

## Annexure B

Report of the Auditor General on the Consolidated Annual Financial Statements for year ended 30 June 2006

### 1. AUDIT ASSIGNMENT

The financial statements and consolidated financial statements as set out on pages [ ] to [ ], for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004), and section 126(3) of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). These financial statements are the responsibility of the accounting officer. My responsibility is to express an opinion on these financial statements, based on the audit.

## 2. SCOPE

The audit was conducted in accordance with the International Standards on Auditing read with General Notice 1512 of 2006, issued in Government Gazette no. 29326 of 27 October 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements
- assessing the accounting principles used and significant estimates made by management
- evaluating the overall financial statement presentation.

I believe that the audit provides a reasonable basis for my opinion.

## 3. BASIS OF ACCOUNTING

The municipality and the municipal entities are required to prepare financial statements and consolidated financial statements on the basis of accounting determined by the National Treasury, as described in the accounting policy note 1 to the financial statements.

## 4. AUDIT OPINION

In my opinion, the financial statements present fairly, in all material respects, the financial position of eThekweni and the group at 30 June 2006 and the results of its/their operations and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury of South Africa, as described in the accounting policy note 1 to the financial statements, and in the manner required by the MFMA.

## 5. EMPHASIS OF MATTER

Without qualifying the audit opinion expressed above, attention is drawn to the following matters:

### 5.1 Financial management

Although financial and internal control systems were developed and documented, they were not consistently implemented and maintained throughout the year. The following serve as examples of discrepancies noted during the audit:

- Owing mainly to a lack of regular reconciliations and independent reviews, assets with a negative book value totaling R12,9 million were included in the asset register. In

addition, accumulated depreciation were overstated and fixed assets understated by R3,3 million.

- The council did not enforce all contractual requirements relating to housing agreements. As a result, four housing loans totalling R30,6 million were not recovered in terms of the loan agreements.
- Minutes of procurement meetings were not always signed by the chairperson and in some cases found to be incomplete. In addition, a formal process was not in place to ensure that officials attending the procurement meetings declare possible conflict of interest which is contrary to implemented policy.
- Regular reconciliations between the VAT returns and the transactions processed through the general ledger system were not performed during the year.
- Council did not have proper controls and procedures in place to ensure that all required legal representation from council's attorneys are made available to confirm the contingent liabilities and/or assets disclosed.

## 5.2 Non-compliance with laws and regulations

5.2.1 In terms of the section 10 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997) an employer may not require or permit an employee to, inter alia, work overtime except in accordance with an agreement and to work more than 10 hours overtime a week. However, due to the lack of an adequate policy, certain employees worked overtime exceeding 10 hours per week.

5.2.2 In terms of section 6(2)(c) of the Local Government: Municipal Systems Act, 2000 (Act No.32 of 2000) the administration of the municipality must take measures to prevent corruption. Although certain measures were implemented in this regard the following shortcomings were noted:

- An approved fraud prevention policy and plan did not exist.
- An approved strategic plan did not exist to ensure that the ombudsperson and investigations unit were functioning efficiently and effectively.
- Regular feedback was not provided to the audit committee on progress made with investigations.
- For most of the year the position of head of the ombudsperson and investigations unit were vacant. At year-end the vacancy level of the unit was at 74% (20 of 27 posts).

## 5.3 Computer control environment

A follow-up information systems audit of the general and application controls surrounding the information systems environment of the municipality was completed for the 2005-06 financial year. It was established that although some progress had been made in addressing the shortcomings identified during the previous audit, certain control weaknesses that could compromise the confidentiality, integrity and availability of data were still present in the control environment as a whole. These significant control weaknesses related to inadequately configured logical access to the information systems, allocation of excessive system rights to users, application process controls that did not support the validity, accuracy and completeness of transaction data, inadequate separation of incompatible responsibilities and inadequate monitoring of critical security

processes. Furthermore, the disaster recovery plan did not cover all the critical systems of the municipality.

The shortcomings identified could be attributed to delayed implementation of the policy framework necessary for the effective governance of the information systems environment as well as a shortage of staff.

In their management comments the municipality indicated that corrective actions and initiatives were in progress and would be implemented subsequent to the completion of the audit to address the reported control weaknesses.

#### 5.4 Late finalisation of the audit report

In terms of section 126(3)(b) of the MFMA the Auditor-General is required to submit the audit report to the accounting officer within three months of the receipt of the financial statements. In the interest of improving accountability and due to the process implemented to ensure consistency in the manner in which material audit findings are reported, I have delayed the finalisation of the audit report to the date reflected on the audit report.

## 6. APPRECIATION

The assistance rendered by the staff of the eThekweni Municipality during the audit is sincerely appreciated.

Auditor-General (South Africa)

Pretoria

15 February 2006

AUDITOR-GENERAL

## Annexure C

### Responses to the audit report: year ended 2006-06-30

Notwithstanding the fact that the Auditor General once again expressed an unqualified opinion, the following comments and recommendations are made in connection with his Report. (Paragraph references coincide with those in the report.)

#### 5.1. Financial Management

##### Assets with negative net book value

Negative net book value's arose mainly due to the processing of credit notes in the year subsequent to the creation of the asset within the fixed asset register.

A working group is currently investigating and rectifying all assets with negative balances in the register. This exercise is substantially complete.

##### Depreciation and Accumulated Depreciation calculations

The auditors findings are currently being reviewed and entries will be processed in the 2007 financial year to rectify any errors that may have occurred.

##### Recoverability of loans

A proposal from First Metro Housing company for the repayment of the loans was received and accepted by the Municipality. Correspondence confirming this was forwarded to the Auditor General's office.

The capital portion of the short term loans will be repaid by 31/03/2007 in terms of the proposal.

Further , the current value of the fixed property owned by First Metro Housing company far exceeds the liabilities.

##### Minutes of procurement meetings

A file has been created for minutes and the Bid Administration Branch will ensure that the appropriate Chairperson signs these. In addition, on each of the contract files it will be noted which committee meetings the items were considered. This will take place with immediate effect.

##### Vat reconciliations

A reconciliation of the general ledger to the VAT returns was completed as at 30 June 2006.

With effect from 1 July 2006, monthly reconciliations of the VAT return to the general ledger is completed prior to the submission of the monthly VAT return to the South African Revenue Services.

##### Legal representation

Proper procedures and controls will be implemented to ensure that all required legal representation from council's attorneys are made available to confirm the contingent liabilities/assets disclosed.

#### 5.2. Non-compliance with laws and regulations

5.2.1. We accept that in terms of the Basic Conditions of Employment Act, an employee may not work overtime in excess of ten (10) hours per week, except by agreement. We, however, confirm that we have a practice whereby we obtain overtime authority / approval prior to an employee working overtime and this forms part of the agreement for the employee to work overtime. As a further control, we send out an Overtime Analysis report, which outlines all employees that work overtime and earn in excess of thirty percent (30%) of their basic salary, to all line managers on a monthly basis. You must also be aware that employees do accumulate a few months overtime and then request payment in a particular month. This could therefore account for some of the high amounts of overtime being paid. In addition, in view of the urgency of a situation, for example burst water mains, staff would be required to work overtime to ensure continuation of the service.

In addition, all managers have been advised to ensure that the authorisation of overtime to be worked, is in terms of the Basic Conditions of Employment Act.

5.2.2. The fraud prevention policy has been submitted to the Executive Committee through the office of the Accounting Officer for approval. The fraud plan is to be finalised subject to the completion by Internal Audit of the Enterprise Wide Risk Management Process as per advice of the former Head Internal Audit. In the meantime our office is busy researching and collating information that will be used in the development of this plan.

The strategic Plan document has been completed and will be submitted to Council through the office of the Accounting Officer for approval. Further, it has to be noted that at this point in time there are 3 vacant posts for Forensic Investigators and one (1) for Forensic Auditor and these posts will be filled before the end of March 2007.

The Ombudsperson now has a standing item on the agenda of Audit Committee meetings, with regards to feedback and progress made with investigations. The audit committee will accordingly be updated at every meeting.

#### 5.4. Computer control environment

Many of the critical areas of concern are around the security settings and the management of these settings across the various software applications. The reasons for these are:-

The organization is in the final stages of a complete restructuring process. The required engagement with labour has had a negative impact on management's ability to fill certain posts and the placement of all staff in the new structure. This has hindered the performance of certain activities that would address many of the concerns now being reported on.

The approval for the filling of the post of Security Officer has been finalised and this should be implemented soon.

A high-level risk sub-committee, which reports to the City Manager, is in place and meets once a month. This committee monitors risks across the municipality and the IT risks identified in your report feature on the agenda of this committee.

A risk management tool, viz Barnowl, has been adopted and all the risks identified council wide are prioritised and will be managed using this tool.

Full compliance with best practice in so far as implementing the security settings on servers and across applications have a negative impact on system performance, eg,

systems slows down, jobs fall over and queue up for unacceptable time frames. Management have attempted to strike a balance between system performance, which is crucial to service delivery, and risk. Once the new Revenue Management System is fully bedded down efficiencies will improve and more security features on the servers can be switched on.

The City Treasurer has commissioned a management team to address risks prioritised by the risk Sub-Committee, at an operational level.

Management will examine the report in detail and immediately implement those recommendations that do not require additional resources or have an impact on systems performance.

In addition, we confirm that a large part of the placement process has been completed, funding has been approved and positions will be filled. This will eliminate the staff shortage issues that have made it difficult to implement some of the desired controls.

Late finalisation of the audit report

Generally Accepted Municipal Accounting Practice (GAMAP) and Generally Recognised Accounting Practice (GRAP) were adopted in the preparation of the Annual financial Statements for the year ended 30 June 2006 that were delivered to the Auditor General on 31 August 2006. The National Treasury guidelines and Specimen Financial Statement per MFMA circular 18 were strictly adhered to.

However on the 4th of October, a communique issued by the Accountant General requested that SA GAAP be adopted for material balances falling outside the scope of GRAP & GAMAP standards.

On 21 December 2006, the Office of the Auditor General advised that the Annual Financial Statements may be resubmitted, by 31 January 2007, in compliance with the communiqué issued by the accountant General on the 4th of October 2006.

We took advantage of the opportunity and complied with the Auditor Generals request within the strict timeframe placed upon us.