

**REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON PERFORMANCE  
MEASUREMENT AT EKURHULENI METROPOLITAN MUNICIPALITY FOR THE YEAR ENDED  
30 JUNE 2006**

**1. ASSIGNMENT**

The compilation, presentation and publishing of performance measurements as included on pages .....to..... of the annual report and the implementation, management and internal control of supporting systems, are the responsibility of the accounting officer.

As required by section 45(b) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) my responsibility is to provide an assessment of the controls implemented by the accounting officer to develop and manage the municipality's performance management system, my role is not to assess or comment on the municipality's actual performance.

**2. NATURE AND SCOPE**

I have performed the procedures agreed upon and described below regarding the performance measurement system of Ekurhuleni Metropolitan Municipality. The assignment was undertaken in accordance with the International Standard on Related Services (ISRS 4400) applicable to agreed upon procedures engagements.

The procedures were performed solely to evaluate the controls implemented and managed by the accounting officer regarding the municipality's performance measurement system against the criteria set out in:

- chapter 6 of the Municipal Systems Act, 2000;
- the Local Government: Municipal Planning and Performance Management Regulations, 2001 (No. R. 796)

The procedures performed during my assignment were based on the high-level overview checklist completed by the accounting officer and included a review of the following aspects:

- (i) Development of an integrated development plan;
- (ii) Development of a performance management system;
- (iii) Development and implementation of key performance indicators;
- (iv) Setting of targets for key performance indicators;
- (v) Actual service delivery process;
- (vi) Internal monitoring of performance measurements;
- (vii) Internal control of the performance management system;
- (viii) Performance measurement and reporting; and
- (ix) Revision of strategies and objectives.

**3. FACTUAL FINDINGS**

I report my findings below:

**3.1. Development of an integrated development plan**

A formalised process was adopted for the development of the integrated development plan (IDP). The adoption, implementation and disclosure of the 2005-2006 IDP were in

arrangement could be presented for audit. This was due to a lack of sufficient control framework to perform independent checks as well as reconciliations.

## **OTHER REPORTING RESPONSIBILITIES**

### **Reporting on performance information**

36. A separate report on the performance measurement at the Ekurhuleni Metropolitan Municipality was issued for the financial year ended 30 June 2006.
37. I could not audit the performance information of municipal entities due to the reason stated in paragraph 41 of this report.

### **Responsibility of the accounting officer**

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).

### **Responsibility of the Auditor-General**

39. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).
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 finding**

42. Due to inadequate management reporting systems on performance information, the municipality's entities did not submit performance information for audit.

## **APPRECIATION**

43. The assistance rendered by the staff of the Ekurhuleni Metropolitan Municipality during the audit is sincerely appreciated.



B R Wheeler for Auditor-General

Johannesburg

21 September 2007



AUDITOR-GENERAL

6. An audit also includes evaluating the:
- appropriateness of accounting policies used
  - reasonableness of accounting estimates made by management
  - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis of accounting**

8. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury as set out in accounting policy note 1.

#### **Basis for adverse opinion**

##### **Property, plant and equipment**

9. The following accounting and disclosure inadequacies relating to property, plant and equipment were identified during the audit:
- As reported in the previous period, the requirements of GAMAP 17 were not complied with. Some assets could not be verified physically to confirm their existence.
  - As reported previously, the useful life of assets was not assessed. Therefore depreciation could be misstated, resulting in the misstatement of the asset value.
  - The requirements of GAMAP 17 were not complied with, as the plan for testing impairment of assets was not implemented and consequently the accuracy of the asset valuation could not be confirmed.

Management was in the process of appointing service providers to assist with the updating of the asset register in order to comply with GAMAP 17 requirements.

10. East Rand Water Care Company (ERWAT) did not comply with the requirements of International Accounting Standard (IAS) 16, since a periodic review of the useful life or residual values of fixed assets was not conducted during the current financial period. An annual assessment of asset impairment was also not conducted.

##### **Revenue and receivables**

11. The completeness and accuracy of rates and taxes, services and direct income revenue could not be verified due to the following:
- At year-end 12 198 properties were identified by management on which rates and taxes were not levied. The possible impact on revenue was not calculated by management and the revenue understated was not accrued for. Some properties on the valuation roll were incorrectly billed for rates and taxes.
- The projected impact of unbilled properties and properties billed at incorrect rates indicated that rates and taxes revenue might be potentially understated by R29 million and R4 million, respectively.
- Rates and taxes were charged based on old zonings and outdated land values instead of the new rezoned property at the current value. Sufficient appropriate

audit evidence could not be obtained for some transactions tested in the sample. The monetary value of the misstatement could not be quantified.

- Interest was not always charged to receivable accounts that were in arrears. The debtor accounts were marked as inactive for purposes of calculating interest on the system. A projection to determine the impact of the misstatement indicated that interest received on outstanding debtor accounts might be potentially understated by R21 million.
- At year-end, management identified 47 684 active consumption metres in existence which were not billed. Management did not determine the impact of the understatement on revenue. The projected impact indicated that services revenue might potentially be understated by R28 million.
- The electronic data files for third party cash receipts, the valuation roll and service meter readings that were requested in order to perform audit procedures could not be provided, resulting in a limitation of scope on the audit procedures to assess the completeness of revenue. It was not possible to perform alternative audit procedures to assess the completeness of the applicable revenues.

Management had identified the weaknesses and in responding to these issues, a consumer clean-up project was launched. At the date of this report, the project was still in progress. The impact of this project on revenue management and controls will be evaluated in the next financial period.

12. During the year under review indigent write-offs amounted to R794 million. Management was unable to provide appropriate supporting documentation for a number of debtors that were written off to support the indigent status as per the policy approved by council. Therefore the validity of the indigent debtors write-off could not be verified.

#### **Housing development fund**

13. The housing development fund was established in terms of the Housing Act, 1997 (Act No. 107 of 1997). In terms of this act, all proceeds from housing developments, which include rental income and sales of houses, must be paid into the fund. The fund can only be used for housing developments in accordance with the national housing policy. The municipality could not provide an analysis of the assets and liabilities underlying the fund amounting to R144 983 408 as at 30 June 2006. The completeness and accuracy of the revenue and expenditure as well as the valuation of the fund could therefore not be established.

#### **Creditors**

14. A difference of R64 863 542 was noted between the balance per the general ledger for trade creditors and the creditors listing at year-end. No supporting documentation could be provided for the difference. Management initiated the reconciliation process, subsequent to the audit, to address this difference. The impact will be evaluated in the next financial period.

#### **Departure from GRAP, GAMAP and SA Generally Accepted Accounting Practice**

15. IAS 39 (AC 133), Financial Instruments: Recognition and Measurement, requires that financial assets or financial liabilities should be measured at fair value or amortised cost by applying the effective interest rate, where applicable. EMM did not comply with this requirement since financial assets and financial liabilities were measured at historical cost. This resulted in the misstatement of long-term liabilities, non-current

to adopt a supply chain management policy with effect from 1 July 2005. A decision was taken by management to delay the implementation to fully prepare for the new requirements. This led to the adoption of the policy on 1 March 2006. However, approval for the delay beyond the extended deadline of 1 October 2005 was not obtained from the National Treasury.

28. The annual report for the 2005 financial year did not fully comply with the requirements of section 121(4) of the MFMA, as the report did not include the municipality's strategic objectives and performance against predetermined objectives.
29. In terms of section 126(3)(b) of the MFMA the audit report must be submitted to the accounting officer within three months of the receipt of the financial statements. The audit was delayed due to the late finalisation of the prior year audit as well as late submission of audit evidence.

#### **Housing Rental Act**

30. In terms of the Rental Housing Act, 1999 (Act No. 50 of 1999) the deposit paid by a tenant must be invested in an interest-bearing account, and such interest must be paid to the tenant subject to section 5(3)(g) of chapter 3 of the said Act. The municipality did not comply with this requirement as interest was not accrued on the housing rental deposits.

#### **Basic conditions of employment**

31. Overtime conditions as stipulated in the Basic Conditions of Employment Act were not complied with. This was evident in the emergency services division. A high rate of vacancies contributed to departure from legislative requirements.

#### **Special investigations**

32. As previously reported, an internal forensic investigation was launched by the municipality into possible irregularities at the municipality involving employees at the mechanical workshops. At the date of this report, the investigation had not been concluded, as it led to further investigations that were still underway.

#### **Matters of governance**

33. EMM entered into an agreement with its municipal entities to utilise the municipality's audit committee. However, during the year under review, the scope and focus of the audit committee was only directed at the parent municipality. Therefore, the audit committee did not oversee the financial affairs of its municipal entities as required by section 166(6) of the MFMA.
34. In terms of section 165(1) of the MFMA, each municipal entity must have an internal audit unit, subject to section 165(3). Section 165(3) stipulates that such internal audit function may be outsourced. Although the municipal entities of EMM utilised the internal audit function of the parent municipality for the year under review, the internal audit function did not prepare a risk-based audit plan for each of the municipal entities of EMM as required by section 165(2)(a) of the MFMA.
35. The credit control and debt collection policy of the municipality required that where services were disconnected or restricted, they would only be restored if the debtor paid the account in full or entered into an arrangement. Certain instances were identified where reconnections took place without evidence that the procedures outlined in the credit control policy were followed. In some instances no proof of payment or

provisions, consumer deposits, provisions, creditors, long-term receivables as well as consumer and other debtors. The impact of this error could not be quantified. Subsequent to year-end the Minister of Finance exempted municipalities from complying with certain accounting standards for the next two financial years, as per the provisions of *Government Notice 522* contained in *Government Gazette No. 30013 of 29 June 2007*.

16. Included in the capitalisation reserve was an amount of R214 million that originated in the books of ERWAT, a municipal entity of EMM, as a result of the transfer of various water care works and regional outfall sewers from the Ekurhuleni Metropolitan Council to ERWAT at no cost or at a reduced value. Property, plant and equipment were brought to account at existing market value at the date of transfer by crediting this reserve.

IAS 20 (AC 134), Accounting for Government Grants and Disclosure of Government Assistance, stipulates that government grants shall not be credited directly to shareholders' interests. Paragraph 26 of the said standard requires that the grant must be deferred and then recognised as income on a systematic basis over the useful life of the asset. This accounting treatment was not adopted by ERWAT. This resulted in the misclassification of the year-end balances in respect of deferred income and the capital replacement reserve.

17. The amount of the provision should be the best estimate of the expenditure required to settle the present obligation at reporting date. Contrary to this requirement, the municipality adopted an approach where a fixed percentage of income of the municipality was contributed to the provision. The provision balance of R14 964 446 as disclosed in note 3 to the financial statements was calculated at R5 per ton of waste disposed on the landfill sites of the municipality. The municipality did not review the provision at the reporting date, as required by GAMAP 19, to reflect the current best estimate of the landfill rehabilitation provision.

#### **Adverse opinion**

18. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of the group and the Ekurhuleni Metropolitan Municipality as at 30 June 2006 and its financial performance and cash flows for the year then ended in accordance with the identified basis of accounting and in the manner required by the MFMA.

#### **OTHER MATTERS**

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

##### **Internal control**

19. Due to the incomplete asset register and lack of detailed asset descriptions, the existence of assets could not be verified. Furthermore, lack of capacity resulted in non-compliance with GAMAP 17.
20. Weaknesses in the management of revenue and receivables were due to a lack of formal and coordinated risk management processes to ensure accurate and complete billing of services. Policies and procedures were not always adhered to.

21. Non-compliance with accounting standards was attributable to: lack of capacity, incorrect interpretation of accounting standards and late clarification of the applicable accounting framework.
22. Poor monitoring controls to ensure compliance with the provisions of the Housing Act, 1997 (Act No. 107 of 1997), proceeds from sales of houses and rental income were not ring-fenced as required in terms of the Act.
23. Lack of regular reconciliation and review by management resulted in an un-reconciled difference between the general ledger and the creditors listing.
24. A high rate of vacancies contributed to departure from the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997). As a result of emergency services to be rendered, staff had to work excessive overtime.
25. Inadequate monitoring controls resulted in non-compliance with rules and regulations.

#### **Information system matters**

26. As reported in the previous financial year, a number of weaknesses still existed in the IT general control environment. The following control weaknesses were identified:
  - A business continuity plan (BCP) and disaster recovery plan (DRP) did not exist.
  - A lack of segregation of duties within the Human Resource (HR) IT environment was identified and change control weaknesses were identified surrounding the HR and Payroll applications.
  - Certain general control weaknesses were identified on the Venus application.
  - Backup and recovery control weaknesses were identified on the HR application.

A follow-up audit of the network security was completed in January 2007 and the findings were brought to the attention of the accounting officer. The systems were found not to be adequately protected and contained a number of weaknesses that could seriously compromise the system of internal control and data integrity. The root cause of the weaknesses identified was the lack of standardised security procedures.

The following weaknesses were identified:

- There was still a lack of adequate, formally documented security standards to ensure effective security management.
- Certain security control weaknesses were identified on the Oracle databases.
- Application, database and operating system software were still not updated with the latest vendor updates to minimise the risk of unauthorised access to information on the systems.
- The wireless environment was unprotected, resulting in poor access controls.

#### **Material non-compliance with applicable legislation**

##### **Municipal Finance Management Act, 2003 (Act No. 56 of 2003)**

27. In terms of *Government Notice 1404* issued by the National Treasury in *Government Gazette No. 27044 of 1 December 2004*, all high-capacity municipalities were required

international Standards on Review Engagements other matters might have come to my attention that would have been reported to you.

This report relates only to the purpose set forth in the first paragraph of this report and does not extend to the financial statements of Ekurhuleni Metropolitan Municipality, taken as a whole.

## 5. APPRECIATION

The assistance rendered by the staff of Ekurhuleni Metropolitan Municipality during the assignment is sincerely appreciated.



B R Wheeler for Auditor General

Pretoria

21 September 2007



AUDITOR GENERAL