Audit opinion —2012	Financial unqualified with findings	Clean Audit	Clean Audit
Assets Value on 30 June 2012	R3,85 billion	R2,03 billion	R6,67 billion
Capital expenditure for 2012	R97,24 million	R107,85 million	R237,9 million
Average payment rate for 2012 financial year	91,04%	96,64%	101,3%
Consumer debtors	R174,0 million	R45,04 million	R69,9 million
Population	162 762	113 762	229 831

Source: Swartland Local Municipality (2009a, 2010a, 2011a, 2013a); Statistics South Africa (2013); Steve Tshwete Local Municipality (2013a, 2013c); Tlokwe City Council (2013a)

The 101,3% debtors payment rate achieved by the Steve Tshwete Local Municipality is owing to strict adherence to the Credit Control and Debt Collection Policy, resulting in collection of consumer debt for rates and services outstanding for longer than a year. It is clear from the above summary of the audit opinions and financial information of the Tlokwe City Council, the Swartland and the Steve Tshwete local municipalities that, although the sizes of the municipalities vary, the Tlokwe City Council can benchmark and learn from the best practices of both the municipalities identified. Both the Steve Tshwete and the Swartland local municipalities have obtained clean audit opinions, have substantially less consumer debtors than the Tlokwe City Council, have better average payment rates and expend more on capital projects than the Tlokwe City Council.

Except for repetitive findings regarding information technology at the Swartland Local Municipality, no repetitive findings occurred regarding financial management, predetermined objections or compliance with legislation at the Swartland and the Steve Tshwete local municipalities. Both municipalities immediately implemented an action

plan to address audit findings after the audit findings were raised by the Auditor General.

5.3.3 Organisational structure

5.3.3.1 Swartland Local Municipality

The organisational structure of the Swartland Local Municipality is reviewed on an annual basis and if needed, owing to legislation or service delivery requirements, amendments to the structure are made. The latest amendments to the organisational structure were approved by Council on 24 November 2011. The total personnel corps consists of the municipal manager, 6 executive managers appointed on a five-year contract basis in accordance with section 56 of the MSA and 534 employees.

The top two tiers of the organisational structure of the Swartland Local Municipality, including the staff in the Office of the Municipal Manager, are indicated in Figure 5.1.

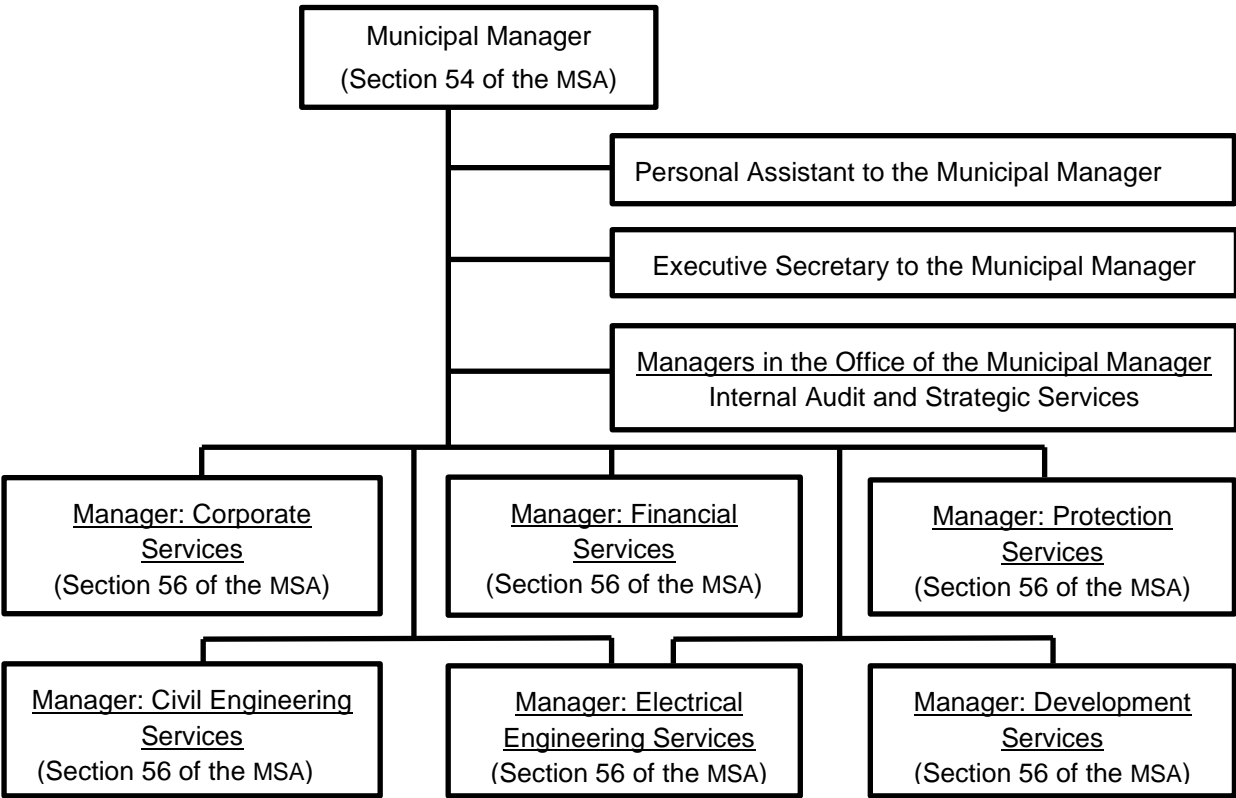


Figure 5.1 Top two tiers of organisational structure of the Swartland Local Municipality

Source: Swartland Local Municipality (2012b)

The total personnel expenditure for the 2012 financial year amounted to 30,38% of the total operating expenditure. However, if the depreciation charges and the bulk purchases are deducted from the total operating expenditure amount, the employees

costs amounted to 56,5% — 6,5% higher than the benchmark set by the National Treasury. This higher employee costs percentage is owing to the municipal policing service which is delivered by the Swartland Local Municipality.

The Auditor General commented in the 2012 Swartland Annual Report (Swartland Local Municipality, 2013a:9–11) that the Swartland Local Municipality is well managed and all staff is dedicated to provide a good service to the community. The municipality considers its human resources as one of its most critical assets and this is reflected in the human resource strategy goal to create a flexible organisation which enables the optimal performance of personnel by training, developing and retaining a properly skilled and representative workforce (Swartland Local Municipality, 2013a:9).

The organisational structure of the Financial Services department consists of 74 approved posts allocated to seven sections, as indicated in appendix H. The department is managed by the Manager: Financial Services, who is also the Chief Financial Officer of the Swartland Local Municipality. Of the 74 approved posts in the Financial Services department only three posts or 4,05% are vacant.

The importance to achieve a clean audit and a financially sustainable municipality is clearly indicated by the placement of 13 officials in the supply chain management section. The efficiency of the supply chain management unit is apparent as the last audit finding reported for lack of internal control in supply chain management occurred in the 2009 financial year and only one finding on non-compliance with legislation occurred in the 2010 financial year. The unit works closely with the Provincial Treasury to comply with all legislative requirements. Reports of all awards above R100 000 are submitted to the Provincial Treasury on a monthly basis, all awards above R30 000 have been placed on the National Treasury website and the supplier database is continuously updated on a daily basis. The supply chain management unit is continuously improving its processes and procedures to ensure that the municipality receives value for money in terms of procurement of goods and services (Swartland Local Municipality: 2013b).

5.3.3.2 Steve Tshwete Local Municipality

The organisational structure of the Steve Tshwete Local Municipality is reviewed annually and necessary amendments are made if necessitated by legislation or service delivery requirements. On 30 June 2012 the total personnel corps consisted of the

municipal manager, 4 executive managers (section 56 of the MSA five-year fixed-term contract appointees) and 1 290 permanent employees (Steve Tshwete Local Municipality, 2013a:44). The top two tiers of the organisational structure consist of the municipal manager, the deputy municipal manager — who was appointed during the 2013 financial year — and four executive managers responsible for Financial Services, Technical and Facilities, Public Services and Corporate Services, as shown in Figure 5.2. The personnel component in the Office of the Municipal Manager is also included.

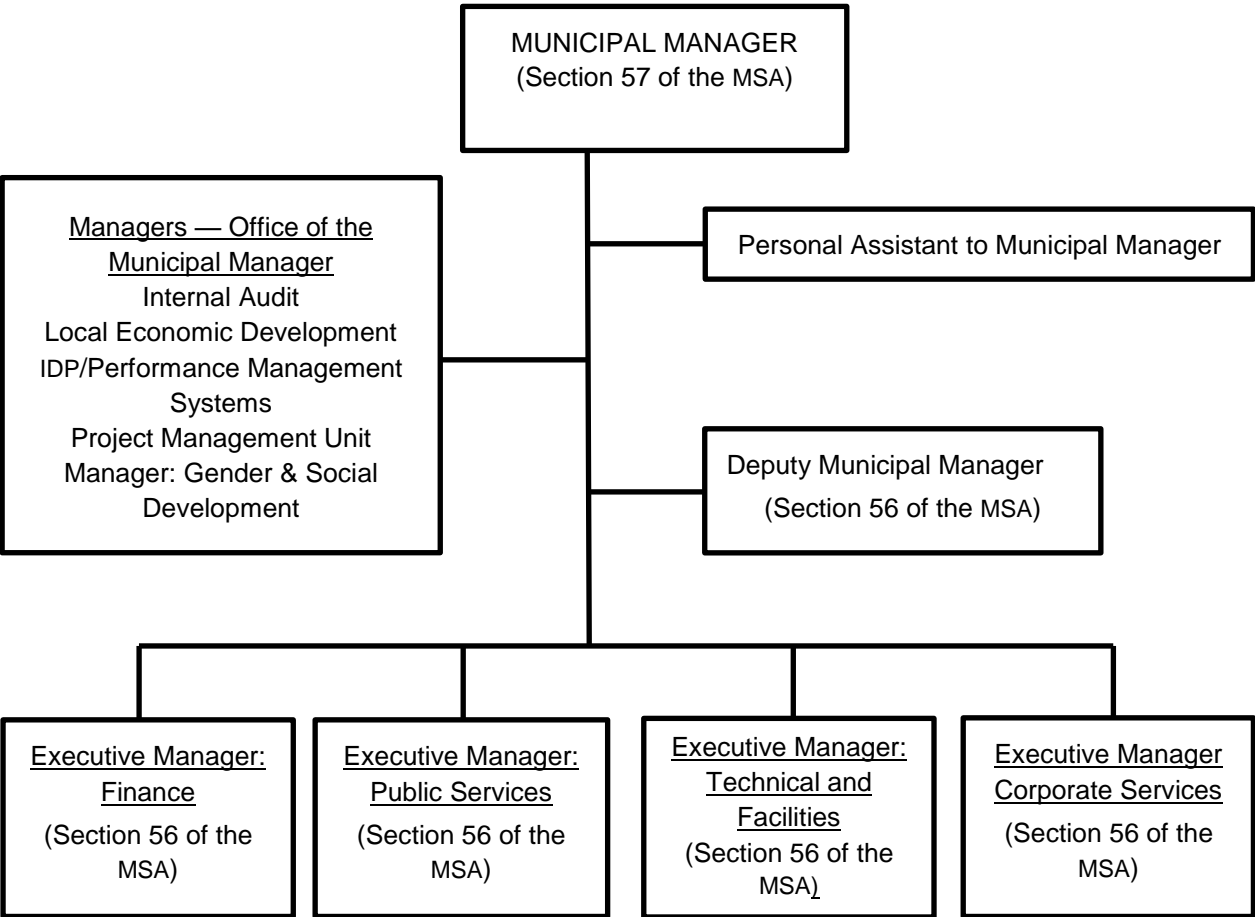


Figure 5.2 Top two tiers of organisational structure of the Steve Tshwete Local Municipality
Source: Steve Tshwete Local Municipality (2013c)

The total employee costs budgeted for the 2013 financial year amounted to 31,9% of the total operating expenditure. The projected percentage employee costs of the total operating expenditure will decrease to 27,7% in the 2015 financial year. However, if depreciation charges and bulk purchases are deducted from the total operating expenditure amount, the employee costs will amount to 50,79%; only 0,79% higher than the benchmark set by National Treasury.

The Finance department is managed by the Executive Manager: Finance, who is also the Chief Financial Officer, assisted by the Senior Manager: Finance (Deputy Director Finance) and four assistant directors. The total staff complement of 109 employees in the Finance department, as provided for in the organisational structure of the Steve Tshwete Local Municipality (2013c), is allocated in nine sections.

The organisational structure of the Finance Services department is shown in appendix H. Of the total of 109 posts, as provided for in the organisational structure of 22 April 2013, 15 posts or 13,76% were vacant.

All the staff in the Finance Services department is dedicated to achieve the vision of the department to manage the financial affairs of the municipality in an efficient and effective manner, to sustain a sound financial position towards sustainable service delivery within the prescribed legislative framework (Steve Tshwete Local Municipality, 2012a). This vision of the Finance Department is achieved by strict upholding of the following values:

- ensuring transparency and accountability;
- managing expenditure, revenue, assets and liabilities in a responsible manner;
- well thought-out budgetary and financial planning processes;
- adhering to all legislative requirements;
- applying full credit control measures;
- effective supply chain management; and
- effective cash flow management.

5.3.3.3 Summary of the best practices on organisational structure

In both the Steve Tshwete and the Swartland local municipalities the organisational structures are in place and are reviewed annually if amendments are necessitated owing to legislation or service delivery requirements. Although the Steve Tshwete Local Municipality has a 13,76% vacancy rate in the Finance department, the dedicated staff had ensured that the municipality obtained clean audit opinions for three consecutive years. The municipality did identify the retention and obtaining of skilled staff as a key institutional challenge (Steve Tshwete Local Municipality, 2013c).

In Table 5.8 information regarding the organisational structures of the Tlokwe City Council, the Swartland and the Steve Tshwete local municipalities are provided.

Table 5.8 Summary of organisational structures and number of posts in the Tlokwe City Council and both the Swartland and the Steve Tshwete local municipalities

Description	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Organisational structures in place and reviewed annually	No	Yes	Yes
Number of section 57 and 56 managers	Municipal manager and seven budgeted managers posts	Municipal manager and six executive managers	Municipal manager, deputy municipal manager and four executive managers
Total number of staff	1 188 employees	534 employees	1 290 employees
Total number of posts in Finance Department	93 posts	74 posts	109 posts
Vacant positions in Finance Department	21 posts (22,58%)	3 posts (4,05%)	15 posts (13,76%)
Salaries payment as a percentage of total operational expenditure	25,74%	30,38%	31,9%

Source: Swartland Local Municipality (2013a), Steve Tshwete Local Municipality (2013c), Tlokwe City Council (2013a)

In appendix H the organisational structures of the Finance departments of both these benchmarked municipalities as well as the Tlokwe City Council are tabled with regard to the number of personnel and the number of vacant positions per section.

It is apparent from the above table and appendix H that a clean audit opinion can be obtained with limited human resources but adequate staff must be allocated to critical sections as, for example, the supply chain management unit. Before the Tlokwe City Council can address the 12 audit findings on non-compliance with laws and regulations regarding procurement and contract management and the findings on irregular expenditure, the six vacant positions in the supply chain management unit and the three vacant positions in the municipal stores must be filled. A vision and core values for the Finance department at the Tlokwe City Council must be developed, based on the best practice of Steve Tshwete Local Municipality. All staff must adhere to the core values.

5.3.4 Policies and compliance to legislation

5.3.4.1. Swartland Local Municipality

At the Swartland Local Municipality risk assessment is done on an annual basis by each department. The following five major risks were identified by the municipality:

- insufficient revenue to meet the increasing demand of services;
- expensive and unaffordable services for the community;
- ageing and poor insufficient maintenance of fixed assets which can result in the collapse of services;
- lack of appropriate skilled and productive staff; and
- unsafe and unhealthy working conditions.

Managers are expected to limit the risks and to implement controls over their activities by establishing policies and appropriate procedures with regard to approvals, authorisations, segregation of duties, reconciliations and physical safeguarding. Greater corporate responsibility and conduct of business within acceptable ethical standards are obtained by strict implementation of these policies and procedures (Swartland Local Municipality, 2013a: 21–2).

Financial policies are reviewed annually and when either legislation or local circumstances necessitate any amendments, these amendments are indicated in the Budget and in the Annual Report. All current financial and budget-related policies, the annual and adjustment budgets and all budget-related documents are duly published on the website of the Swartland Local Municipality. The Swartland Local Municipality has promulgated 74 municipal by-laws, of which eight budget-related by-laws are required by the Municipal Budget and Reporting Regulations. These budget-related by-laws and other financial policies, as required by the Municipal Budget and Reporting Regulations, are shown in appendix G.

The Financial By-Law, as approved in 2006, comprehensively covers all the aspects of local government financial management, ranging from budgeting, income, expenditure, internal audit and audit committees. The Financial By-law, as well as the above-mentioned specific by-laws and policies, apply to and regulate the actions of the political structures, the political office bearers, the municipal officials and the service providers to ensure transparent, accountable and financially sound administration of income,

expenditure, assets and liabilities of the municipality (Swartland Local Municipality, 2006).

Newly drafted policies including the borrowing policy, funding and reserve policy and the long-term financial plan were not finalised in March 2013 at the time when the Draft Budget was submitted to Council.

5.3.4.2. Steve Tshwete Local Municipality

As stated in the Annual Report of the Steve Tshwete Local Municipality (2012a:12) the purpose of the budget-related and financial policies is to provide a comprehensive environment to manage the financial affairs of the municipality within the relevant legal framework. As indicated in appendix G, 16 key budget-related policies are available on the website and these are reviewed annually. Amendments to these policies are made when local circumstances or new legislation necessitates it.

The mission statement of the Steve Tshwete Local Municipality describes a dedicated municipality which strive to promote and to implement the values and principles of public administration, as embedded in section 195(1) of the Constitution, and which is committed to the total well-being of its citizens. This commitment will be achieved by the municipality, *inter alia*, through an effective management system, procedures, skilled and motivated personnel and the desire to strive to sustain the fiduciary position of the municipality towards achieving a clean audit (Steve Tshwete Local Municipality, 2013a).

The municipality has adhered fully to the MFMA legislation through the implementation of the following activities:

- In-year reporting, as determined by the Municipal Budget and Reporting Regulations, is strictly compiled within the timeframes according to the prescribed formats.
- The Budget and Treasury Office (Finance department) has been established in accordance with the MFMA.
- An audit committee serving the district was established and is fully functional.

The Steve Tshwete Local Municipality fully comply with the stipulations of the following legislation, circulars and regulations issued specifically with regard to local government:

- Local Government: Municipal Structures Act, Act 117 of 1998 with all its amendments.
- Local Government: Municipal Systems Act, Act 32 of 2000 with all its amendments and promulgated regulations.
- Local Government: Municipal Property Rates Act, Act 6 of 2004 and its regulations.
- MFMA, Act 56 of 2003 in its entirety including all the promulgated regulations.
- Compliance to National Treasury Circulars in line with the MFMA and the MSA in so far as the stipulations are approved by Council for adoption and implementation.

The municipality is also in full compliance with 14 various acts, where sections and the stipulations of sections of these acts are applicable to local government; amongst others the Constitution of South Africa, 1996 and the Division of Revenue Act, as enacted annually (Steve Tshwete Local Municipality, 2013a).

5.3.4.3. Summary of the policies and compliance with legislation

The clean audit opinions of both the Steve Tshwete Local Municipality and the Swartland Local Municipality indicate that these municipalities fully comply with all the requirements of the MFMA and its promulgated regulations as well as all other relevant legislation. As indicated in appendix G, of the 26 financial policies required by regulation 7(1) of the Municipal Budget and Reporting Regulations, the Tlokwe City Council, the Steve Tshwete and the Swartland local municipalities have only 14, 11 and 8 policies or by-laws in place, respectively. Although the Tlokwe City Council have more policies in place than the two benchmarked municipalities, the Tlokwe City Council does not adhere to these policies — resulting in 34 audit findings with regard to compliance with legislation in the 2012 financial year. In both the 2011 and 2012 financial years the Auditor General repeatedly reported on deficiencies in the Supply Chain Management By-Law and the Cash Management and Investment Policy, the lack of an inventory management policy as well as procurement of goods and services which were done in contravention of the procurement procedures, as contained in the Supply Chain Management By-Law, resulting in irregular expenditure.

5.3.5. Budget and Integrated Development Plan

5.3.5.1. Swartland Local Municipality

The IDP and the Performance Management of the Swartland Local Municipality are performed by the Strategic Manager, reporting directly to the Municipal Manager. The five-year IDP determines the budget and the performance management system is closely reporting on the achievement of objectives set for the budget and the IDP. The IDP is reviewed annually and the community is invited to submit proposals for consideration in the operating and the capital budgets as well as in the capital programme by 31 October in any year. Specific guidelines regarding the capital budget are included in the Financial By-law, which is strictly adhered to. Each capital project is indicated in terms of IDP objectives, project classification of National Treasury, financial sources, expected costs of financing, maintenance, and operation as well as monthly cash-flow projections for the first financial year. The budget is aligned to the key performance areas in the strategic plan. By a performance management system top and middle management are evaluated on an annual basis. The service delivery and client services are monitored on a monthly basis by satisfaction surveys and in this regard monthly and quarterly reporting are done to Council Committees (Swartland Local Municipality, 2006; 2013a:21–3).

According to the Financial By-law (Swartland Local Municipality, 2006) the managers of the departments together with the municipal manager analyse the budgets and the actual expenditure or revenue to ensure that the figures are accurate. A cost centre controller, who is accountable to the head of the department, is appointed for each department to perform the following tasks:

- determination of key performance indicators;
- monitoring of actual expenditure and income against budgets;
- authorising of disbursements in terms of delegated powers granted by the head of the department;
- regular reporting of variances compared to the budgets; and
- co-operation with the municipal manager or the departmental accountant regarding financial matters.

At least once a year the departmental managers prepare a financial plan which, amongst others, includes a budget summary, a short description of the organisational

structure, explanations of variances in the operating budget between expenditure and the budget, shortcomings in the department and strategies to overcome these shortcomings. The purpose of these financial plans is to focus a department, section or project on future operations against planned, measurable and achievable objectives, which support the IDP. All variances against the budget are reported by the departmental manager to the municipal manager and the financial plans are updated at least three times during a financial year (Swartland Local Municipality, 2006).

The Financial By-law stipulates that no expenditure may be incurred unless it is provided for in the operating budget. Expenditure in the case of emergency may only be undertaken if the executive mayor approves it, after the municipal manager has briefed him in this regard.

No unauthorised, irregular, fruitless and wasteful expenditure were incurred in the 2011 financial year but in the 2012 financial year unauthorised and fruitless and wasteful expenditure to the value of R8,26 million and R12,188 respectively are reflected in the financial statements (Swartland Local Municipality, 2013a:57,86). The latter amount was for interest raised by SARS on a VAT claim in 2009 and 2010 financial years whilst the vendor was not registered for VAT. Of the R8,26 million, R5,79 million overspending on the acquisition of property, plant and equipment was owing to borrowing costs that was not budgeted for. The internal controls which are in place, as well as strict adherence to the supply chain management regulations, prevented that any irregular expenditure was incurred.

5.3.5.2. Steve Tshwete Local Municipality

On 31 May 2012 when the Executive Mayor of the Steve Tshwete Local Municipality, Councillor M.A. Masina, presented his Budget Speech to the Council, he explained that in the past three years the Steve Tshwete Local Municipality did achieve clean audits; firstly because of political will. He further made it clear that the capable chief financial officer and personnel in the Finance department, the commitment of all personnel to comply with legislation, the united stand against corruption and the commitment of the community to pay for services all contributed to the clean audit status (Steve Tshwete Local Municipality, 2012b:5).

A well-planned functional budgetary and IDP planning process, political oversight, a 99% payment rate, as well as good governance and financial administration contributed

to the sound financial status of the municipality. As part of the IDP process, in a strategic analysis done by the management, financial viability owing to a good income base, sound financial planning and management, and proper credit control was identified as important strengths of the municipality (Steve Tshwete Local Municipality, 2013c). The IDP and the budget of the Steve Tshwete Local Municipality are guided by the following seven strategic developmental priorities:

- financial viability;
- poverty alleviation;
- good corporate governance;
- economic growth and development;
- integrated environmental, social and economic spatial development;
- good co-operative governance; and
- cost effective and sustainable services.

As part of the IDP process, a series of consultative meetings is held at ward level to discuss issues affecting the community. Submissions of the community, which are in line with above-mentioned strategic priorities, are included in the IDP. The IDP is seen as the business plan of the municipality and is incorporated in the final budget. The community participation process ensures that the objective of the aligned IDP and the budget of continuous service delivery to all the communities in the demarcated area of the municipality is implemented (Steve Tshwete Local Municipality, 2012b:9). The Executive Mayor reiterates that expectations of the IDP can only be implemented if the good co-operation which exists between the politicians, the community and the administration, is maintained (Steve Tshwete Local Municipality Website, 2013e).

The variance between the final budget and the actual operating expenditure in the 2012 financial year amounted to a mere 1,21% but a 46,48% underexpenditure was incurred in the capital budget. The five-year capital budget per department is fully aligned to the five-year IDP and is presented in the budget in a detailed service delivery and budget implementation plan for the coming financial year. The service delivery and budget implementation plan provides the monthly cash flow forecasts of the planned project, an indication in which ward the capital project will be incurred as well as the funding source of the capital project.

With regard to budget control, the Executive Manager: Finance — as part of delegated authority to her — promptly informs the heads of departments when the budgeted

provisions in their vote under their control are overspending or likely to overspend. No overspending of votes, which results in unauthorised expenditure, is allowed and the Executive Manager: Finance advises the managers on the possible reallocation of funds within the budgetary vote, subject to compliance with accounting standards and National Treasury budget prescriptions (Steve Tshwete Local Municipality, 2012c:83).

A condition of the system of delegation is that a manager must satisfy himself, before he incurs any expenditure in executing his delegated powers, that provision was made in the budget for the expenditure and that sufficient funds are available on the relevant budget vote (Steve Tshwete Local Municipality, 2012c:5).

5.3.5.3. Summary of the best practices of the budget and Integrated Development Plan

The budget, service delivery and implementation plan and the IDP of both the Swartland and the Steve Tshwete local municipalities, as discussed in sections 5.3.5.1 and 5.3.5.2 (refer to pp. 109–10), are clearly aligned. Through consultative meetings the communities raise issues in respect of service delivery requirements in their wards, provide suggestions to address their needs and if these suggestions are in line with the strategic priorities of the municipality, these suggestions will be included in the IDP. The five-year capital budget is aligned to the five-year IDP and the annual service delivery and budget implementation plan provides the cash flow forecasts per month, the funding source as well as in which ward the capital project will occur.

In both the Swartland and the Steve Tshwete local municipalities any occurrence of overexpenditure resulting in unauthorised expenditure is prevented, as strict budgetary controls are implemented. The system of delegation in the Steve Tshwete Local Municipality and the Financial By-Law at the Swartland Local Municipality forbid any spending on votes if sufficient funds are not available. The departmental managers are also timeously informed of the likelihood of overspending on their votes.

5.3.6. Internal control and segregation of duties

5.3.6.1. Swartland Local Municipality

The Internal Audit Unit at the municipality exists under the control and the direction of the Audit Committee and reports on matters relating to internal control, accounting procedures and practices, risk and risk management, loss control as well as compliance

with applicable legislation. Audits are planned and are executed based on a compiled risks-based audit plan. During the five meetings held in the 2012 financial year, the Audit Committee decided on recommendations made by the Internal Audit Unit regarding the improvement of the internal control environment and also monitored whether these recommendations were implemented timeously. The Audit Committee also assists the Council members in discharging their responsibility relating to the operation of adequate and effective systems and control processes and the preparation of financial statements in compliance with all legislative requirements and accounting standards (Swartland Local Municipality, 2013a:21–3).

A strict demarcation of the roles and responsibilities of each political structure, political office-bearer and the municipal manager does exist and every councillor, political office bearer and the municipal manager must sign a Declaration of Intent to abide by the demarcation of roles and responsibilities for the period until the re-election of council (Swartland Local Municipality, 2011c).

Segregation of duties also exists within the procurement function and politicians are excluded from the procurement processes. The delegation of powers and duties are reviewed regularly and, if necessary, delegated powers are amended or withdrawn (Swartland Local Municipality, 2011c:56). A diagram is included in the System of Delegations of the Swartland Local Municipality indicating the powers or duties conferred on officials in the finance department relating to financial matters. In respect of supply chain management, the power to procure all goods and services is delegated to the Manager: Financial Services who may subdelegate the power to the manager of the supply chain section. Heads of departments are only involved in the procurement process by advising the Manager: Financial Services regarding the specifications of goods and services which must be procured.

No person, in accordance with the Financial By-law, may commit the municipality to any authorised expenditure without the completion of an official requisition or order, which must be submitted for approval to the municipal manager or his delegate. Requisitions or orders are only processed if sufficient budgetary provision exists to cover the expenditure.

5.3.6.2. Steve Tshwete Local Municipality

One of the strategic objectives of the Finance department of the Steve Tshwete Local Municipality is to sustain the sound fiduciary position of the municipality through continued accountable and developmental-orientated monetary management (Steve Tshwete Local Municipality, 2013b:25). The following strategies are formulated and programmes are implemented to achieve this objective:

- The strategy of establishing controls, procedures, policies and by-laws to regulate correct, fair and transparent transactions is achieved by annually reviewing all relevant policies, by-laws and internal control procedures.
- The annual review of the budget policy is designed to implement additional controls and procedures to monitor and to prevent unauthorised, irregular, fruitless and wasteful expenditure.
- Strategic risks are identified and prioritised annually in an annual risk identification and assessment workshop. A risk register is established and risk control is applied through various identified strategies.
- The strategy of ensuring that the budget process and budget format is compliant with the Municipal Budget and Reporting Regulations is obtained by the involvement of the Budget Steering Committee. The monthly, quarterly and mid-year budget assessment is done strictly according to the regulations. The budget policy and procedures are prepared in line with the regulations and are reviewed annually.
- The objective to maintain the clean audit status is attained by the development of a system to prepare interim financial statements.
- The strategy of ensuring that all Finance staff comply with the municipal regulation on minimum competency levels is attained by conducting adequate skills training.
- The strategy of aligning all tenders and procurement to the Municipal Supply Chain Management Regulations is achieved by regular updating of tender and order documents, constant updating of the database of suppliers and quarterly reporting of approved procurement to Council and National Treasury (Steve Tshwete Local Municipality , 2013b:25–9).

A System of Delegation of Authorities is approved by Council and the delegated powers are reviewed whenever it becomes necessary in terms of section 59(2)(f) of the MSA. The last amendment to the system of delegations was approved by the council in June 2012 (Steve Tshwete Local Municipality, 2012c:4).

According to the principles of delegations, as contained in above-mentioned document, subordinate delegators may subdelegate their power to their subordinates on condition that the delegators remain accountable to the Council. Any delegated power may be withdrawn if it appears that the delegated official abuses his delegated power or is not competent to handle the additional power. Neither the municipal manager nor an official may submit matters delegated to them to the executive mayoral committee or council without valid reason and the permission of the executive mayor or the municipal manager, respectively. Another pertinent condition of the delegated authorities is that in executing any delegated power, the official must observe all applicable legislation, by-laws and policies of the municipality (Steve Tshwete Local Municipality, 2012c:4–5).

The municipal manager is tasked to ensure that an effective internal control system exists for expenditure control, including procedures for the approval, withdrawal and payment of the municipality's funds. The internal audit unit, as part of the Office of the Municipal Manager, reports to the audit committee, which was established to serve the district and is fully functional.

A discussion with Booyens, budget manager of the Steve Tshwete Local Municipality, revealed that although the procurement process at the municipality is not centralised and different departments and sections still do their own procurement of non-stock items and services, the Municipal Supply Chain Management Regulations are strictly adhered to. Only the municipal manager can dispense of minor deviations of the procurement process according to regulations 36(1)(a) and 36(1)(b) of the Municipal Supply Chain Management Regulations, but he must state the reasons for the deviations at the next council meeting and must include the deviations as a note in the financial statements. The monthly budget reporting, mid-year reports as well as financial statements are consistently done strictly within the timeframes stipulated by National Treasury and are compliant with the Municipal Budget and Reporting Regulations (Booyens, 2013).

At the stores section, no stock-items may be issued without the requisition form, duly signed by a manager to whom the authority in this regard was delegated to and within the monetary limits placed on the manager. The list of the signatures of officials who have the delegated power to request requisitions, orders and requests for payments, are updated regularly. These lists are provided to the stores section, the supply chain management unit and the creditors section to verify each transaction before it is

captured. Before any transactions are captured on the financial management system, the three officials in the transaction verification control section (see appendix H) scrutinise the document and verifies whether funds are available and the relevant legislation is complied with (Booyens, 2013).

The power to approve contracts for the procurement of goods and services is delegated to all executive managers, senior managers and assistant managers but limits are placed on the monetary value of the expenditure to be incurred. Executive managers may authorise expenditure up to a maximum of R200 000, provided that three quotations are obtained for all procurement exceeding R30 000. Senior or deputy managers and assistant managers may approve expenditure up to a maximum of R60 000. Executive managers are allowed to approve budget amendments per line-item within their cost centre to the maximum value of R100 000 and this power may be subdelegated for an amount not exceeding R60 000 per line-item.

A crucial aspect of the delegation process is that informed trained officials are more likely to accept well-designated powers and duties and perform them properly. If they understand their powers and the tasks designated to them, they will recognise their responsibility and will be held accountable for the results (National Treasury, 2011b:12). The Steve Tshwete Local Municipality ensures that all senior officials and the staff working in the supply chain management section attend accredited training to comply with the Municipal Minimum Competency Levels Regulations as gazetted in June 2007. MFMA sections 83, 107 and 119 outline the competency levels required of all financial officials and the regulations prescribe the required competency levels for the uniform application of the MFMA. If a municipality fails to implement the requirements of the regulations, it will result in non-compliance with legislation (National Treasury, 2012a:8).

5.3.6.3. Summary of the best practices of internal control and segregation of duties

In both the Swartland and the Steve Tshwete local municipalities the system of delegations is in place and is reviewed in accordance with the MSA. The roles and duties of councillors and officials are strictly demarcated and councillors at the Swartland Local Municipality must sign a declaration that they will abide by the demarcated roles and responsibilities of a councillor. Any delegated authority of an official may be retrieved if any abuse of the delegated authority occurs.

The internal audit units in both the municipalities are fully functional and they report to the Audit Committee with regard to their audit in the municipalities in accordance with their internal audit risk plan. The internal audit units report on risk assessments, internal control deficiencies in the municipality and how these internal control deficiencies could be addressed. The established internal controls, operational procedures, policies and by-laws to regulate correct, fair and transparent transactions are reviewed on an annual basis to implement additional controls and procedures, to monitor and to prevent unauthorised, irregular, fruitless and wasteful expenditure.

5.3.7. Authorised signing powers

5.3.7.1. Swartland Local Municipality

The municipal manager, on advice of the managers of the various departments, determines which official may be authorised to sign requisitions for goods and services and he places a limit on the monetary value of requisitions which the official may authorise (Swartland Local Municipality, 2011c). These signature powers of officials are then approved by Council and amended from time to time. The specimen signatures of all officials authorised to sign for requisitions are submitted to the municipal manager and updated when amendments to the list of signing powers are made. The delegated authority of at least two persons to sign cheques or other methods of payments, including electronic payments, is in writing and is kept on record and is reviewed and amended by the municipal manager if he deems it necessary.

5.3.7.2. Steve Tshwete Local Municipality

The municipal manager may, according to his delegated authority, determine the categories of officials who may approve requisitions and invoices for payment and which officials must verify, must approve and must sign cheque payments or must activate electronic payments. The categories and limits on officials who may sign cheques drawn on the bank account of the municipality are also determined by the municipal manager (Steve Tshwete Local Municipality, 2012c:36–77).

The Executive Manager: Finance has the delegated powers to authorise senior officials in the finance department to sign or to countersign cheques or to activate electronic transfers, excluding officials dealing with audit, transaction verification and data preparation. Effective internal control is thus ensured by this segregation of powers.

5.3.7.3. Summary of authorised signing powers

The best practice of both the Swartland and the Steve Tshwete local municipalities — with a formalised system of categories of officials who may approve requisitions, who must verify the transaction, who will capture the transaction, who approve the payments and who ultimately sign the cheques or approve EFT payments — must be used by the Tlokwe City Council to improve internal controls. Although the shortage of staff in the Finance department of the Tlokwe City Council are often used as an excuse why these controls cannot be implemented, this internal control mechanism of an approved system of categories of authorised signing powers must be implemented and be adhered to.

5.4. SUMMARY

The aim of this chapter was to analyse the policies and best practices used by several municipalities to improve their budgetary internal control system, to enable them to achieve clean audits. In an interview with Moholola (2012:12) the chairperson of the Finance Select Committee of Parliament, Charl de Beer, indicated that as several municipalities had improved their audit findings from the 2011 financial year, it is clear that some municipalities have the solutions to achieve a clean audit. De Beer was quoted saying "If Municipality A can do it, then presumably so can Municipality B. They just have to find the right recipe".

Firstly in this chapter, suitable local municipalities to benchmark the Tlokwe City Council are identified. Both the audit opinions of the Auditor General as well as the MFSI research done by Ratings Africa were used to identify both the Swartland and the Steve Tshwete local municipalities for the benchmarking exercise. In the analysis of both municipalities the organisational structure, approved policies as required by legislation, the budget and IDP process, the internal control system aligned to the system of delegations as well as authorised signing powers are analysed.

According to Naidoo and Reddy (2008:39) it is not sufficient to identify best practises of other organisations. These best practices need to be adapted and modified to the specific situation in the own organisation before it is improved with time. Creativity and innovation are also essential to apply best practises of other organisations in the own organisation.

As quoted by Moholola (2012:21) De Beer, chairperson of the Finance Select Committee, stated that the operation Clean Audit 2014 is a process and is not obtained

by a "click of a finger". According to De Beer, the audit of 2014 is the target date for all municipalities to obtain a clean audit but some municipalities will take longer to reach the clean audit status.

Although the Swartland Local Municipality is categorised by National Treasury as a medium-capacity municipality, it addressed its challenges and achieved the clean audit status in the 2011 financial year. The Auditor General (2012f) confirmed that any size of municipality, with the commitment of the leadership, can achieve a clean audit. This is clearly proven by the Swartland Local Municipality.

Strict adherence to the internal budgetary control systems and all applicable legislation also ensured that the Steve Tshwete Local Municipality obtained clean audit opinions for the last three years.

In chapter 6, based on the best practises applied in the budgetary internal control systems of both the Steve Tshwete and the Swartland local municipalities, as well as the literature review of internal control as dealt with in chapter 3, recommendations are made to address the budgetary internal control deficiencies in the Tlokwe City Council, discussed in chapter 4.

CHAPTER 6

6. SUMMARY, CONCLUSION AND CONTRIBUTION

6.1 BACKGROUND

The purpose of this chapter is to provide a summary of the objectives provided in the first chapter of this research study as well as conclusions drawn from the literature study and the analysis of the current internal budgetary control system of the Tlokwe City Council, benchmarked with the best practices of various identified local municipalities. Recommendations for the improvement of the internal budgetary control system of the Tlokwe City Council are made.

6.2 RESEARCH FINDINGS

The research question for this study is defined as follows: Will the proposed amendments of the current internal budgetary control system at the Tlokwe City Council enhance service delivery?

The **main objective** of this study, as stated in chapter 1 (section 1.7.1, p. 7), is to investigate and to evaluate the current internal budgetary control system of the Tlokwe City Council and to suggest improvements to the internal budgetary control system, to enhance service delivery to the community.

The **first secondary objective**, as stated in chapter 1 (section 1.7.2, p. 7), is also to evaluate compliance of the current internal budgetary control system of the Tlokwe City Council with legal requirements.

The empirical results are discussed in chapters 4 and 5. The study was conducted by using a case study analysing the internal budgetary control system of the Tlokwe City Council. As the audit findings of the Auditor General are based on an independent and extensive verification process of the annual financial statements — which are the most important record of the financial status of a municipality — and performance information captured in the annual report (National Treasury, 2011c:85), in chapters 4 and 5 the audit opinions of the Auditor General regarding the financial status of the Tlokwe City Council and both the Swartland and the Steve Tshwete local municipalities are emphasised. Although an adverse disclaimer or a qualified audit opinion clearly indicates that fundamental principles of good financial management, governance and

transparency are not adhered to, an unqualified audit opinion with an emphasis of matter, as received by the Tlokwe City Council in the 2012 financial year, can still indicate serious financial shortcomings — depending on the audit findings by the Auditor General (National Treasury, 2011c:86).

In chapter 4, based on the reports of the Auditor General for the 2006–12 financial years, but with emphasis on the 2009–12 financial years, the budget and the budget reporting process; approved council policies; council resolutions in respect of the systems of delegations, segregation of powers and the organisational structure, the effectiveness of the internal budgetary control system, the internal audit unit and the audit committee to ensure the integrity of integrated reporting and internal financial controls of the Tlokwe City Council, is analysed.

In each audit report of the Tlokwe City Council the Auditor General indicated that internal control is relevant to the statutory audit, but he did not express an opinion on the effectiveness of internal control. However the Auditor General did report that significant deficiencies in internal control do exist, resulting in findings on the annual performance report and on compliance with laws and regulations. These deficiencies had resulted in high levels of material losses, unauthorised and irregular expenditure and in fruitless and wasteful expenditure. The audit findings identified severe weaknesses in management and accounting skills, inadequate internal control systems, a high vacancy rate in the Finance department, a lack of monitoring and reviewing as accounts are not reconciled on a monthly basis, and limited adherence to council policies and procedures (section 4.2.2, p. 61). The study also reveals that, owing to limited staff, especially in the supply chain management unit, the control instruments of segregation of duties and authorisation and approval procedures are not utilised to limit the risk of misappropriation of funds (section 4.4.1, p. 75).

Since 2005 to date, contrary to legislation, the Tlokwe City Council did not review and did not amend the approved system of delegations; separating the roles and responsibilities of the executive mayor, councillors, the municipal manager and officials of the Tlokwe City Council (section 4.4.3, p. 79) although amendments were made to the MSA, various MFMA regulations were promulgated and other legislation, which affects local government, was enacted. Internal control deficiencies were also triggered off because the organisational structure was not reviewed adequately and approved by Council since 2007, formally approved job descriptions do not exist, and several

discrepancies exist in the number and salary levels of posts that appear on the payroll system, the posts provided for in the personnel budget and contained in the 2007 approved organisational structure (section 4.4.4, p. 80). Although the budgeting process and budgetary reporting is done according to the Municipal Budget and Reporting Regulations (National Treasury, 2009), the findings of the Auditor General on unauthorised expenditure and underspending of the budget clearly indicate that the current line-item budgeting process is not credible and that variance reporting to departmental managers regarding their votes does not institute strict budgetary control (section 4.3.2.1, p. 67).

The **second secondary objective** of this study, as stated in chapter 1 (section 1.7.2, p. 7), is to gain a better understanding of the current existing literature and legislation on budget formulation, internal control and budgetary control in the local government sphere. In chapter 3 a literature study regarding the internal budgetary control system is conducted. Firstly, the legislative framework in which local government has to operate is discussed. Secondly, an overview regarding budget formulation, budgetary control and internal control processes in both the private and public sectors is provided. The link between budgetary and internal control is established through the literature study.

One of the principles of the MFMA is to modernise municipal financial management as the municipalities can only deliver services on a long-term sustainable basis if the financial management practices are sound (Fourie & Opperman, 2010:8; National Treasury, 2011c:73). Weak financial management results in misdirection or misuse of funds and increases the risk of fraud and corruption. The municipal manager, as the accounting officer, holds the primary legal authority for financial management in terms of the MFMA. All the components of municipal financial management — which encompasses budgeting, revenue, cash and expenditure management, procurement, asset management, reporting and oversight — have to be managed in such a way so as to ensure that public money spent must be developmental, effective and efficient and that the municipality could be held accountable (National Treasury, 2011c:74).

Laubscher and Van Straaten (2009:93) described financial control and responsibility as being of the utmost importance in the determination of either the success or failure of local government in South Africa. If municipalities strive to implement accountability

and effective and efficient financial control, the community will have a more positive attitude towards and trust in the municipal council.

Municipalities are required to include a statement in the annual report to disclose whether the established and maintained framework of internal control of the organisation is effective and appropriate to the nature of the organisation (Fourie, 2007:737). Van Schalkwyk (2013:6) warned municipalities not to underestimate the identified internal control deficiencies reported in the management reports of the Auditor General, as these matters in the future can lead to worse audit opinions or financial losses. National Treasury (2011c:86) warns municipalities that an unqualified audit opinion does not mean that the municipality is financially sound, as a statutory compliance audit of the Auditor General is not an assessment of financial health.

The benefits of benchmarking for local government is discussed in chapter 3 (section 3.6, p. 53). As stated by Naidoo and Reddy (2008:50), municipalities must ensure that they have both dynamic world-class management processes and appropriate political, managerial and structural leadership in place. The usage of benchmarking with other municipalities to amend the values and measurement system of a municipality must be more focused on sustained improvement than on short-term gains and on what is important to the municipality, such as people, quality and finance.

According to Naidoo and Reddy (2008:39), for benchmarking to be successful, the following elements are crucial:

- Senior management must render their support, understanding and commitment to the benchmarking process and they also must actively partake in the process;
- the persons involved in the benchmarking process must understand the own processes of the organisation;
- teamwork and good planning are needed in the benchmarking process; and
- benchmarking must be included as part of the organisational strategy.

According to Woods (2011:30), in well-run organisations across the world best practice systems such as budgeting, strategic planning, procurement, internal control and personnel systems are utilised — not only to ensure an efficiently run organisation but also to control transactions and to provide information regarding these transactions, which eliminates the opportunity for corruption and which exposes any wrongdoings. These systems can be used by public-sector organisations in South Africa to curb

corruption. Woods stated further that weak management systems, which allow for exploitable internal controls and information gaps, are caused by weak managers.

The **third secondary objective** of this study, as stated in chapter 1 (section 1.7.2, p. 7), is to compare the internal budgetary control system of the Tlokwe City Council with internal budgetary control systems of municipalities of similar size or which are had already achieved a clean audit.

In chapter 5 (section 5.2.3, p. 95), based on the clean audit opinions of the Auditor General for both the 2011 and 2012 financial years and the published MFSI, the Swartland and the Steve Tshwete local municipalities are identified for the benchmarking exercise. The audit findings, approved council policies, systems of delegations and segregation of powers, organisational structure, effectiveness of the internal budgetary control systems and compliance with legislation of both municipalities are analysed. The study reveals that both municipalities immediately have formulated and have implemented strategies to address audit findings, to prevent reoccurrence of these audit findings and to strive to maintain clean audit status. The best practise strategies, policies and procedures of both the Swartland and Steve Tshwete local municipalities are incorporated in the recommendations to improve the internal budgetary control system of the Tlokwe City Council.

6.3 STRATEGY TO IMPROVE THE INTERNAL BUDGETARY CONTROL SYSTEM

6.3.1 Background

The **fourth secondary objective** of this study, as stated in chapter 1 (section 1.7.2, p. 7), is to formulate a strategy for effective budgeting as well as to improve the internal control system of the Tlokwe City Council. This includes recommendations to improve the budget approaches, budgetary control, and the system of delegations, organisational structure and internal control policies.

On 10 May 2013, when all mayors and provincial head of departments in the North West Province signed a pledge to strive for a clean audit in 2014, the Auditor General made clear that the following areas — in which findings in the audit reports of all municipalities, including the Tlokwe City Council, repeatedly were identified — need urgent attention to improve the audit outcomes:

- unauthorised, irregular and wasteful expenditure must be prevented and investigated;
- the budget must be prepared in accordance with the IDP and better control of budgets must be implemented to prevent material underspending;
- laws and regulations need to be complied with in the management of procurement and contracts;
- timing and content of financial statements, performance reports and annual reports must be improved;
- effectiveness of the Internal Audit Unit and the Audit Committee must be increased;
- vacant posts need to be filled;
- assets and investments must be managed and recorded in adherence to GRAP 17 accounting standards; and
- the quality of the financial statements needs to be improved before being submitted for auditing.

In every audit report (section 4.6, p. 85) internal control — which comprises leadership involvement, financial and performance management and governance — is indicated as the key driver of improved audit outcomes. The Tlokwe City Council must develop a strategy to address the deficiencies identified in internal control in the above-mentioned spheres as well as in budget formulation and budget control. The aspects that must be considered and incorporated in this strategy are the following: leadership involvement, financial and performance management and governance (Jansen, 2013).

6.3.2 Leadership

Nombembe (2011) stressed that the leadership of a municipality must be involved in the design, implementation and maintenance of an effective internal control system. The Accounting Officer, and not the Chief Financial Officer, must be the driver of the process to achieve a clean audit and all departments must contribute to the audit outcome (Van Schalkwyk, 2013:6). All managers and leaders must support the clean audit plan by leading by example, doing the right things and by their actions (Nel, 2013).

According to Nombembe (2011), the leadership and executive management must — in the quest to achieve a clean audit — ensure that a culture of honesty, ethical business practices and good governance is established and maintained. A tracking process or a

"key control dashboard" was developed by the Auditor General to assist management and the oversight structures, such as the audit and oversight committees, to monitor the internal control effectiveness of the municipality.

The audit findings regarding the leadership component of internal control can be addressed by the Tlokwe City Council by the implementation of the following strategies:

6.3.2.1 Formal code of conduct

Nombembe (2011) advised that municipalities must adopt and monitor a formal code of conduct and ethics. The Code of Conduct, which addresses appropriate moral and ethical behaviour, will ensure that service delivery and financial prudence is understood by all and that it is embedded in the value system of the municipality. The leadership of a municipality must lead by example and clearly communicate the ethical values to all officials.

Although the Tlokwe City Council has established a formal Code of Conduct for councillors and officials, based on the Code of Conduct included in the MSA, the code was neither communicated to all staff nor understood and implemented in order to set the standard to ensure compliance with laws and regulations. The municipal manager must ensure that copies of the Code of Conduct be made available and explained to all officials on an annual basis and that newly appointed officials must be issued a copy of the Code of Conduct when they report to duty at the Tlokwe City Council. Officials and councillors must strictly adhere to the Code of Conduct and failure to do so can evoke disciplinary action.

The vision, mission and core values of the Tlokwe City Council also have to be communicated to all officials, councillors and to the public, by being printed in a prominent post in all council agendas and in public documents such as the budget, the IDP and the annual report, as done by both the Steve Tshwete and the Swartland local municipalities. In addition the vision, the mission, core values as well as the Code of Conduct must be communicated to the staff and the public by using posters on noticeboards in all departments and revenue offices.

6.3.2.2 Operation Clean Audit Committee and action plan

According to Nel (2013) an action plan to address all the identified internal control deficiencies must be developed and implemented. This plan must address all the

internal and external audit findings, and the resolutions of the oversight committee regarding the audit findings must be implemented substantially. Adherence to this action plan must be monitored on a monthly, a bi-monthly or a quarterly basis by the appropriate level of management. Van Schalkwyk (2013:6) advises that appropriate decision-making and monitoring committees, especially an Operation Clean Audit Committee, must be established. The Accounting Officer or his/her delegate must chair these meetings. The delegate must have the authority to issue instructions to departments and if these instructions are not followed, to institute disciplinary proceedings against the defaulting officials.

In both the Swartland and the Steve Tshwete local municipalities the accounting officer chairs the established Operation Clean Audit Committee, convened monthly to discuss methods to address the internal control weaknesses identified and to sustain the clean audit status. These monitoring Operation Clean Audit committees are clearly effective, as proven by both the benchmarked municipalities obtaining clean audits for consecutive years.

At the Tlokwe City Council the municipal manager must establish such an Operation Clean Audit Committee, consisting of all departmental managers, key personnel in the Finance department as well as the officials responsible for the IDP and performance management. This Operation Clean Audit Committee must be given a clear mandate to develop an action plan, strategies and procedures to address all the audit findings with regard to financial management, compliance with legislation and predetermined objectives and to enhance financial and performance reporting. The action plan must include clear timeframes and appropriate responsibility to implement the instructions must be assigned. The Operation Clean Audit Committee must set targets and achievement attained of these set targets must be monitored on a bi-monthly basis. Instructions given at these bi-monthly meetings with regard to the action plan and to address the internal budgetary control weaknesses must be incorporated in the minutes of the meeting. During the following meeting departmental managers must report back on progress made in adherence to the instructions.

6.3.2.3 Organisational structure

In accordance to section 62(1) of the MFMA, the accounting officer must ensure economical, effective and efficient use of resources. To abide by this legislative prescript the municipal manager of the Tlokwe City Council must ensure that an

effective organisational structure for assigning appropriately skilled officials is approved by Council before the end of the 2014 financial year. Henceforth the organisational structure must be reviewed on an annual basis if amendments are needed, owing to legislation or service delivery imperatives, as done by both the Swartland and the Steve Tshwete local municipalities (sections 5.3.3.1 and 5.3.3.2, pp. 101–2). The personnel budget, information regarding posts in the payroll system and information in the human resources section has to be aligned to the approved organisational structure.

An effective human resources management system with effective human resources policies and practices must be implemented. All the crucial vacant posts in the Finance department, especially in the supply chain management unit, must be filled by adequate and sufficiently skilled personnel. In doing so, the Tlokwe City Council must comply with regulation 18 of the Municipal Regulations on Minimum Competency Levels (National Treasury, 2007) which determines that from 1 January 2013 no financial official or supply chain management official may be employed if that person does not meet the competency levels prescribed for the relevant post. Continued employment of current personnel in the Finance department, especially senior officials and supply chain management personnel, is also subject to a condition that the officials attain the required higher education qualification, as prescribed for the relevant post. In-house job training, skills transfer by consultants and development must be provided for Finance personnel to address the underlying deficiencies that have caused audit findings on non-compliance of laws and regulations and predetermined objectives.

6.3.2.4 Policies and procedures

Policies and procedures to enable and to support the execution of internal control objectives, processes and responsibilities must be established by the municipal manager in accordance with regulation 7 of the Municipal Budget and Reporting Regulations (National Treasury, 2009). These policies, drafted in line with relevant legislation — which must guide performance activities and compliance with laws and regulations — must be adopted by Council. Should Council fails to adopt or to implement a budget-related policy and should either a political structure or an official not comply with such a policy the municipal manager must, in terms of section 73(a) of the MFMA, promptly report such occurrence to Provincial Treasury. The approved budget-related policies and procedures must be communicated to all relevant officials to ensure that they understand the operating thereof and will implement the procedures as

required. Senior managers, as part of their performance contracts, must sign a declaration that they will abide by the approved policies and procedures and that by failure thereof, disciplinary actions can be instituted against them.

6.3.2.5 Segregation of duties, a system of delegated powers and authorised signing powers

As part of the process to address the weaknesses of internal control, the municipal manager of the Tlokwe City Council must ensure that a legally compliant system of delegated powers is adopted by Council and is implemented as a matter of urgency. This system of delegations, which will provide adequate checks and balances in the administration, must also be reviewed whenever it becomes necessary in terms of section 59(2) of the MSA. To address the uncertainty prevailing in the Tlokwe City Council (sections 4.4.2 and 4.4.3, pp. 77–9) with regard to which official has authorised signing powers and to which amount, the municipal manager must finalise the allocation of signature powers with fixed monetary limits for officials. A financial system of delegations will determine the job level and the amount an official can authorise for payments.

The internal control deficiencies identified by the Auditor General regarding segregation of duties and the lack of adequate oversight regarding the reporting of performance, compliance with laws and regulations and the adherence of reporting due dates, as prescribed by the MFMA, as well as the lack of review of the financial statements by the municipal manager prior to submission for audit, will be eliminated with the filling of the crucial vacant posts in the Finance department (section 6.3.2.3, pp. 127).

6.3.2.6 Information technology governance framework

Although in this research study the information technology governance framework of the Tlokwe City Council is not analysed, it must be mentioned that integrity and reliability of information in the financial management system can only be assured with the establishment of a good information technology governance framework. The information technology governance framework must support and must enable the Tlokwe City Council to deliver value services and to improve performance as well as to improve the internal budgetary control system. A strategic plan that supports the information technology requirements of the municipality and ensures that spending on

information technology hardware and systems is in accordance with the Council-approved plan must be developed and implemented (Nel, 2013).

6.3.3 Financial and performance management

The leadership and the management of a municipality must also ensure that adequate internal controls exist in financial and performance management (Nombembe, 2011). In the pursuit to achieve a clean audit opinion and to have sound financial controls in place, internal control deficiencies identified in the following areas need to be addressed in the recommended strategy of the Tlokwe City Council:

6.3.3.1 Control environment

The internal control weaknesses identified in all the sections of the Finance department can be eliminated if the internal control environment is enhanced substantially by the designing and implementation of a formal internal control system, work procedure manuals for each function and relevant policies. The existing work procedure manuals must be reviewed and in sections where no work procedure manuals exist, new procedures must be established, benchmarked by the best practises observed at both the Steve Tshwete and the Swartland local municipalities. The implementation of the work procedures must be monitored by the section managers and a progress report on the implementation of and compliance with the work procedure manuals must be submitted on a regular basis to the Chief Financial Officer, who will subsequently forward the report to the Operation Clean Audit Committee.

Internal control over the daily and monthly processing of either cheque or electronic payments must be enhanced to address the risk of financial losses whether owing to fraud or error. Banking details of creditors may only be amended in the financial management system if the request to change the banking details is verified by two senior managers in the Finance department. Creditor accounts, salary and wages accounts and cash book/bank accounts must be reconciled on a monthly basis to prevent the occurrence of either double or incorrect payments. Creditors must be paid within 30 days to prevent interest charges on overdue accounts, which may be seen as fruitless and wasteful expenditure (section 6.3.3.4, p. 131). Strict adherence to the procedure manuals for approval, authorisation, withdrawal and payment of funds must be maintained at all times.

6.3.3.2 Record keeping

In the light of several repetitive audit findings (Tlokwe City Council, 2013a:152) regarding the lack of a proper record keeping system, especially with regard to information that supports compliance to the Municipal Supply Chain Management Regulations, a proper system of records management needs to be implemented which will ensure that accurate, relevant and complete information is easy accessible to support financial and performance reporting as required by legislation. A register of delegated access to documentation in the archives section must also be developed to prevent access to confidential files by unauthorised personnel.

An accurate record keeping and audit trail must be established for all tenders, including all the reports from the onset of the tender process with the request from a department to procure goods and services, the approved specifications for these goods and services, the advertisement placed in the media, the bid documents received, reports of the evaluation and adjudication committees, the resolution of the accounting officer and the final letter of appointment to the successful bidder. An electronic document management system to provide a comprehensive audit trail has to be introduced in the Finance department to prevent the occurrence of missing documents such as orders; requisitions; invoices and authorisation requests for payments.

6.3.3.3 Financial reporting

The management of the Tlokwe City Council must ensure that accurate and complete financial and performance reporting, supported by reliable information sources, be prepared and submitted to the relevant stakeholders as required by legislation. As part of the internal controls and processes that must be implemented to ensure that the financial reporting is accurate and free of material misstatements, the financial statements and in-year reports must be submitted to management before the legislated due dates to enable them to scrutinise the reports for correctness. Key personnel must also be requested to abstain from taking leave during the crucial stages of drafting the financial statements and the in-year financial reports as well as during the period of the statutory audit by the Auditor General.

6.3.3.4 Compliance with legislation

The management of the Tlokwe City Council has to implement a system of internal controls and procedures to monitor and to review on a regular basis compliance with

applicable laws and regulations. The Tlokwe City Council must understand which laws, regulations and policies it must adhere to, a checklist must be developed to monitor compliance thereof and the reporting dates as prescribed by the MFMA must be strictly observed.

According to MFMA Circular No. 68 (National Treasury, 2013:1) the municipality must introduce policies and procedures to prevent unauthorised, irregular, fruitless and wasteful expenditure. If unauthorised, irregular, fruitless and wasteful expenditure is identified, the municipality must investigate the expenditure and must respond appropriately in accordance with sections 171 and 173 of the MFMA. National Treasury (2013:5) defines irregular expenditure as any use of municipal funds that is in contravention of the MFMA and its regulations, the MSA and its regulations, the Remuneration of Public Office-Bearers Act and its regulations, and the municipality's own supply chain management policy or by-law.

The Tlokwe City Council must develop compliance checklists especially for creditors, salary and supply chain management units to prevent unauthorised and irregular transactions. No transaction may be processed if it does not comply with the relevant checklist. With regard to compliance with the Supply Chain Management By-law of the Tlokwe City Council, all goods and services may only be acquired by means of an official order. No order for goods and services may be placed if the following conditions are not met: the supplier must be registered in the supplier data base of the Tlokwe City Council; the tax clearance certificate must be in order; the correct procurement process — depending on the amount — must be followed and sufficient funds must be available on the relevant vote.

The Tlokwe City Council must embark on the following key activities to address the unauthorised, irregular, fruitless and wasteful expenditure findings:

- It must ensure that no person interfere with the supply chain management process of the Tlokwe City Council. Controls must be in place to curb any amendment or tampering of bids, quotations or tenders after submission.
- The Supply Chain Management By-law must be reviewed annually and be implemented in accordance with the Municipal Supply Chain Management Regulations of the MFMA.
- Unsolicited bids must be dealt with in accordance with relevant legislation.

- Creditors must be paid within 30 days and all legislative payments, such as SARS payments, must be made on time to avoid penalties or interest charges.
- If disciplinary procedures are instituted against officials for making, permitting or authorising irregular expenditure not in good faith, these procedures must be concluded within three months in accordance with the Collective Agreement between the trade unions and the employer.
- All contracts must be reviewed on a regular basis and managed by the Supply Chain Management Unit.

6.3.3.5 Controls over the information technology system

Although the internal control weaknesses in the information technology system of the Tlokwe City Council are not analysed in this research study (section 6.3.2.6, p. 129), it must be mentioned that the Auditor General identified deficiencies in the internal control of the information technology system which must be addressed before a clean audit can be achieved. The Auditor General revealed in its management report (Tlokwe City Council, 2012b:16) that the Tlokwe City Council also must design and must implement formal controls over the information technology system to ensure the reliability of the systems and the availability, accuracy and protection of the information.

The Financial Management System also must be reviewed and be developed on an on-going basis, necessitated by the need for compliance to the GRAP accounting standards and the legislated reporting requirements. The need to enhance the internal controls in the financial management system must also be incorporated in the clean audit action plan.

6.3.4 Governance

Van Schalkwyk (2013:6) suggested that a municipality can make substantial progress to achieve a clean audit if it implements and adheres to sound governance processes which will result in compliance with laws and regulations.

The MFMA, as indicated in Table 6.1, delineates the political (policy and outcome) and administrative (implementation and outputs) roles, it clarifies the political and administrative oversight roles and enables the political and administrative accountability in furthering the goals of local government, as envisaged by the Constitution. According to MFMA Circular No. 32 (National Treasury, 2006) the financial governance framework applicable to local government is indicated as follows:

Table 6.1 Financial governance framework

	Responsible for	Oversight over	Accountable to
Council	Approving policy and budget	Executive mayor or committee	Community
Executive mayor or committee	Policy, budgets, outcomes, management of/ oversight over municipal manager	Municipal manager	Council
Municipal manager	Outputs and implementation	Administration	Executive mayor or committee
Chief financial officer and senior managers	Outputs and implementation	Financial management and operational functions	Municipal manager

Source: National Treasury (MFMA Circular No. 32, 2006:13)

In the 2012 financial year the audit findings regarding governance at the Tlokwe City Council were in respect of an ineffective internal audit unit, no response by council to the concerns raised by the audit committee and the absence of a risk management unit and strategy (Auditor General, 2012d:152). The Council has to take its oversight responsibility seriously to address all the shortcomings in the internal control environment.

6.3.4.1 Internal audit unit

With regard to governance, the leadership of a municipality must ensure that the internal audit unit is staffed adequately and fully functional and that this internal audit unit identifies internal control deficiencies timely and recommend corrective actions effectively.

At the Tlokwe City Council, the staff complement of only two internal auditors, assisted by two interns, is insufficient for the scope of work. The unit must be enlarged with additional qualified skilled staff before the internal audit unit can be of value to the Tlokwe City Council. The current staff must also be allowed to perform their internal audit duties in accordance with internal auditing standards and to submit their audit reports without any interference by officials or management. The recommendations of

corrective actions to address internal control deficiencies, made by the internal audit unit, must also be implemented and be monitored by management.

6.3.4.2 Audit Committee and Municipal Public Accounts Committee

Another task of the leadership of a municipality is to ensure that an effective Audit Committee is established and is functional and that it promotes accountability and service delivery through evaluating and monitoring responses to risks. The Council must also assess the effectiveness of the Audit Committee. Van der Nest (2008:545) acknowledges that audit committees are key contributors to improve corporate governance in public sector.

The Audit Committee — as an independent advisory body to Council — is functional at the Tlokwe City Council. However, the objective of providing oversight over the effectiveness of the internal control environment — including financial and performance reporting and compliance with laws and regulations — is rendered ineffective, because the Tlokwe City Council does not respond to the concerns raised by the committee (section 4.5, p. 83). To address this shortcoming, although the chairperson of the Audit Committee is given the opportunity to submit reports to Council regarding the concerns raised by the committee, the reports must include clear timeframes for Council to respond to the concerns. The municipal manager must be assigned the appropriate responsibility immediately to implement corrective actions to address the concerns raised by the Audit Committee. At each Council meeting, the municipal manager must table a report which has to contain set targets to improve the internal control environment and the performance monitored against these set targets.

At the Tlokwe City Council, a Municipal Public Accounts Committee (MPAC), which consists of only councillors, was established in 2012 and is functional according to their statutory duties and responsibilities which comprise the following primary functions:

- to examine the financial statements and audit reports and to consider improvements against previous reports and statements;
- to evaluate the extent to which the recommendations of both the Audit Committee and the Auditor General have been implemented;
- to review the information relating to past recommendations made in the audit report to the current in-year reports, including the quarterly, mid-year and annual reports;

- to evaluate the content of the annual report and to make recommendations to Council when adopting an oversight report on the annual report;
- to promote good governance, transparency and accountability for the use of municipal resources;
- to undertake an investigation in its area of jurisdiction, after reviewing any investigation report already undertaken by the Tlokwe City Council or Audit Committee; and
- to perform any other function assigned to it by a council resolution within its area of responsibility (Department of Co-operative Governance and Traditional Affairs, 2011:7–8).

A fully functional MPAC at the Tlokwe City Council will surely contribute to the credibility and reliability of financial and performance reporting, compliance with applicable legislation and effective internal control, will have a positive impact on the future audit outcomes and will assist in the attempt at a clean audit. However, if the recommendations of the MPAC and the recommendations of the Audit Committee, as alluded to in section 4.5 (p. 83), are not implemented and monitored by management, the impact of the two committees to play an important role in municipal oversight and good governance will be negatively affected. Equivalent to the Audit Committee, the municipal manager therefore must be assigned the appropriate responsibility immediately to respond to and to implement the recommendations made by the MPAC.

6.3.4.3 Risk management

The Tlokwe City Council must implement appropriate risk management activities to ensure that regular risk assessments, including Information Technology risks and fraud prevention, are performed and that a risk strategy to address the risks is developed and is monitored. As part of the strategy to address the audit findings and to reach the target of a clean audit for the 2014 financial year, the post of risk manager must be included in the organisational structure and must be filled before the end of the 2014 financial year. A Risk Management Committee must be established, a risk management strategy must be developed and risk assessments must be conducted on a regular basis. A fraud prevention plan, which will determine what control measures need to be implemented to minimise risks, must also be developed and be implemented.

6.3.5 Budget and budgetary control

The financial budget is a crucial part of the total budgeting process as the budget indicates the financial viability of the organisational plans and underscores the interrelationships among the different departments. The budgeting process may not be a once-a-year effort but management needs to get the budgeting process underway at an earlier time. The operating budget must be based on organisational goals and objectives. Before the operating budget is approved, several drafts of the budget must be discussed by management (Adams *et al.*, 2003:332).

Gunter (2005:32) indicated that municipalities often use IDPs as "mere wish lists" of what the municipality wants to achieve, but owing to budgetary constraints are unable to do so. A recurrent audit finding of the budget of the Tlokwe City Council is that the current budget is not based on the development priorities, objectives and performance targets as determined by the municipality in its IDP (Tlokwe City Council, 2013a:149). To address this audit finding of non-compliance with legislation, the budget of the Tlokwe City Council must be restructured to present the financial information based on the strategies and programmes as contained in the IDP, rather than on the organisational structures of departments as per the current practice. The IDP must guide the budget with measurable non-financial goals and objectives to improve service delivery to the community.

The programmes, as provided for in the restructured budget, must reflect IDP priorities. The level of outputs, the impact on outcomes and input cost must be assessed by means of a cost benefit analysis against IDP priorities. The projects and programmes which are not achieving IDP priorities and non-priority expenditure must be eliminated (National Treasury, 2012b:19).

The IDP must drive the budget and the line-item budgeting system must be replaced by a system of community-needs budgeting and activity-based budgeting. If the budget is linked to the IDP via programmes and action plans, and also is calculated in terms of output units per vote, the budget is then more flexible to be amended. The outputs can then be measured in financial and non-financial terms via the SDBIP and the annual report as well. As the objective of the SDBIP is to strengthen local accountability and governance, it assists in planning and spending of the operational and capital programmes and overall service delivery.

Underspending of the budget also can be avoided by the inclusion of an outline of quarterly projections of service delivery targets and performance indicators in the SDBIP.

The recommended key activities to address the findings on material underspending of the capital and operating budgets are:

- detailed expenditure reports to enhance budget control regarding underexpenditure and overexpenditure against the budget as well as correct vote allocations must be developed;
- annual project procurement plans must be developed which must be aligned with the three-year MTREF;
- supply chain management bid committees must be fully functional to expedite the lengthy procurement process;
- all officials dealing with procurement must attend the required training sessions to meet the prescribed competency requirements;
- the supply chain management unit must be adequately staffed and the procurement function must be centralised;
- costs for all projects, capital and operational, must be determined realistically and budgeted for; and
- section 71 budget statements must be compiled on a monthly basis; variances on the budget must be analysed and underperformance on projects must be reported. Managers must account for variances in the budget as they will be held accountable for overspending or underspending of the budget in their votes.

The real power of budgeting will become apparent when the budget provides information on how many kilometres of roads will be tarred, how many burials are provided for, or how many kilolitres water will be purified (Hofert, 2005:25). The implementation of Activity Based Costing methodology will assist a municipality with information on the actual costs of a product or service to be delivered, which will then support the municipality to make more informed business decisions to improve their usage of restricted funds and to improve service delivery (Du Plessis, 2005:23). Hofert (2005:26) further explains that the integration of Activity Based Costing with budgeting and performance management will be the last phase in the drive for business performance management in a municipality. Activity Based Costing and Activity Based Management, integrated with strategy mapping and balanced scorecards, will offer

solutions to address the worldwide political pressure on all public sector organisations to keep taxes and tariffs low but still retain service delivery (Cokins, 2008:59). The Tlokwe City Council, as part of its strategy to improve the internal budgetary control system, must benchmark with municipalities which have already implemented an activity-based costing system and must introduce the activity-based costing methodology in those departments where tariffs for services to be delivered must be determined.

6.3.6 Summary of recommended strategy

The following conclusions were reached by answering the research question raised in the problem statement in chapter 1 (refer to section 1.6, p. 6) which was "Will the proposed amendments of the current internal budgetary control system at the Tlokwe City Council enhance service delivery?"

An improved internal budgetary control system at the Tlokwe City Council firstly will assist in managing the budgeting and administration of the limited funds to give priority to the basic services needs of the community as contained in the IDP. Secondly, an improved internal budgetary control system will decrease the occurrence of unauthorised, irregular and fruitless and wasteful expenditure. This will result in more funds being available to be spent on basic service delivery, to invest in constructing new infrastructure and for repair and maintenance of existing assets as well as underspending of the budget — which is also seen as negatively affecting service delivery. Thirdly, an improved internal budgetary control system will decrease the audit findings and improve the audit outcome. A clean audit opinion which reflects clean administration will improve the trust of the community and confidence in the municipality and will enhance the culture of payment of the municipal accounts, as clearly indicated in the payment rates of the Steve Tshwete and the Swartland Local Municipalities. An improved payment rate will increase the revenue pool to be spent on service delivery. As indicated above, the proposed amendments of the current internal budgetary control system at the Tlokwe City Council will enhance service delivery.

Before the key internal budgetary controls can be improved, the management of the Tlokwe City Council needs to demonstrate strong and committed leadership by developing a strong culture of accountability. They need to take ownership and implement good governance practices. As Nombembe (Auditor General, 2013c:1) indicated, clean administration in local government is achievable when the leadership is committed and constantly monitor basic internal controls. The strategy recommended

to the Tlokwe City Council substantially to improve the internal budgetary control system and to address the audit findings to achieve a Clean Audit by 2014 is summarised as follows:

- A formal Code of Conduct has to be developed and must be communicated to all officials, councillors and to the public together with the vision, the mission and core values of the Tlokwe City Council. Leadership and employees must buy into the concept of doing it the proper way.
- The municipal manager must establish an Operation Clean Audit Committee, which must be given a clear mandate to develop an action plan, strategies and procedures to address all the audit findings with regard to financial management, compliance with legislation and predetermined objectives, and to enhance financial and performance reporting.
- An effective organisational structure for assigning appropriately skilled officials must be approved by Council and all key vacant posts in the Finance department must be filled. The organisational structure also must be reviewed on an annual basis if amendments are needed owing to legislation or service delivery imperatives.
- A legally compliant system of delegated powers must be adopted by Council and the municipal manager must finalise the allocation of authorised signature powers with fixed monetary limits for officials.
- Policies and procedures in line with relevant legislation — to enable and to support the execution of internal control objectives, processes and responsibilities — must be established by the municipal manager and be approved by Council. Policies and procedures must be adhered to strictly to enhance internal control.
- The information technology governance framework must be developed to support and to enable the Tlokwe City Council to deliver value services and to improve performance as well as the internal budgetary control system. The reliability of the systems, especially the financial management system, and the availability, accuracy and protection of information must be ensured.
- The internal control environment must be enhanced by designing and implementing a formal internal control system. Relevant policies and work procedure manuals for every function in the Finance department must be established.

- The procedure manuals for approval, authorisation, withdrawal and payment of funds must strictly be adhered to at all times.
- A proper system of records management needs to be implemented. This will ensure that accurate, relevant and complete information is easily accessible to support financial and performance reporting, as required by legislation. An accurate record keeping and audit trail must be established regarding all financial transactions, reconciliations and tender documentation.
- The Tlokwe City Council must understand which laws, regulations and policies must be adhered to, a checklist must be developed to monitor the compliance thereof and the reporting dates, as prescribed by the MFMA, must be observed strictly.
- A strong system of internal controls and procedures must be implemented to monitor and to review on a regular basis compliance with applicable laws and regulations. Payment checklists must be introduced to ensure that the procedures for placing orders for goods and services and payments are followed correctly and are authorised.
- A functional Internal Audit section must be established. This internal audit unit must identify internal control deficiencies timely and must recommend corrective actions effectively.
- An effective Audit Committee must be established and be maintained. Council must assess the effectiveness of the audit committee.
- The municipal manager must be assigned appropriate responsibility immediately to respond to and to implement the recommendations made by the MPAC.
- A post of risk manager must be included in the organisational structure and must be filled, a Risk Management Committee must be established, a risk management strategy must be developed and risk assessments must be conducted on a regular basis.
- The budget must be restructured to present the financial information based on the strategies and programmes as contained in the IDP, rather than based on the organisational structures of departments as per the current practice.
- The benefits of the implemented activity-based costing system in other municipalities must be investigated and must be introduced in departments where tariffs for services to be delivered must be determined.

6.4. CONCLUSION

Ababio (2007:5–13) stated that the internal control systems of municipalities are exceptionally weak and that deficiencies in public accountability surely will affect service delivery negatively. This research study of the internal budgetary control system of the Tlokwe City Council confirms the statement of Ababio as it is found that the internal budgetary control system of the Tlokwe City Council is challenged severely and that the material underspending, especially on the capital budget, negatively did affect service delivery to the community. The lack of fiscal discipline confirmed by the material amount of unauthorised spending or overspending of the budget clearly undermines proper budget control.

This study also reveals that the Tlokwe City Council can only achieve a clean audit status if the leadership is committed totally to address the internal budgetary control deficiencies, by implementing the recommended strategy for effective budgeting as well as to improve the internal control system. The Tlokwe City Council must be willing to investigate and to implement best practises of other municipalities.

6.5. LIMITATIONS OF THE STUDY

Two main limitations are identified in this research study. Griffin included in his presentation to the ICANN congress in New Zealand (25–31 March 2006) the reluctance of identified companies or organisations to share information as one of the disadvantages of the benchmarking exercise. The first limitation experienced in this research study is that, although in the local government sphere no competition should exist between municipalities, municipalities which were requested to provide information regarding their reports from the Auditor General and internal control systems were reluctant to assist. Of the seven municipalities which were requested to provide information of their best practice internal control systems, only two municipalities were willing to assist in this benchmarking study. The reasons for the reluctance of municipalities to provide information for the benchmarking study may not be to conceal information or to reveal deficiencies in their internal control system, but may be owing to a high vacancy rate and an unwillingness by leadership and officials to assist, as they do not want to spend limited working time of already overburdened officials on a study which does not benefit their municipality. Except for public documents, such as the budget, the IDP and the annual report for the previous two financial years — which were available on the websites of several municipalities — policies and audit reports prior to

the 2010 financial year were not readily available for reference. Secondly, limited research is done regarding the internal control or budgetary control challenges experienced by local government in South Africa.

6.6. RECOMMENDATIONS FOR FURTHER RESEARCH

Further research in this field is recommended. This research should focus on the introduction of activity-based costing as a management tool to address the internal budgetary control deficiencies in local government, especially in municipalities in Africa, and will be beneficial to increase service delivery to the community.

APPENDIX A

Appendix A indicates the assessment of the achievement of control objectives at the Tlokwe City Council compared with the Swartland Local Municipality. This assessment tool is developed and is used by the Auditor General (2012c:13) and the Swartland Local Municipality (2012c:8) to indicate the significant internal control deficiencies existing with regard to the fair presentation of financial statements, the performance report and compliance with laws and regulations for the 2011 and 2012 financial years. Significant deficiencies occur when internal controls do not exist, are either not designed to address the risk or are not implemented; and which either had caused or could cause the misstatement of financial statements or the report on predetermined objectives and could cause non-compliance with laws and legislation to occur.

If a significant deficiency is not applicable and the required controls are in place, it is indicated with an **A** symbol. At the assessment of the Tlokwe City Council no A symbol is indicated. When the deficiency still exists but significant progress has been made to implement controls, it is indicated with a **B** symbol. A **C** symbol indicates that no controls are in place and that urgent attention to the matter is required. A, B and C are used for the Swartland Local Municipality.

APPENDIX A

Fundamentals of internal control (table used by the Auditor General to indicate the improvement of internal control objectives)

Three audit dimensions Fundamentals of internal control	Financial	Performance objectives	Compliance with laws and regulations
	Assessment		
Leadership			
<ul style="list-style-type: none"> Provides effective leadership based on a culture of honesty, ethical business practices and good governance; protecting and enhancing the best interests of the entity 	<p>B</p> <p><u>A</u></p>	<p>C</p> <p><u>A</u></p>	<p>C</p> <p><u>A</u></p>

Appendix A (continued)

Three audit dimensions Fundamentals of internal control	Financial	Performance objectives	Compliance with laws and regulations
	Assessment		
<ul style="list-style-type: none"> Exercises control responsibility regarding financial and performance reporting and compliance and related internal controls 	B <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Implements effective human-resources management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored 	C <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Establishes and communicates policies and procedures to enable and to support understanding and execution of internal control objectives, processes, and responsibilities 	B <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Develops and monitors implementation of action plans to address internal control deficiencies 	B <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Establishes an information technology governance framework that supports and enables the business, delivers value and improves performance 	C <u>B</u>	C <u>C</u>	C <u>C</u>
Financial and performance management			
<ul style="list-style-type: none"> Implements proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and is available to support financial and performance reporting 	B <u>B</u>	C <u>A</u>	C <u>B</u>

Appendix A (continued)

Three audit dimensions Fundamentals of internal control	Financial	Performance objectives	Compliance with laws and regulations
	Assessment		
<ul style="list-style-type: none"> Implements controls over daily and monthly processing and reconciling of transactions 	B <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Prepares regular, accurate and complete financial and performance reports supported and evidenced by reliable information 	B <u>B</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Reviews and monitors compliance with applicable laws and regulations 	B <u>A</u>	C <u>A</u>	C <u>B</u>
<ul style="list-style-type: none"> Designs and implements formal controls over information technology systems to ensure reliability of the systems and availability, accuracy and protection of information 	C <u>B</u>	C <u>A</u>	C <u>A</u>
Governance			
<ul style="list-style-type: none"> Implements appropriate risk management activities to ensure that regular risk assessments, including consideration of information technology risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored 	C <u>A</u>	C <u>A</u>	C <u>A</u>
<ul style="list-style-type: none"> Ensures that there an adequately resourced and functioning internal audit unit exists that identifies internal control deficiencies and recommends corrective action effectively 	B <u>A</u>	C <u>A</u>	C <u>A</u>

Appendix A (continued)

Three audit dimensions Fundamentals of internal control	Financial	Performance objectives	Compliance with laws and regulations
	Assessment		
<ul style="list-style-type: none"> Ensures that the audit committee promotes accountability and service delivery by evaluating and monitoring responses to risks and by providing control over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations 	B <u>A</u>	C <u>A</u>	C <u>A</u>

Source: Auditor General (2012c:13) and the Swartland Local Municipality (2012c:8)

This table clearly indicates that, although significant improvements were made by the Tlokwe City Council regarding the controls implemented relating to fair presentation of the financial statements as indicated with 10 **B** symbols, the four **C** symbols in this audit dimension and the 28 **C** symbols relating to performance objectives and compliance with laws and regulations indicate that urgent attention is needed to implement internal controls, to address these significant internal control deficiencies. The Swartland Local Municipality, in comparison with the Tlokwe City Council, has an effective internal control system as indicated with 35 **A** symbols, 6 **B** symbols and only 2 **C** symbols regarding deficiencies in their information technology governance framework.

APPENDIX B

Summary of detailed audit findings classified as internal control deficiencies in the audit reports of the Tlokwe City Council for the 2012 financial year as well as the previous three years

FINDINGS	2012	2011	2010	2009
Cash and cash equivalents				
Bank reconciliation discrepancies		X	X	
Inadequate controls to ensure EFT payments are followed up		X		
Employee costs				
Vacancies		X		
Payroll certification	X	X	X	
Excess leave not forfeited		X	X	
Leave is taken before it has been approved	X	X		
Uncollected wages—wage control deficiencies	X	X	X	
Overtime: employees — no supporting documentation		X		
Overtime — policy and regulations	X	X		X
Vacant posts — unable to determine when position became vacant	X	X		
Overtime: more than 30% of normal salary		X	X	
Overtime: must be approved in advance	X	X	X	
Incorrect UIF threshold used	X			
Incorrect leave encashment	X			
Organisational structure	X			
Competency assessment not performed	X			
Payslips: PAYE recalculations	X			
Journals				
Journals		X		

Appendix B (continued)

FINDINGS	2012	2011	2010	2009
Internal control deficiencies				
Internal control deficiencies — planning	X	X	X	X
Internal controls at the Lakeside Holiday Resort ineffective	X			
Internal audit unit weaknesses	X			
Journals: no supporting documentation provided	X			
Journals: internal control weaknesses	X			
Procurement findings				
Internal control findings		X		
Supply Chain Management (SCM) policy deficiencies		X		
Findings of past years not addressed	X			
VAT				
VAT: monthly reconciliation	X			
Property, plant and equipment				
Classification in the General Ledger	X	X	X	
Overspending on amount budgeted for additions		X		
Asset description does not agree with the invoice		X	X	
Operating expenditure				
Payment not done within 30 days	X			
Inventory				
No inventory management policy	X	X	X	
Investments				
Investments policy incomplete		X	X	
Revenue				
Other income — eNaTiS reconciliation		X		
Revenue — internal controls: Lakeside Holiday Resort		X		
TOTAL FINDINGS	21	23	11	2

Source: Audit reports of the Auditor General for the 2012, 2011, 2010 and 2009 financial years

APPENDIX C

Summary of detailed audit findings classified as non-compliance with laws and regulations in the audit reports of the Tlokwe City Council for the 2012 financial year as well as the previous three years

Findings	2012	2011	2010	2009
Employee costs				
Annual leave — non-compliance with the South African Local Government Bargaining Council (SALGBC)	X	X	X	
Leave — more than 48 days at year-end	X			
Non-compliance of Municipal Performance Regulations 27(4)(d)	X			
Non-compliance of MSA section 54A(2A)(a)	X			
Procurement findings				
Non-compliance with section 32(4) of MFMA: Neither reporting, nor investigation nor recovering of unauthorised, irregular or fruitless or wasteful expenditure	X			
No declaration of interest made by suppliers for bid or quotes	X			
Limitation of scope — lack of proper filing system. Documents not provided to Auditor General	X			
Bid Evaluation Committee did not abide with Preferential Procurement Policy Framework (PPPF) Regulations	X			
Proof of Tender advertisement of several bids not provided	X			
Goods and services not procured through competitive bidding — over R200 000	X			
Non-compliance to Construction Industry Development Board (CIDB) Regulations	X			
Tax clearance certificate not submitted	X			

Appendix C (continued)

Findings	2012	2011	2010	2009
Three written price quotations not obtained	X			
Non-disclosure of interest in Annual Financial Statements (AFS)	X			
Ineffective understaffed Supply Chain Management (SCM) Unit	X			
Deviation of section 32 of Systems Act — organisational structure does not address all functions, roles and responsibilities of Supply Chain Management	X			
No measures to address breaches of code of ethical conduct — no policy	X			
SCM policy deficiencies — SCM Regulation Chapter 2, paragraph 12.3 regarding prohibition of splitting of goods and services	X			
Modification/extension to contracts — must be reported to Council, Auditor General and National Treasury	X			
Non-compliance to 15 SCM Regulations and Code of Conduct — internal control findings	X			
Suppliers data base — not updated quarterly — not used for invitation of quotations	X			
Winning bidder's information not requested	X			
Non-compliance regarding tender number W9/2007		X		
Non-compliance — awards between R2000 and R10 000		X		
Non-compliance findings — awards between R10 000 and R30 000		X		X
Non-compliance — identified for awards between R10 000 and R30 000		X		X
Competitive bidding — non-compliance (points system)		X		X

Appendix C (continued)

Findings	2012	2011	2010	2009
Competitive bidding — non-compliance (tender process not followed)		X		
Competitive bidding — non-compliance (highest score not selected)	X	X		
Competitive bidding — non-compliance (above R10 million)		X		
Competitive bidding — non-compliance (adjudication committee)		X		
Non-compliance findings identified				
No audit and performance audit committee exists		X	X	
Unauthorised, irregular, fruitless and wasteful expenditure		X	X	
Weaknesses — Internal Audit unit		X	X	X
Operating expenditure				
Invoices not paid within 30 days	X	X		
Related parties				
Managers and councillors did not declare their financial interests	X	X		
Predetermined objectives				
Performance management processes — non-compliance to MSA sections	X			
Performance management processes — non-compliance to Municipal Planning and Performance Regulations	X			
TOTAL FINDINGS	26	15	4	4

Source: Audit Reports of the Auditor General for the 2012, 2011, 2010 and 2009 financial years

APPENDIX D

Budget-related policies adopted or amended by the Tlokwe City Council (regulation 7[1] of the Municipal Budget and Reporting regulations)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Tariffs Policy (section 74 of MSA) - Municipal Tariffs By-law	7(1)(1)(a)	10/2005	05/2009	Notice 6230 11/2005	T.23
Property Rates Policy (section 3 of Municipal Property Rates Act) - Property Rates By-law - Property tax — national monuments - Property tax — people who do not pay	7(1)(1)(b)	06/1997 01/1998 08/2003	08/2011	Notice 6653 06/2009	E.22 E.7 E.19
Credit Control and Debt Collection Policy (section 96 of MSA) - Credit Control, Debt Collection and Indigent By-laws	7(1)(1)(c)	06/2006	01/2008	Notice 6315 09/2006	K.27
Cash Management and Investment Policy (section 13(2) of MFMA) - Cash Management and Investments: Surplus Funds By-laws	7(1)(1)(d)	03/2007	05/2009	Notice 6231 87/2009	K.29
Borrowing Policy (Chapter 6 of MFMA) - Long-Term Borrowing Framework By-laws and Guidelines	7(1)(1)(e)	08/2009	03/2010	Notice 6795 06/2010	L.5
Funding and Reserves Policy	7(1)(1)(f) and 8(1)				

Appendix D (continued)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Long-term financial plan	7(1)(1)(g)				
Supply Chain Management Policy (section 111 of the Act) - Supply Chain Management By-law	7(1)(1)(h)	05/2009	07/2009	Notice 6739 03/2010	
Management and disposal of assets: - Fixed Assets Management By-law (properties, installations, equipment and other property)	7(1)(1)(i)	06/2007	02/2010	Notice 6251 01/2006	V.41
Infrastructure investment and capital projects	7(1)(1)(j)				
Planning and approval of capital projects	7(1)(1)(j)(i)				
Policy for Developer Contributions for Property Developments - Engineering services: contributions - Levying of engineering services contributions - Collection of engineering contributions - Engineering services: transferability of bank guarantee	7(1)(1)(j)(ii)	09/2006 05/2007 04/2006 08/1997	07/2009 06/2007		I.1 I.15 I.14 I.3
Indigents Policy - Credit Control, Debt Collection and Indigent By-laws	7(1)(1)(k)	06/2006	02/2007	Notice 6315 09/2006	K.27

Appendix D (continued)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Policy for Provision of Free Basic Services:	7(1)(1)(l)				
Policies related to budget implementation and monitoring: <ul style="list-style-type: none"> - Budget By-law - Budgets: deviations - Budget Committee - Budget control: performance contracts of directors 	7(1)(1)(m)	06/2006 01/1992 05/1999 04/2002	05/2009	Notice 6344 11/2006	B.41 B.10 B.18 B.28
Transfer of Funds Within Votes Policy <ul style="list-style-type: none"> - Virement By-law 	7(1)(1)(m)(i)	02/2010	10/2010	Notice 11/2010	V.48
Introduction of Adjustments Budgets Policy	7(1)(1)(m) (ii)				
Policy dealing with unforeseen and unavoidable expenditure	7(1)(1)(m) (iii)				
Management and Oversight Policy	7(1)(1)(m) (iv)				
Policies relating to managing electricity and water <ul style="list-style-type: none"> - Circuit breakers levies: exemption from payment of churches - Electricity: repair of damages - Water and sewer connections 	7(1)(1)(n)	04/2001 11/2000 04/2006	04/2007 09/2006		S.27 E.15 W.10

Appendix D (continued)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Management of Losses of Water and Electricity Policy - Water leakages: reconnection after termination as a result of non-payment	7(1)(1)(n)(i)	02/1999			W.8
Policy to promote conservation and efficiency	7(1)(1)(n)(ii)				
Policies relating to personnel including overtime, vacancies and temporary staff - Overtime Policy	7(1)(1)(o)	02/1995	Draft 2004		O.8
Policies dealing with entities :	7(1)(1)(p)				
Service Delivery Agreement	7(1)(1)(p)(i)				
Dividend preference of the municipality	7(1)(1)(p)(ii)				
Any other budget-related or financial management policy - Bank accounts - Bank guarantees in respect of internal engineering services contributions - Consumer accounts: closing of — write-off of small balances - Consumer accounts — format - Reports: actual expenditure on the capital budget - Excess expenditure	7(1)(1)(q)	04/2002 09/2005 10/2005 01/1997 06/2006 01/2001	06/2002		B.27 B.39 V.44 V.7 V.46 O.1

Appendix D (continued)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Other policies adopted by Council — budget-related or financial management	7(1)(1)(q)				
Travelling and Subsistence Allowance Policy		11/2005			
Travelling allowances		10/1996			
Internal Cellular Phone Policy — officials and councillors		01/2006	01/2008		S.25
Stores Management Policy					
- Stock obsolete (for auctions)		09/1998			V.22
- Internal Stores Policy		08/2005			M.15
Transport Allowance Policy		01/2009	06/2009		T.26
Utilisation of Entertainment Allowance Policy		12/2004			O.14
Expenditure Management Procedures		05/2004	07/2009		B.35
Donations		11/1997			S.13
Donations: guidelines		2002/2003			S.30
Overseas visits, tours: financial assistance		07/1997	04/2000		B.1
Grants in aid and donations		07/1993	07/1996		H.1
Security Policy — key control		01/2006	04/2006		S.33
Public–Private Partnership By-law		08/2005	08/2005	Notice 6231 11/2005	O.13
Procedural Manual for Cashiers and Cashier Supervisors		08/2005			K.30
Customer care and management in the rates hall of the department of Finance		04/2007			C.1

Appendix D (continued)

Policy	Regulation	Date of adoption by Council	Date of amendment	Date of by-law	Council policy no.
Signing authority: requisitions, orders and work orders		03/2000			T.16
Authorized signature/Signing authority		2006/09			T.6
Vacation leave bonus: payment		05/1997	11/1997		V.13
Housing rental assistance		07/1996	10/2002		B.2
Council property: selling of (confirmation of financing)		09/1998			R.11
Council houses: selling of		01/2001			R.18
Motor vehicle loans		07/1994	01/2005		M.2
Medical Aid Fund: continued contribution by Council		09/1998			M.9
Micro loan agreements		08/2003			M.12

APPENDIX E

Summary of detailed audit findings of the Swartland Local Municipality classified as internal control deficiencies in the audit reports for 2012 and the previous three years

Findings	2012	2011	2010	2009
Information technology systems				
Lack of approved service level agreements and non-establishment of service performance reports	X	X	X	
Lack of information security standards and monitoring	X	X	X	
Programme change management		X	X	
Inadequate environmental controls	X	X	X	
Change to job scheduling not formally authorised		X	X	
Business continuity and disaster recovery plan	X	X	X	
Employee costs				
Authorisation of overtime				X
Annual leave — minimum leave days				X
Calculation of PAYE				X
Overtime hours worked more than 40 hours per month				X
Inventory				
Valuation of property held for sale				X
Revenue/Receivables				
Traffic fines revenue				X
Accounting for output VAT on sales				X
Traffic fines accrual				X
Revenue for conditional government grants subsidies misstated owing to input VAT duplication		X		
Comparative figure relating to revenue foregone not disclosed in AFS		X		

Appendix E (continued)

Findings	2012	2011	2010	2009
Supply chain management/Procurement				
Registration of suppliers				X
Informal tenders				X
Expenditure				
Changes to EFT master file				X
Segregation of duties				X
Creditors				
Creditors are misstated owing to disclosure thereof exclusive of VAT		X		
Investments				
Interest earned on external investments is understated		X		
Property, plant and equipment				
Formula error in the asset register resulted in Property, Plant and Equipment (PPE) being misstated by R28 957 581		X		
TOTAL FINDINGS	4	11	6	12

Source: Swartland Local Municipality (2009b; 2010b; 2011b; 2012c)

APPENDIX F

Summary of detailed audit findings of the Swartland Local Municipality classified as non-compliance with laws and regulations in the audit reports for 2012 and the previous three years

Finding	2012	2011	2010	2009
Compliance				
Reporting of withdrawals from municipal bank accounts				X
Documents on the Municipality's website				X
Reporting of employee costs				X
Financial statements were submitted late			X	
Non-compliance with Municipal Supply Chain Management Regulations and Construction Industry Development Board Act			X	
Municipality failed to deduct UIF from councillors' salaries			X	
Non-compliance with section 64(2)(h) of the MFMA — revenue should be reconciled on a weekly basis	X			
TOTAL FINDINGS	1	0	3	3

Source: Swartland Local Municipality (2009b; 2010b; 2011b; 2012c)

APPENDIX G

Budget-related policies adopted for the Tlokwe City Council and the Swartland and the Steve Tshwete Local Municipalities (regulation 7[1] of Municipal Budget and Reporting regulations)

Policy	Regulation	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Tariffs Policy (section 74 of MSA) - Municipal Tariffs By-law	7(1)(1)(a)	By-law	By-law	In place
Property Rates Policy (section 3 of Municipal Property Rates Act)	7(1)(1)(b)	By-law	By-law	In place
Credit Control and Debt Collection Policy (section 96 of MSA) - Credit Control, Debt Collection and Indigent By-laws	7(1)(1)(c)	By-law	By-law	In place
Cash Management and Investment Policy (section 13[2] of MFMA) - Cash management and investments: Surplus Funds By-laws	7(1)(1)(d)	By-law	By-law	In place
Borrowing Policy (Chapter 6 of MFMA) - Long-Term Borrowing Framework By-laws and Guidelines	7(1)(1)(e)	In place		In place
Funding and Reserves Policy	7(1)(1)(f) and 8(1)	In process		In place
Long-term financial plan	7(1)(1)(g)	In process		
Supply Chain Management Policy (section 111 of the Act) - Supply Chain Management By-law	7(1)(1)(h)	By-law	By-law	In place

Appendix G (continued)

Policy	Regulation	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Management and disposal of assets: - Fixed Assets Management By-law (properties, installations, equipment and other property)	7(1)(1)(i)	By-law	By-law	In place
Infrastructure investment and capital projects	7(1)(1)(j)			
Planning and approval of capital projects	7(1)(1)(j)(i)			
Policy for Engineering Services Contributions for Property Developments	7(1)(1)(j)(ii)	In place		
Free Basic Services and Indigents Policy - Credit Control, Debt Collection and Indigent By-laws	7(1)(1)(k)	In place (part of Credit Control Policy)		In place (part of Free Basic Services and Indigent Support Policy)
Provision of Free Basic Services Policy	7(1)(1)(l)	In place (part of Credit Control Policy)		In place (part of Free Basic Services and Indigent Support Policy)
Budget implementation and monitoring policies	7(1)(1)(m)	In place		In place
Transfer of Funds Within Votes Policy - Virement By-law	7(1)(1)(m)(i)	In place		
Introduction of Adjustment Budget Policy	7(1)(1)(m)(ii)			

Appendix G (continued)

Policy	Regulation	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Unforeseen and unavoidable expenditure policy	7(1)(1)(m)(iii)			
Management and Oversight Policy	7(1)(1)(m)(iv)			
Policies relating to managing electricity and water	7(1)(1)(n)	In place	By-law	
Management of Losses of Water and Electricity Policy - Water leakages: reconnection after termination as a result of non-payment	7(1)(1)(n)(i)	In place		
Policy to promote conservation and efficiency	7(1)(1)(n)(ii)			
Policies relating to personnel including overtime, vacancies and temporary staff - Overtime Policy	7(1)(1)(o)		By-law	
Policies dealing with entities	7(1)(1)(p)			
Service Delivery Agreement	7(1)(1)(p)(i)			
Dividend preference of the Municipality	7(1)(1)(p)(ii)			
Other policies adopted by Council — budget-related or financial management	7(1)(1)(q)			
Travelling and Subsistence Allowance Policy Travelling allowances		In place		In place
Internal Cellular Phone Policy — officials and councillors		In place		

Appendix G (continued)

Policy	Regulation	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Stores Management Policy - Stock obsolete (for auctions) - Internal Stores Policy		In place In process		
Transport Allowance Policy		In place		
Utilisation of Entertainment Allowance Policy		In place		
Expenditure Management Procedures		In place		
Donations Donations: guidelines Overseas visits, tours: financial assistance Grants in aid and donations		In place In place		
Security Policy — key control		In place		
Public/Private Partnership By-law		In place		
Procedural Manual for Cashiers and Cashier Supervisors Customer care and management in the rates hall of the department of Finance.		In place		
Signing authority: requisitions, orders and work orders		In place		
Authorised signature/Signing authority		In place		
Vacation leave bonus: payment		In place		
Housing rental assistance		In place		
Council houses: selling of		In place		

Appendix G (continued)

Policy	Regulation	Tlokwe City Council	Swartland Local Municipality	Steve Tshwete Local Municipality
Medical Aid Fund: continued contribution by Council		In place		
Petty Cash Policy		In process		In place
Short-Term Risks and Liabilities Policy		In process		In place
Write-off of Bad Debts Policy		In process		In place
Blacklisting Policy		In process		In place
Accounting Policy		In place		In place
Whistle-Blowing Policy		In process		
Fraud Prevention Policy		In process		
Deviation of Supply Chain Management Policy		In process		

Appendix H

Organisational structure of the Finance departments of the Swartland and the Steve Tshwete Local Municipalities and the Tlokwe City Council

Management/Section	Sub-Section	Swartland Local Municipality	Steve Tshwete Local Municipality	Tlokwe City Council
Director		1	1	1
Manager: Financial statements/ deputy directors		1	1 (1 vacant)	1
Assets and fleet management/risk management		4		5
Financial statements and assets			6 (1 vacant)	2
Financial systems		1		
Budget office		2 (1 vacant)	4 (1 vacant)	2
Expenditure	Salaries	4	7 (1 vacant)	6
	Creditors	3	6	6
Transaction verification and control			3	
Supply chain management	Demand and procurement	5 (1 vacant)	5	9 (6 vacant)
	Logistics, stores and disposal	7	8	6 (3 vacant)
Credit control	Legal collection	2		
	Indigents	1		1
	Credit control/Debt management	10 (1 vacant)	4 (1 vacant)	4 (3 vacant)

Appendix H (continued)

Management/Section	Sub-Section	Swartland Local Municipality	Steve Tshwete Local Municipality	Tlokwe City Council
Revenue	Property rates	4	5	5
	Estates		5	
	Housing	1		1
	Direct payments			2 (1 vacant)
	Meter reading	10		
	Services/Pre-paid services	8	3	11 (2 vacant)
	Cashiers/vendors/ enquiries Customer care	8	41 (6 posts vacant)	21
Administration		2	5 (1 vacant)	6
Electronic financial data preparation			5 (2 vacant, 1 frozen)	
Information Technology				4
Total		74 (3 vacant)	109 (14 vacant, 1 frozen)	93 (21 vacant)

Source: Swartland Local Municipality (2012b); Steve Tshwete Local Municipality (2013d); Tlokwe City Council (2013c)

Appendix H (continued)

The organisational structure of the Finance department of the Swartland Local Municipality is indicated in Figure 1 (Swartland Local Municipality:2012b).

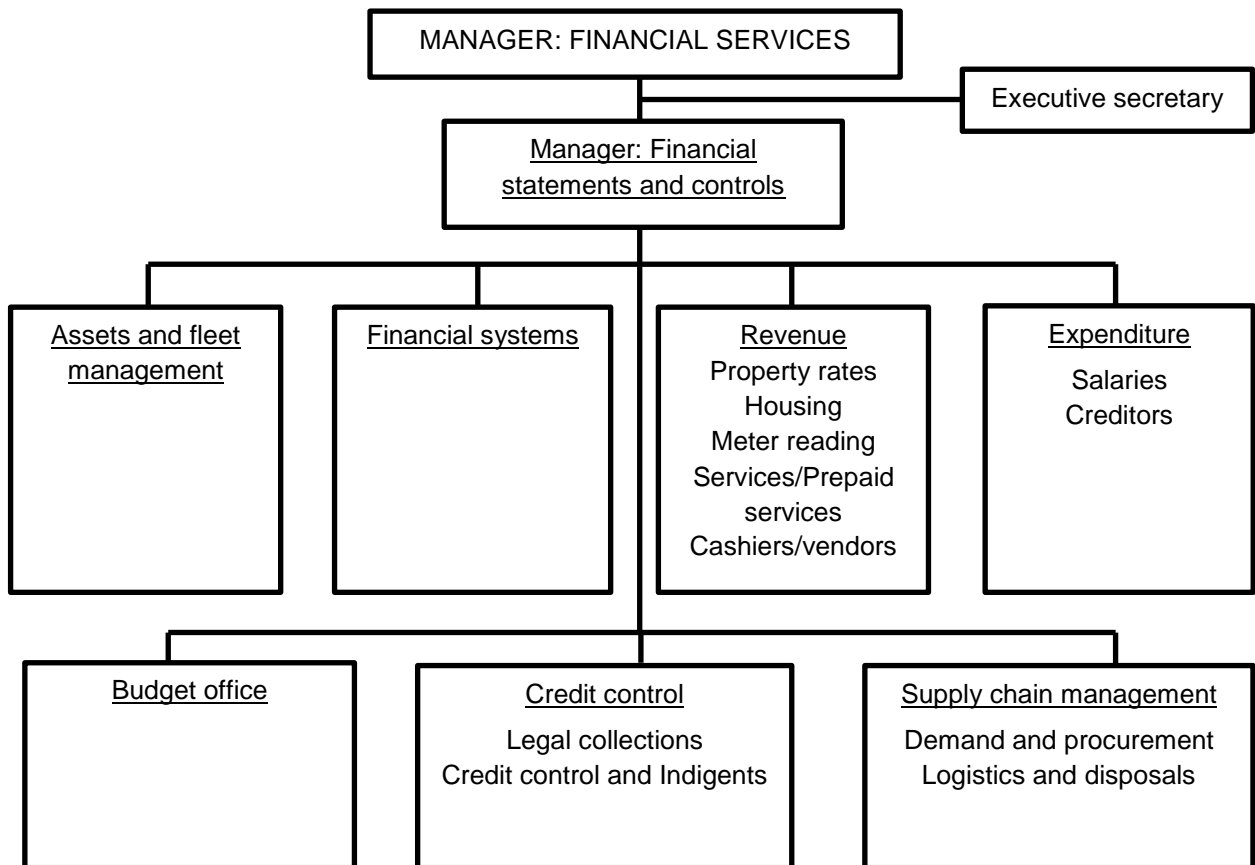


Figure 1 Organisational structure of the department of Financial Services — Swartland Local Municipality

The staff complement of the Supply Chain Management Unit consists of the following:

- Manager: Supply Chain Management
- Head: Logistics
- Head: Demand and Acquisition
- Principal clerk: Orders
- Two senior clerks: Logistics
- Secretary: Supply Chain Management
- A senior storeman and a storeman
- One senior clerk: Stationary and three senior clerks (buyers)

Appendix H (continued)

The organisational structure of the Finance department of the Steve Tshwete Local Municipality is indicated in Figure 2.

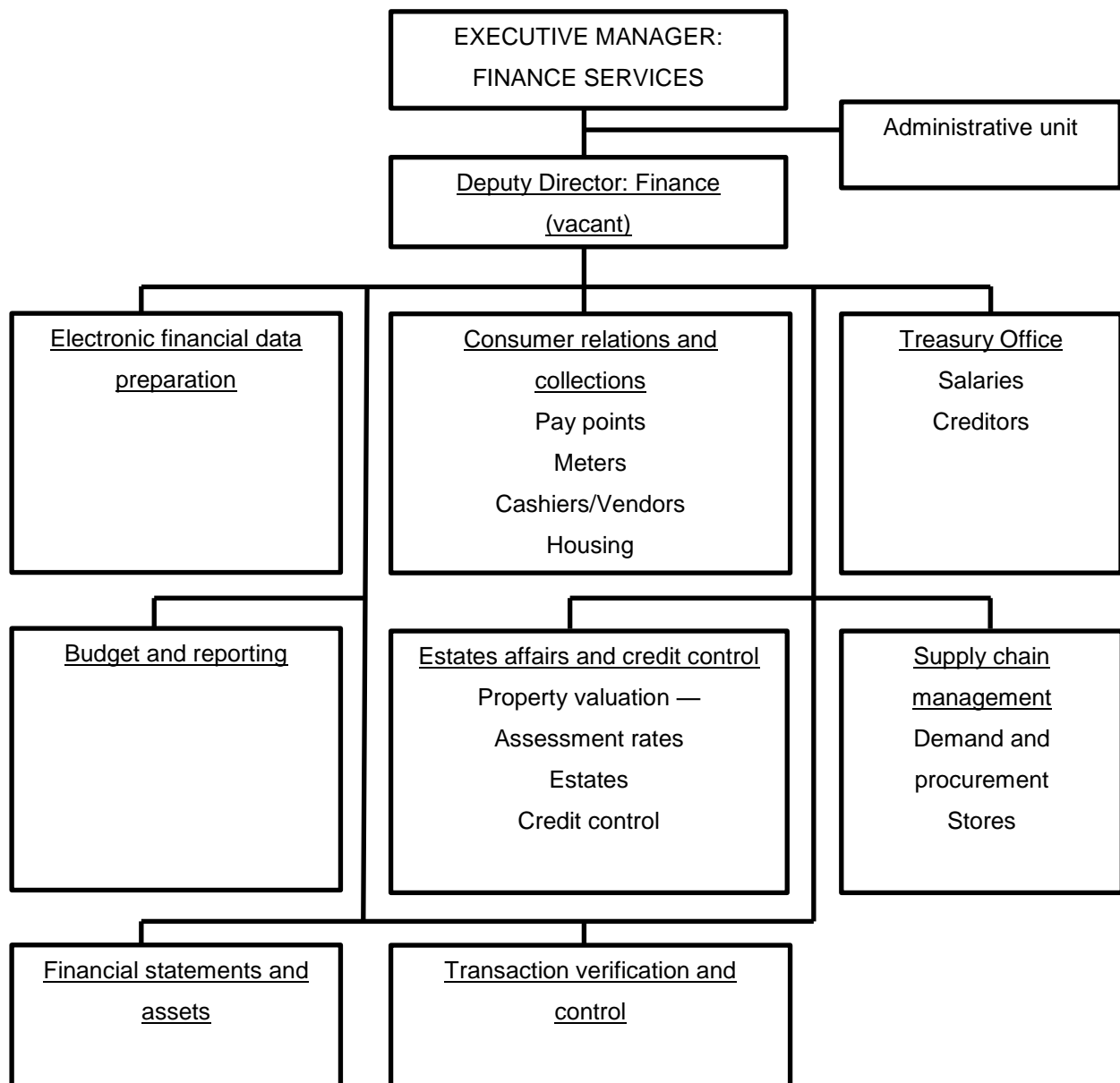


Figure 2 Organisational structure of the department of Finance — Steve Tshwete Local Municipality

Source: Steve Tshwete Local Municipality (2013d)

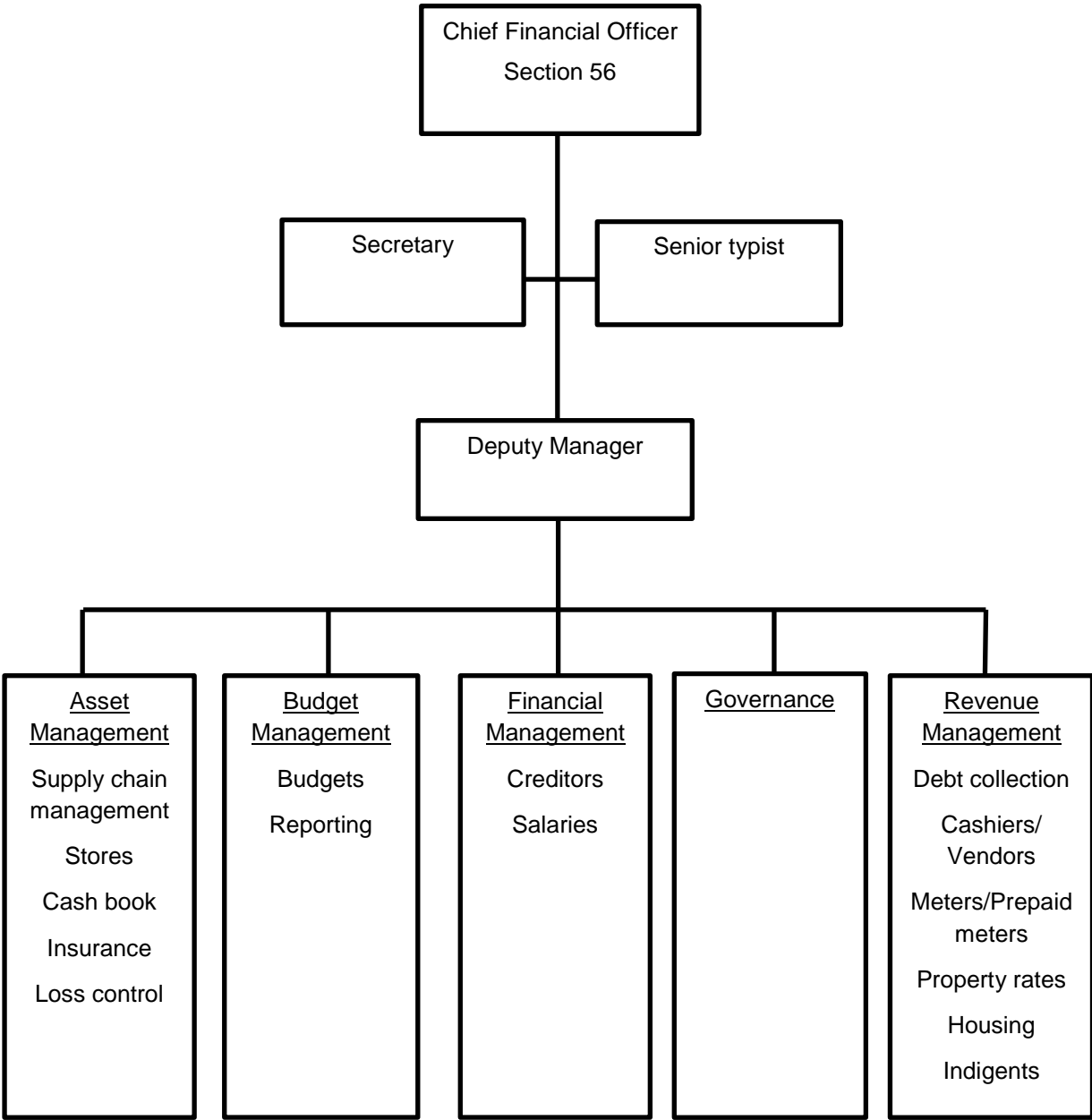


Figure 3: Organisational structure of the department of Finance — Tlokwe City Council

Source: IDP document (Tlokwe City Council, 2013b)

Appendix I

Summary of audit outcomes per province for the 2011 financial year

Province	Clean audit	Unqualified audit opinion with or without findings	Qualified opinion	Disclaimer or adverse opinion	No audit report issued	Total municipalities
KwaZulu-Natal	5	47	7	2	–	61
Limpopo	2	3	12	10	3	30
Mpumalanga	4	7	3	6	1	21
Western Cape	2	20	3	–	5	30
Eastern Cape	–	13	13	18	1	45
Free State	–	6	3	13	3	25
Gauteng	–	9	6	–	–	15
North West Province	–	2	2	5	15	24
Northern Cape	–	8	5	10	9	32
TOTAL	13	115	54	64	37	283

Source: Auditor General (2012f:7)

Appendix I (continued)

Summary of audit outcomes per province for the 2012 financial year

Province	Clean audit	Unqualified audit opinion with or without findings	Qualified opinion	Disclaimer or adverse opinion	No audit report issued	Total municipalities
KwaZulu-Natal	1	44	9	7	–	61
Limpopo	1	1	12	15	1	30
Mpumalanga	2	5	7	5	2	21
Western Cape	5	20	1	–	4	30
Eastern Cape	–	–	19	17	9	45
Free State	–	7	4	10	3	24
Gauteng	–	9	3	–	–	12
North West Province	–	4	3	16	–	23
Northern Cape	–	7	6	9	10	32
TOTAL	9	97	64	79	29	278

Source: Auditor General (2013d:7)

Appendix J

History of audit opinions and audit findings for the Rustenburg Local Municipality and the City of Matlosana Local Municipality

Rustenburg Local Municipality

Financial year	Audit opinion	Qualification findings	Emphasis of matter	Other/ additional matters	Compliance with legal and regulatory requirements
2011	Disclaimer	24	3	1	28
2012	Qualified	16	3	1	30

Source: Rustenburg Local Municipality (2012; 2013)

City of Matlosana Local Municipality

Financial year	Audit opinion	Qualification findings	Emphasis of matter	Other/ additional matters	Compliance with legal and regulatory requirements
2009	Disclaimer	23	2	1	2
2010	Disclaimer	39	0	1	9
2011	Disclaimer	49	1	1	30
2012	Disclaimer	33	4	1	35

Source: City of Matlosana Local Municipality (2010:43–52; 2011a:41–50; 2012:76–87; 2013a)

Appendix K

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
7(1)	Deciding to open a bank account for the Municipality	Council	Council	Municipal Manager	N/a	After consultation with the Chief Financial Officer
8(5)	Submitting the Municipality's primary bank account details, and any impending change thereof	Municipal Manager	Municipal Manager	Chief Financial Officer	Deputy Chief Financial Officer	
9(a)	Submitting the prescribed details regarding any new bank accounts opened for the Municipality	Municipal Manager	Municipal Manager	Chief Financial Officer	Deputy Chief Financial Officer	
9(b)	Submitting the details of the Municipality's bank accounts annually before the start of a financial year	Municipal Manager	Municipal Manager	Chief Financial Officer	Deputy Chief Financial Officer	

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
10(1)(a)	Administering the Municipality's bank accounts	Municipal Manager	Municipal Manager	Chief Financial Officer	–	
10(2)	Enforcing compliance with sections 7, 8 and 11 of the MFMA	Municipal Manager	Municipal Manager	Chief Financial Officer	No further sub-delegation permitted	
11(1)	Authorising staff to withdraw or authorise the withdrawal of money from the Municipality's bank account	Municipal Manager	Municipal Manager	1. Chief Financial Officer 2. Senior Financial Officials	–	1. Subject to the prescribed framework 2. If the Municipality has a primary bank account which is separate from its other bank accounts, only the Chief Financial Officer may be authorised to withdraw money or authorise the withdrawal of money from the Municipality's primary bank account in terms of section 11(2) of the MFMA

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
11(4)(a)	Preparing a quarterly consolidated report of all withdrawals made in terms of sections 11(1)(b)–(j) of the MFMA from the Municipality's bank accounts	Municipal Manager	Municipal Manager	–	–	A quarterly consolidated report of all withdrawals made from the Municipality's bank accounts must be tabled in the Council, and submitted to the Provincial Treasury and the Auditor General within 30 days after the end of each quarter
	Tabling of a quarterly consolidated report of all withdrawals made in terms of sections 11(1)(b)–(j) of the MFMA from the Municipality's bank accounts in the Council	Municipal Manager	Municipal Manager	–	–	

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
11(4)(b)	Submitting a quarterly consolidated report of all withdrawals made in terms of sections 11(1)(b)–(j) of the MFMA to the Provincial Treasury and the Auditor General	Municipal Manager	Municipal Manager	Chief Financial Officer	Deputy Manager	
12(1)	Deciding to set up a relief, charitable, trust or other fund of whatever description	Municipal Manager	Municipal Manager	–	–	Subject to obtaining the prior approval of the Council
12(2)	Deciding to open a separate bank account in the name of the Municipality for the purpose of a relief, charitable, trust or other fund	Council	Municipal Manager	–	–	After consultation with the Chief Financial Officer

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
12(4)	Issuing written authority to withdraw money without appropriation in terms of an approved budget from a bank account opened for the purpose of a relief, charitable, trust or other fund	Municipal Manager	Municipal Manager	–	–	Such authorisation must be in accordance with decisions of the Council in this regard and only for the purposes for which, and subject to the conditions on which, the fund was established or the money in the fund was donated
13(2)	Establishing an appropriate and effective cash management and investment policy for the Municipality	Council	Council	–	–	NOTE: In terms of section 60(2) of the Municipal Systems Act 2000 the Council may only delegate to the Chief Financial Officer the authority to make investment decisions on behalf of the Municipality — see Investment Regulations

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
14(2)	Deciding to transfer ownership as a result of a sale or other transaction or otherwise permanently dispose of a capital asset	Council	Council	–	–	On condition that — 1. the asset concerned is not needed to provide the minimum level of basic municipal services; and 2. the Council considered the fair market value of the asset concerned
14(2)(a)	Deciding, at a meeting open to the public and on reasonable grounds, that an asset of the Municipality is not needed to provide the minimum level of basic municipal services	Council	Council	Municipal Manager	–	Delegation to Municipal Manager. Only in respect of movable capital assets below a determined amount

Draft MFMA system of delegations for the Tlokwe City Council

		RESPONSIBILITY & DELEGATION CHANNEL				
Section	Power conferred	Responsibility	From	To	Sub-delegated to	Conditions & limitations
Local Government: Municipal Finance Management Act 2003 (Act No. 56 of 2003)						
14(2)(b)	Considering the fair market value of an asset to be disposed of and the economic and community value to be received in exchange for an asset to be disposed of	Council	Council	–	–	Delegation to Municipal Manager. Only in respect of movable capital assets below a Council-determined amount

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LIZ SMIT

BA (Languages) (Rand Afrikaans University), BA Hons (Afrikaans) (North West University)

SA Translators' Institute (SATI) membership number: 1002474

168 Kock Street, POTCHEFSTROOM 2531

Cell Number 082 529 8055

E-mail: lizsmit@imagnet.co.za

Your reference number: PW5

Date: 12 October 2013

To: PNR Wilgenbus
pamw@tlokwe.gov.za

Dear Ms Wilgenbus

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