

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL  
LEGISLATURE AND THE AMATHOLE DISTRICT MUNICIPAL COUNCIL ON THE  
GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF  
AMATHOLE DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying group financial statements of the Amathole District Municipality which comprise the consolidated and separate statements of financial position as at 30 June 2008, consolidated and separate statements of financial performance, consolidated and separate statements of changes in net assets and consolidated and separate cash flow statements for the year then ended, and a summary of significant accounting policies and other explanatory notes and the accounting officer's report as set out on pages [xx] to [xx].

**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 applicable basis of accounting determined by the National Treasury, as set out in accounting policy note 1 to the financial statements and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). 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), 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 and *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 on 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. 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 the Amathole District Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis of accounting**

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

#### **Basis for qualified opinion**

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

10. Disclosed in note 1 are capital assets under construction of R140.45 million and acquisitions of R929 000. Completed projects of R48.18 million were incorrectly classified as capital assets under construction. Capital assets under construction is thus overstated and acquisitions understated by R48.18 million. Furthermore the municipality expensed all items of property, plant and equipment with a cost of R5 000 or less in terms of their accounting policy. These assets should have been capitalised and depreciated in terms of GAMAP 17. Thus the treatment of such assets by the municipality does not meet the recognition requirements of GAMAP.
11. Even through alternative procedures the extent of the misstatement could not be determined and is thus unknown, but material. Due to this the completeness of property, plant and equipment of R1.3 billion as disclosed in the financial statements could not be confirmed.

### **Revenue and receivables**

12. Government Notice 849 transferred all of the rights, obligations, assets and liabilities in respect of water and sanitation services of seven local municipalities to Amathole District Municipality from 1 July 2006. A service provider was appointed to assist in an exercise to confirm the accuracy and completeness of accounts receivable for water and sanitation. Based on the work performed by the service provider the Amathole District Municipality continued with the updating of accounts receivable records after the financial year-end under review. As at 30 June 2008 water and sanitation receivables for only one of the erstwhile authorities, namely Mbashe, has been fully completed and updated on the municipality's accounting system (Venus).
13. It could not be determined, even through alternative procedures that water and sanitation receivables were accurate or complete. Consequently both revenue of R76.6 million and receivables of R32.3 million reflected in the annual financial statements are not accurate, correctly valued or complete. As the municipality uses receivables as a basis for determining the provision for bad debt it was also not possible to confirm the completeness and accuracy of the provision for bad debt of R78.4 million that are disclosed in notes 6 and 7.

### **Commitments**

14. According to note 33 of the annual financial statements commitments at 30 June 2008 amounted to R1.3 billion. It was not possible, even through alternative procedures, to conclude on a comparison of awarded contracts and the individual commitments as documentation of R94.8 million was not provided by the municipality. Of the comparisons that could be performed differences of R17.24 million existed. Under these circumstances the completeness and accuracy of commitments of R1.3 billion could not be confirmed.

### **Housing inventory**

15. A reconciliation of houses planned, completed and in progress and those that were transferred to beneficiaries was provided by the municipality during the audit. An unexplained difference in this reconciliation of R2.54 million was found. It was thus not, even though alternative procedures, possible to confirm the accuracy and completeness of the work in progress of R6.2 million that is disclosed in note 5 of the annual financial statements.

### **Irregular expenditure**

16. Disclosed in note 28.3 of the annual financial statements is irregular expenditure of R7.58 million. It was not, even through alternative procedures, possible to confirm the accuracy and completeness of this irregular expenditure as contracts and opening registers for expenditure of R4.98 million could not be provided during the audit.

### **Qualified opinion**

17. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Amathole District Municipality and group as at 30 June 2008 and its financial performance and cash flows for the year then ended, in accordance with basis of accounting and in the manner required by the MFMA and DoRA.

### **Emphasis of matters**

I draw attention to the following matters:

#### **Unspent project funds**

18. In note 18.3 to the annual financial statements, includes unspent conditional grants of R199.69 million. Of these, individual projects totalling R16.35 million (eight percent) showed no movement for the financial period under review except for interest earned. Furthermore, the municipality did not spend R199.69 million (forty three percent) of the total allocated budget (including rollovers) in the financial year under review.
19. Included in the surplus for the financial year of R62.24 million in the statement of financial performance are unspent priority project funds of R79.88 million. These underspent funds represent sixty eight percent of the total available funds for the financial year of R117.47 million and include prior financial year rollovers of R38.6 million.

### **OTHER MATTERS**

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

#### **Appointment of the municipal manager**

20. During July 2008 the municipality appointed a municipal manager. As another candidate scored the highest points during an interview this matter was litigated. On 16 November 2008 the Grahamstown High Court ordered the decision not to appoint the candidate who scored the highest number of points to be reversed. The municipality's application to appeal the decision of the Grahamstown High Court was dismissed on 19 November 2008.

#### **Internal controls**

21. 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 that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an



effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property, plant and equipment					X
Revenue and receivables			X		
Commitments					X
Housing inventory	X				
Irregular expenditure			X		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

#### Matters of governance

22. 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 certain key governance responsibilities, which I have assessed as follows:

No.	Matter of governance	Yes	No
	<b>Audit committee</b>		
1(a)	The municipality had an audit committee in operation throughout the financial year.	✓	
1(b)	The audit committee operates in accordance with approved written terms of reference.	✓	
1(c)	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓

No.	Matter of governance	Yes	No
	<b>Internal audit</b>		
2(a)	The municipality had an internal audit function in operation throughout the financial year.	✓	
2(b)	The internal audit function operates in terms of an approved internal audit plan.		✓
2(c)	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
	<b>Other matters of governance</b>		
3	The annual financial statements were submitted for audit as per the legislated deadlines in Section 126 of the MFMA.	✓	
4	The annual report was submitted for the auditor for consideration prior to the date of the auditor's report.		✓
5	The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
6	No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
7	The prior year's external audit recommendations have been substantially implemented.		✓
8	There are documented policies and procedures and control systems to ensure the reliability of financial reporting.		✓
9	There are documented policies and procedures and control systems to ensure compliance with applicable laws and regulations.	✓	
10	The information systems were appropriate to facilitate the preparation of financial statements that are free from material misstatement.		✓
11	Delegations of responsibilities are in place.	✓	
12	Supply chain management policies and procedures were appropriately applied.		✓
13	There is a functioning performance management system.		✓
14	Based on the available information, performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	
	<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
15	The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October	✓	

No.	Matter of governance	Yes	No
	2007.		
16	The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		✓
17	The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.	✓	

#### Unaudited supplementary schedules

23. The schedules set out on pages xxx to xxx do not form part of the annual financial statements and are presented for information purposes only. Accordingly, they have not been audited and no opinion is expressed thereon.

#### REPORT ON PERFORMANCE INFORMATION

1. I have reviewed the performance information as set out on pages xx to xx.

#### Responsibility of the accounting officer for the performance information

2. 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 MSA.

#### Responsibility of the Auditor-General

3. 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 Municipal Systems Act (Act 32 of 2000) (MSA).
4. 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.
5. 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)**

##### **Reasons for variances between planned and actual performance not included in the annual report**

6. None of the reasons between planned and actual performance of reported information for priority areas and objectives were supported by adequate explanations for the variances in the annual report.

##### **Evidence materially inconsistent with reported performance information**

7. The planned, objectives, indicators and targets in the integrated development plan were inconsistent when compared with the objectives, indicators and targets reported in the annual report. Examples are in the *maximising internal governance systems and water and sanitation* priority areas.

##### **Changes to planned performance information not approved**

8. None of the changes to the objectives, indicators and targets in the current year's integrated development plan were approved for maximizing internal governance systems and water and sanitation.

##### **Lack of sufficient appropriate audit evidence**

9. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the Amathole District Municipality, as I was unable to obtain access to the following supporting documentation pertaining to objectives listed below:
  - To create a healthy working environment within ADM
  - To ensure compliance with the Employment Equity Act
  - To meet the HDI targets set for capital and non-capital projects as per the SCM Policy
  - Alignment of IT Strategy to ADM business strategy
  - Business continuity
  - Improve financial management in line with financial management requirements
  - Address all matters associated with the audit report.



**APPRECIATION**

10. The assistance rendered by the staff of the Amathole District Municipality during the audit is sincerely appreciated.

*Auditor-General*

East London

11 December 2008



AUDITOR - GENERAL