

**REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND THE KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE AMAJUBA DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Amajuba District Municipality, which comprise the balance sheet as at 30 June 2007, income statement, cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 17 to 43.

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy 1.1 to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

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) 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. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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.
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 entity-specific basis of accounting, as set out in accounting policy 1.1.

**Basis for qualified opinion**

9. Investment – Uthukela Water (Proprietary) Limited

**9.1 Off-balance sheet investments via special purpose entities**

The district municipality entered into a water services-provider agreement with Uthukela Water (Proprietary) Limited together with two other water services authorities on 26 May 2004. The shareholders agreement with this company had, not been finalised at the date of the audit. Consequently, the district municipality was unable to reasonably determine the value of its investment, notwithstanding the ensuing transactions totalling R45,4 million, which were recorded with this company during the year:

Transactions/Balances	(R) Millions
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Payables	11,5
Expenses	20,1
Commitments	13,8
Total	45,4

## 9.2 Opening balance discrepancy

An unexplained difference of R352 624 was noted in the opening balance for the item described as “Uthukela water- water and sanitation” in the financial records. This amount is represented by differing balances of R10,8 million and R10,5 million as recorded in the opening general ledger and prior year-end financial statements for this item.

### **9.3 Difference between confirmation and financial statements**

The completeness and accuracy of an amount of R11,5 million described as payables in note 10 to the financial statements could not be adequately relied upon. In this regard, a confirmation received from Uthukela Water (Proprietary) Limited indicated an amount of R3,2 million, being owed by the district municipality to them, representing an unresolved disparity of R8,3 million.

### 10. Property, plant and equipment

#### **10.1 Transfer of water assets**

In terms of the instructions by the Minister for Provincial and Local Government in Government Gazette 25076 issued in terms of General Notice no. 840, dated 13 June 2003 assets, rights, liabilities and obligations relating to the water and sanitation services for the Newcastle area should be transferred to the appointed water services-provider. The assets of the Ngagane Water Purification Works, used for the provision of water in the Newcastle area, were still in the books of account of the district municipality and had not been valued and transferred at year-end.

#### **Qualified opinion**

11. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraph, the financial statements of Amajuba District Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy 1.1 and in the manner required by the MFMA.

#### **Emphasis of matters**

I draw attention to the following matters:

Highlight of a matter affecting the financial statements which is included in a note to the financial statements

### 12. Revenue

#### **12.1 Levy income – Prior year adjustment**

Attention is drawn to note 15 to the annual financial statements, which reflected an amount of R2,6 million, as a prior year adjustment for regional services council levies (RSCL). Albeit, the abolishment of the Regional Services Council Act, 1985 (Act No. 109 of 1985) by the Minister from 30 June 2006, the district municipality continued to receive RSCL that related to the prior year in 2006-07. Consequently, it was necessary to record levy income that related to the prior year as an adjustment to the appropriation account.

13. Property, plant and equipment

13.1 **Asset register issues**

The completeness, accuracy, and valuation assertions for certain assets included in the amount of R27,9 million as disclosed in note 5 to the annual financial statements could not be relied upon because management did not implement adequate controls to ensure that the asset register was periodically maintained, in that, assets were not valued, reconciled to the accounting records, and/or bar-coded. Moreover, policies and procedures for the safeguarding and management of assets were not developed.

**OTHER MATTERS**

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

**Non-compliance with applicable legislation**

14. **Municipal Finance Management Act (MFMA)**

The following sections of the MFMA were not complied with:

- a) The last three quarterly reports for the year on the implementation of the budget were not submitted to Council, as prescribed by section 52(d).
- b) The prior year annual report was tabled on 27 June 2007 instead of January 2007, as required by section 127(3).
- c) There was no evidence of invitation of public comments on the 2005-06 annual report as required by section 127(5).

- d) There was no evidence of any explanation provided to Council for late submission of the 2005-06 annual report as required by section 127(3).
- e) A fraud prevention plan was not developed to mitigate instances of potential fraud, as required by 62(1)(a)(i).
- f) The website was not updated as prescribed by section 75(2), for example, the applicable tariff structures for 2006-07 were not included, and the number and names of some councillors recorded thereon did not agree to the financial statements in certain instances.

**15. Division of Revenue Act (DORA)**

The following sections of the Division of Revenue Act, 2006 (Act No. 2 of 2006) (DORA) were not complied with:

- a) An evaluation report on performance with regard to schedule 5 and 6 allocations in terms of section 27, was not submitted to the transferring officer.
- b) There was no evidence of submission of an internal audit plan to National Treasury as prescribed by section 21(1b).

**16. Unemployment Insurance Contributions Act**

Unemployment insurance fund deductions were not computed as prescribed by section 6(a) and 6(b) of the Unemployment Insurance Contributions Act, 2002 (Act No. 4 of 2002)(UICA). In this regard, instances were noted whereby unemployment insurance was either not deducted and/or exceeded the percentages established in terms of the UICA.

**Matters of governance**

**17. Risk assessments not performed**

Management did not perform risk assessments neither was a policy developed to manage risks impacting on the municipality. Consequently, management was unable to identify potential threats and opportunities to fully promote the overall well-being of the district municipality.

**18. Non-adherence to internal auditing standards**

The Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, that is, standard 2010A1 and 2120A2 have reference in this regard. These standards require that the internal audit be based on a risk assessment, the results of which will drive the evaluation of the adequacy and effectiveness of controls encompassing the municipality's governance, operations, and information systems. Notwithstanding these standards, the following was noted:

- a) The internal audit plan was not based on the risk assessment.
- b) An approach to internal audits was not documented.
- c) No methodologies were documented on how audits were to be conducted.

**19. No assessment of internal audit**

The audit committee did not perform an assessment of the effectiveness of the internal audit function for the year under review.

**Material corrections made to the financial statements submitted for audit**

20. The financial statements, approved by the accounting officer and submitted for auditing on 31 August 2007, have been significantly revised in respect of the following misstatement identified during the audit:

**20.1 Revenue not recognised on the accrual basis**

Contrary to the accrual basis of accounting, which was adopted by the district municipality in its preparation of financial statements, misstatements totalling R329 587 were noted for interest income, due to the incorrect application of proper cut-off procedures.

**Value-for-money matters**

**21. Potential interest revenue not realised**

Sections 62(a) and 64(e) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA) has reference in this regard. An analysis of the municipality’s ABSA current account for the year revealed that this balance did not descend below the R20 million mark. Interest received for the year on this account balance totalled R2,6 million at a rate of 4,5 percent in relation to a short-term investment, which could have realised interest of R2,7 million (based on an averaged rate of 6,5 percent). Therefore, potential interest in an amount of R150 211 had been forgone.

**Internal control**

22. Section 62(1)(c)(i) of the MFMA states that *the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control.* The table below depicts the root causes of the matters indicated, as they relate to five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for qualification</b>					
Investments	✓		✓		
Property, plant and equipment	✓	✓	✓		
<b>Emphasis of matter</b>					
Revenue			✓		
Property, plant and equipment			✓		
<b>Other matters</b>					
Non-compliance with applicable laws and regulations	✓		✓		✓
Matters of governance		✓			
Value for money matters		✓			



### **Investigations in progress or completed**

23. During November 2006, an investigation was conducted to probe into possible fruitless and wasteful, irregular and unauthorised expenditure incurred at the district municipality. The investigation was completed at year-end, however, the recommendations have not yet taken effect, as Council ratification is pending.

### **OTHER REPORTING RESPONSIBILITIES**

#### **Reporting on performance information**

24. I have audited the performance information as set out on pages 44 to 76.

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

25. 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**

26. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.
27. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
28. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

#### **Audit findings**

### **Internal audit of performance measurements**

29. The district municipality did not develop and implement mechanisms, systems, and processes for auditing the results of performance measurement as part of its internal auditing processes as required by section 45 of the MSA.

### **Reporting on actual performance**

30. The district municipality's report on performance did not provide reasons for differences between planned and actual performance as prescribed by sections 45(a) and 46(iii) of the MSA. In addition, general key performance indicators as envisaged by section 43(1) of the MSA were not reported upon.

### **Indicators not compliant**

31. The district municipality's performance report and integrated development plan did not incorporate input indicators, which measured costs, resources, and time required to produce outputs. Furthermore, the output and outcome indicators did not measure the results of activities and strategies as well as the quality or impact of the outputs. This was in contravention of paragraph 9(1)(a) of General Notice No. 796 of 24 August 2001, issued in terms of the Local Government Municipal Planning and Performance Regulations of 2001.

### **Development priorities and objectives**

32. The district municipality's performance report did not indicate development priorities and objectives for environmental planning as per the integrated development plan. Consequently, environmental compliance was not monitored in terms of section 16(4)(b) of the National Environment Act, 1998 (Act No. 107 of 1998).

### **APPRECIATION**

33. The assistance rendered by the staff of the Amajuba District Municipality during the audit is sincerely appreciated.

Pietermaritzburg

30 November 2007



**AUDITOR-GENERAL**