

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL AND EASTERN CAPE PROVINCIAL LEGISLATURE ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE NELSON MANDELA BAY METROPOLITAN MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements of the Nelson Mandela Bay Metropolitan Municipality which comprise the consolidated and separate statement of financial position as at 30 June 2009, the consolidated and separate statement of financial performance, the consolidated and separate statement of changes in net assets and the consolidated and separate cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes, as set out on pages 263 to 438.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(d) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by Nelson Mandela Bay Metropolitan Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

8. In my opinion the financial statements present fairly, in all material respects, the consolidated and separate financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2009 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended, in accordance with Statements of GRAP and in the manner required by the MFMA.

Emphasis of matter(s)

Without qualifying my opinion, I draw attention to the following matters:

Unauthorised, irregular or fruitless and wasteful expenditure as well as material losses through criminal conduct

9. As disclosed in note 44 to the consolidated financial statements, irregular expenditure to the amount of R1, 56 million was incurred during the year because the supply chain management policy had not been adhered to, cash were stolen and penalties were incurred due to the late payment of VAT. This expenditure occurred due to a lack of monitoring and review of transactions throughout the year under review.

National and provincial government accounts

10. As disclosed in note 16 of the consolidated annual financial statements, Consumer debtors, the debts owed by national and provincial governments to the municipality at 30 June 2009 amounted to R80 million. This amount had increased to R105 million as at 30 September 2009.

Going concern

11. As disclosed in note 36.2 of the consolidated financial statements, the council of the parent municipality resolved that the entities, Centenary Hall Promotions and Feather Market Promotions, be absorbed into the parent municipality with effect from 1 May 2009. The legal process of deregistering these two Section 21 Companies was still ongoing at the date of this report.

Other matter(s)

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

12. The supplementary information set out on pages 439 to 452 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act (MFMA)

13. Certain suppliers of the municipality were not paid within 30 days of receiving the relevant invoice or statement as required by section 65(2)(e) of the MFMA. Manual or automated controls are not designed to ensure that payments are made within 30 days of receipt of the invoice.
14. Instances were identified where the municipality did not submit a separate report to National Treasury within 15 days after the end of each month for each contract awarded (and signed) above R100 000, as required by MFMA Circular No. 34 read with section 74(1) of the MFMA.
15. Feather Market Promotions (FMP) and Centenary Hall Promotions (CHP) did not comply with section 111 of the MFMA as these entities did not have a supply chain management policy in place.
16. MFMA section 95(c) & (d) states that the accounting officer of a municipal entity is responsible for managing the financial administration of the entity, and must for this purpose take all reasonable steps to ensure that the entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control and that irregular and fruitless expenditure and other losses are prevented.

The following instances of non-compliance were noted during the audit of Feather Market Promotions and Centenary Hall Promotions:

- a) No risk assessment had been performed for the period under review.
 - b) No fraud prevention plan in place to prevent and detect fraud.
 - c) No compensating control to deal with segregation of duties due to staff shortages.
 - d) Insufficient controls with regard to the safekeeping of supporting documentation for all transactions recorded (Centenary Hall Promotions).
 - e) No policy documents in place for most of the significant transaction cycles such as revenue and receivables, purchases and payables, asset management and employee costs (Centenary Hall Promotions).
 - f) No plans to recover information in disaster situations, e.g. back-up facilities, recovery plan for business continuity. Lack of space also presents a challenge with regard to storing records (Feather Market Promotions).
17. Section 96(1) of the MFMA states that the accounting officer of a municipal entity is responsible for the management of (a) the assets of the entity, including the safeguarding and maintenance of those assets; and subsection (2)(b) further states that the accounting officer must ensure that the entity has and maintains a system of internal control of assets and liabilities, including an asset and liabilities register, as may be prescribed. The following was noted during the audit of property, plant and equipment of Feather Market Promotions and Centenary Hall Promotions:
 - a) A proper and complete asset register is not kept as assets do not have asset numbers assigned and no location details are documented. The assets of the entity are also not marked.
 - b) Reconciliation between physical assets and the register is not performed.
 - c) No policy exists for the maintenance and disposal of assets.
 18. In addition to not having a performance management system (PMS), the municipal entities of Feather Market Promotions and Centenary Hall Promotions did not have an audit committee, nor internal audit function during the 2008-09 financial year. (MFMA section 166(2) (a)).

South African Local Government Bargaining Council's Collective Agreement on Conditions of Service

19. Certain officials of the municipality did not take the minimum number of leave days as stipulated in section 7(2) of the South African Local Government Bargaining Council's Collective Agreement on Conditions of Service.
20. Certain instances were identified where municipality officials' accumulated leave exceeded the maximum of 48 days, which is contrary to the stipulation of section 7(4) of the South African Local Government Bargaining Council's Collective Agreement on Conditions of Service. Leave transactions and leave credits were not monitored adequately to enable management to inform employees of leave credits approaching 48 days.

Value-Added Tax Act (VAT Act)

21. The municipality claimed input tax on the supply of motor vehicles, which is contrary to the stipulation of section 17(2)(c) of the VAT Act. A proper review was not conducted to determine whether the VAT accounts concerned had been correctly set up to account for VAT.

Supply Chain Management Regulations - GRN.868 of 30 May 2005 (SCMR)

The following instances of non-compliance were noted during the audit of the municipality;

22. Annual financial statements for the past three years were not in all instances obtained from bidders where the value of the transaction exceeded R10 million (excluding VAT) as required by paragraph 21(d)(i)(aa) and (bb) of the SCMR.
23. Certain tender documentation could not be submitted for review. The lack of proper record keeping is contrary to the requirements of paragraph 20(h) of the SCMR. Ongoing monitoring and supervision of the tender files are not undertaken in all instances to ensure that all the required information is filed on the tender files.
24. Contrary to the requirement of section 46(2)(e), not all role players involved in the supply chain management process of the municipality had declared to the accounting officer the details of any private or business interest which that person, or any close family member, partner or associate, may have in any proposed procurement or disposal process of, or in any award of a contract by the municipality.

Municipal Systems Act (MSA)

25. Section 93F(1)(d) of the Municipal Systems Act stipulates that a person who is an official of the parent municipality are not eligible to be a director of the related municipal entity. Some of the directors of Centenary Hall Promotions and Feather Market Promotions are officials of the parent municipality.
26. The board of directors of the Centenary Hall Promotions and Feather Market Promotions did not meet on a regular basis in order to exercise oversight over the entities' operational and financial affairs and therefore had not complied with their oversight duties as required by section 93H(1)(a) read with section 93I of the MSA.

Governance framework

27. The governance principles that impact the auditor's opinion on the financial statements relate to the responsibilities and practices of the accounting authority and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Key governance responsibilities

28. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✓
Quality of consolidated financial statements and related management information			
2.	The consolidated financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	✓	
Timeliness of consolidated financial statements and management information			
4.	The annual consolidated financial statements were submitted for auditing as per the legislated deadlines as required by section 126 of the MFMA.	✓	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	✓	
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 	✓	
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		✓
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	✓	
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		✓
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set	✓	

No.	Matter	Y	N
	out in section 62(c)(i)/95(c)(i) of the MFMA.		
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		✓
14.	Oversight resolutions have been substantially implemented.	✓	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the metro against its mandate, predetermined objectives, outputs, indicators and section 68 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	

29. Significant difficulties were experienced to obtain the fixed asset register of the Nelson Mandela Bay Metropolitan Municipality to support the property plant and equipment-related balances and disclosures in the financial statements. The fixed asset register was provided on 16 October 2009 and was resubmitted for auditing on 23 October 2009.

30. Linked to the above is the delay in submitting relevant and appropriate evidence to support a journal entry processed to account for the duplication of movable assets in the fixed assets register amounting to R48 million. Evidence in support of the adjustment made in the general ledger was submitted on 23 November 2009.

31. The *Internal Audit and Risk Assurance – Three-year Audit Plan 2008-2011* of the Nelson Mandela Bay Metropolitan Municipality does not include a review of the accuracy of annual financial statements and the supporting information. For the year under review the internal audit function managed to implement 40% of its internal audit plan.

Investigations

In addition to the investigations into unauthorised, irregular, fruitless and wasteful expenditure as disclosed in note 44 to the annual financial statements, investigations into the following matters had not been finalised at the reporting date:

32. Fraudulent electronic fund transfers amounting to R19,7 million, of which R17,9 million has been recovered.

33. Fruitless and wasteful expenditure amounting to R850 000 incurred in connection with the grant that was awarded for the GA Soccer challenge.

34. Fruitless and wasteful and irregular expenditure incurred with regard to the opening of the Red Location Museum.

35. Allegations that cemetery officials had defrauded the municipality.

36. The investigation into allegations made against the municipal manager relating to the administration of service delivery and non-compliance with relevant laws and regulations.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

37. I have reviewed the performance information as set out on pages 15 to 167.

The accounting officer's responsibility for the performance information

38. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

39. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

40. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

41. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

42. The key performance indicators set by the Nelson Mandela Bay Metropolitan Municipality in their integrated development plan (IDP) did not include the following general key performance indicators applicable to the municipality, as prescribed by section 43(1) of the MSA: .

- a) The percentage of households with access to basic level of water, sanitation, electricity and solid waste removal.
- b) The percentage of the municipality's capital budget actually spent on capital projects identified for a particular financial year in terms of the municipality's IDP.
- c) The percentage of a municipality's budget actually spent on implementing its workplace skills plan.

43. The mid-year budget and performance assessment of the Centenary Hall Promotions and Feather Market Promotions was not performed as required by section 88(1) of the MFMA by the entities themselves. The accounting officer of the parent municipality only took into account the performance of the Mandela Bay Development Agency (MBDA) in assessing the performance of the municipality as at 25 January 2009, as required by section 71(1)(a)(iv) of the MFMA.

44. The Mandela Bay Development Agency, in most instances, did not establish measurable performance indicators and objectives as required by section 121(4)(d) of the MFMA.

Internal auditing of performance information

45. The internal auditors of the Nelson Mandela Bay Metropolitan Municipality did not audit the performance measurements and did not submit quarterly reports on their audits to the municipal manager and audit committee, as required by regulation 14(1)(c) of Local Government: Municipal Planning and Performance Management Regulations, 2001 (published under GN R796 in GG22605 of 24 August 2001).

Inconsistently reported performance information

46. The Nelson Mandela Bay Metropolitan Municipality has not reported in all instances on all its key performance indicators and targets as per the IDP.

Reported performance information not relevant

47. The following targets with regard to the provision of water and electricity were not:
- specific in clearly identifying the nature and the required level of performance
 - measurable in identifying the required performance.
- a) Provision of bulk infrastructure and services to support Coega
 - b) Energy efficient lighting in municipal building
 - c) Replacement of existing streetlights with energy-efficient lighting by June 2009.

Reported performance information not reliable

48. The source documentation provided did not support the reported performance information with regard to the following key performance indicators:
- a) Percentage compliance of potable water samples in terms of the national norm
 - Reported performance 95% and supporting evidence indicated 97%
 - b) Number of households connected to hot water load control
 - Reported performance 45 332 and supporting evidence indicated 47 983.

APPRECIATION

49. The assistance rendered by the staff of the Nelson Mandela Bay Metropolitan Municipality group during the audit is sincerely appreciated.

Auditor-General

Pretoria

21 December 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence