

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL OF THE AMAHLATHI LOCAL MUNICIPALITY AND THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF AMAHLATHI LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Amahlathi Local Municipality which comprise the balance sheet as at 30 June 2009, the income statement, and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting as set out in accounting policy note 1 and in the manner required by the 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) 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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Debtors

7. The debtors age analysis and the ageing thereof differed by R1,4 million from the financial statements. Management is of the opinion that the difference was system related and arose as a result of the change of the operating system from Abakus to Venus. However, they were not able to provide an adequately supported explanation for the difference and it was not possible to perform alternative procedures. As a result, there is significant uncertainty concerning debtors of R30,1 million included in the balance of R32,2 million disclosed in note 11 to the financial statements as well as the corresponding revenue related thereto. As a result, I was unable to confirm whether all debtors were recorded and shown at the correct value and whether all related revenue was correctly recorded.

No reliance could be placed on the calculation of the provision for bad debts disclosed as R25 million in note 11 to the financial statements as it is based on the debtors age analysis. As a result, I was unable to confirm whether the provision was recorded at the correct amount.

The net value-added tax (VAT) balance of R44 000, included in debtors of R32.2 million disclosed in note 11 to the financial statements, is made up of a VAT debtor and VAT creditor in the amounts of R5.18 million and R5.14 million respectively. A journal passed to the VAT creditor of R4.1 million could not be verified as the transaction was based on the debtors age analysis upon which no reliance was placed. I was therefore unable to confirm whether all transactions relating to the VAT creditor were recorded at the correct amount.

Revenue

8. Included in revenue of R72.8 million as disclosed in the income statement is an amount of R1.6 million which relates to traffic income. I was unable to verify the completeness of such revenue as there were missing receipt numbers that could not be explained.

Qualified opinion

9. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Amahlathi Local Municipality have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 and in the manner required by the MFMA.

Emphasis of matter

I draw attention to the following matter:

Basis of accounting

10. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Other matters

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

Unaudited supplementary schedules

11. The supplementary information set out on pages XX to XX 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

Division of Revenue Act

12. The municipality received R15,9 million as a municipal infrastructure grant (MIG) despite the Division of Revenue Act (DoRA) allocation only being for R13 million. The excess funds were not transferred back to the transferring body as required by section 36 of DoRA.

Municipal Finance Management Act

13. Fixed assets disclosed in the balance sheet and note 6 to the financial statements are stated at cost less loans redeemed and other capital receipts. Although the cost of the fixed assets amounting to R114,4 million was supported by a fixed asset register, a proper fixed asset register in terms of section 63(2)(c) of the MFMA was not maintained as fixed assets were not marked with unique identification numbers that are appropriately cross-referenced to the asset register. As a result, assets selected from the asset register could not be physically verified and it could not be confirmed whether all assets were recorded on the asset register.

14. The municipality did not make all payments to creditors within 30 days of receipt of the invoice, as required by section 65(2) (e) of the MFMA.

15. The municipality did not comply with section 127(2) of the MFMA as the annual report was not tabled seven months after year-end.

Municipal Systems Act

16. Not all members of the council have disclosed their direct and indirect business interests as required by section 54 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) read with paragraph 5(a) and (b) of schedule 1 of the code of conduct for councillors of the same act.

Environment Conservation Act

17. The Environment Conservation Act, 1989 (Act No. 73 of 1989), section 20(1)(a) states that "no person shall establish, provide or operate any disposal site without a permit issued by the Minister of Water Affairs and that the Minister may issue a permit subject to such conditions as he may deem fit."

A permit was not issued for the municipality's landfill site located in Cathcart.

Governance framework

18. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

19. 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 deficiencies 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. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for qualified opinion	CE	RA	CA	IC	M
7	Debtors			3		
8	Revenue			2		

Control activities

20. Basic control activities for debtors such as regular reconciliations, isolating responsibilities and the performance of data integrity checks were found to be either ineffective or non-existent. In addition, the level of reliance placed on consultants without adequate oversight by management impacted on the accurate processing of debtor transactions.

21. General information technology controls have not been designed to maintain the integrity of the information system and the security of the data relating to revenue. There were no controls in place and insufficient oversight of management to identify the risks associated with the completeness of transactions. In addition, the municipality did not prepare a risk assessment which should have identified the weaknesses identified.

Legend	
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7

Key governance responsibilities

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 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 financial statements and related management information			
2.	The 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 financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	✓	
5.	Key officials were available throughout the audit process.	✓	
Development 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. The audit committee operates in accordance with approved, written terms of reference. 	✓	✓

No.	Matter	Y	N
	<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 out in section 62(1)(c)(i) of the MFMA.		✓
12.	Powers and duties have been assigned, as set out in section 79 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	✓	
Issues relating to the reporting of performance information			
14.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
15.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
16.	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 municipality against its mandate, predetermined objectives, outputs, indicators and targets in section 68/87 of the MFMA.	✓	
17.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

23. Management's attention is specifically drawn to the following key governance responsibilities which, according to the above table, have not been effectively addressed:

24. The finance section of the municipality has adequate skills and competencies which have been utilised effectively. However, the manual systems in place to facilitate the preparation of the financial statements were not subject to adequate monitoring and oversight as a result material amendments had to be made to the financial statements after submission for auditing.

25. The weaknesses in the design and implementation of internal control in respect of financial and risk management were attributable to a lack of approved documented policies and procedures in respect of the various financial cycles.

26. The audit committee's term of office expired at the end of March 2009 and a new committee was not constituted owing to an inability to obtain council approval as a result of the suspension of certain councillors.
27. The municipality operates under a shared internal audit function which was not effective during the year since they operated without an updated audit plan.
28. The municipality did not perform a risk assessment during the year nor was there a fraud prevention plan in place. This is as a result of weak governance structures at the municipality.

Investigations

29. An investigation is currently being conducted by an independent body. The investigation was initiated based on an allegation of possible misappropriation of revenue by officials of the municipality.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

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

The accounting officer's responsibility for the performance information

31. 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

32. 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.
33. 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.
34. 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

Existence and functioning of a performance audit committee

35. The term of the performance audit committee expired at the end of March 2009, resulting in the lack of an independent advisory body to advise the municipality on performance management issues. The municipality has since not appointed another performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.
36. The performance audit committee was assessed as ineffective due to the following:
- Lack of evidence to indicate that the committee reviews the performance management system (PMS) and makes recommendations in this regard to the council. This review should focus on economy, efficiency, effectiveness and impact of the key performance indicators and performance targets.
 - Lack of evidence to indicate that the committee submitted audit reports on performance management to the council at least twice during the financial year.

Internal auditing of performance measurements

37. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance information as part of its internal audit processes, as required in terms of section 45(1)(c) of the MSA.

Lack of adoption or implementation of a performance management system

38. The municipality's Framework for Performance Management is dated January 2009 and there is no evidence to indicate that mechanisms to subsequently monitor and review its performance management system were established.

Non-compliance with regulatory requirements

39. The MFMA requires a municipality to set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan. The municipality did not include outcome indicators for each of the development priorities and objectives as indicated in the integrated development plan for the 2008-09 financial year.
40. The municipality does not make use of the general key performance indicators as prescribed in terms of section 43 of the MFMA.

Mid-year budget and performance assessments

41. The mid-year budget and performance assessment report does not include information related to the municipality's service delivery performance and the service delivery targets and performance indicators set as required by section 72 of the MFMA.
42. Assessment of the mid-year budget and performance assessment report revealed that the following was not included therein:
- An explanation of any material variances from the municipality's projected revenue by source and from the municipality's expenditure projections per vote; any material variances from the service delivery and budget implementation plan; and any remedial or corrective steps taken to ensure that projected revenue and expenditure remain within the municipality's approved budget.
 - Only the engineering services and electrical engineering services sections were included as service delivery targets and performance indicators in the report. The following areas as per the Service Delivery and Budget Implementation (SDBIP) were not included as service delivery targets and performance indicators:
 - Administration services
 - Strategic management
 - Community services
 - Protection services
 - Human resources
 - Finance
 - Executive services
43. The prior year's annual report and progress on resolving problems identified in the annual report have not been included in the report.

Usefulness and reliability of reported performance information

44. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:
- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
 - **Relevance:** Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
 - **Reliability:** Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

Instances were identified where targets set for the 2008-09 financial year were not measurable (not easy to calculate from data that can be generated quickly, easily and at a reasonable cost) and reliable (clearly state what is to be measured without ambiguity). Furthermore, in certain instances the targets did not correspond with the key

performance indicators.

Inconsistently reported performance information

45. The municipality has not reported throughout the year on its performance with regard to its targets as per the approved integrated development plan.

46. According to Regulation 12(2)(c) of the Local Government: Municipal Planning and Performance Management Regulations, 2001, "A performance target set in terms of subregulation (1) must be commensurate with available resources and be commensurate with the municipality's capacity."

Instances were identified where targets per the performance information report could not be achieved as a result of capacity constraints.

Reported performance information not relevant

47. The targets with regard to all the objectives were not:

- specific in clearly identifying the nature and the required level of performance
- measurable in identifying the required performance
- time bound in specifying the time period or deadline for delivery.

Reported performance information not reliable

48. Lack of appropriate information systems generating performance information

Sufficient appropriate audit evidence with regard to the reported performance information of the objectives could not be obtained, as the information system used for generating performance information was not appropriate to facilitate the preparation of accurate and complete actual performance information.

49. Source information not accurate and complete

The source information or evidence provided to support the reported performance information with regard to the objectives did not adequately support the accuracy and completeness of the facts.

Measurable objectives not consistent

50. The municipality did not align the priorities, objectives and targets set in the integrated development plan to the annual budget as required by section 26(i) of the MSA.

APPRECIATION

51. The assistance rendered by the staff of the Amahlathi Local Municipality during the audit is sincerely appreciated.

East London

30 November 2009



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

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