

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Lukhanji Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets 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 and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (Statements of GRAP) 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. 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 Lukhanji Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

8. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Lukhanji Municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the GRAP accounting framework and in the manner required by the MFMA.

Emphasis of matters

Without qualifying my opinion, I draw attention to the following matters :

Distribution losses

9. The municipality is currently incurring distributions losses of 24.7% on electricity due to technical losses on the existing network, faulty meters, own use, billing errors and theft.

Restatement of corresponding figures

10. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2007 and 30 June 2008 have been restated as a result of errors discovered during 30 June 2009.

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

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

12. 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.

Property Valuation Ordinance, 1993 (Act No. 148 of 1993)

13. In terms of sections 8(1) and (2) of the Property Valuation Ordinance 148 of 1993, a local authority shall from time to time cause a general valuation to be performed on all property. The general valuation must be performed at least every four years and the MEC may extend the period on request for one year. The last general property valuation was performed in 1997. The council is therefore in contravention of the above-mentioned legislation.

Municipal Systems, 2000 (Act No. 32 of 2000)

14. 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.

Governance framework

15. 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:

Key governance responsibilities

16. 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.	✓	
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.	✓	

No.	Matter	Y	N
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	✓	
Availability of key officials during audit			
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. 	✓	
	<ul style="list-style-type: none"> • The audit committee operates in accordance with approved, written terms of reference. 	✓	
	<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)/95(c)(i) of the MFMA.		✓
12.	Delegations of responsibility are in place, as set out in section 79/106 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	✓	
14.	SCOPA resolutions have been substantially implemented.		N/A

No.	Matter	Y	N
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
17.	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 section 68/87 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	

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

18. 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 and processing of financial transactions were not subject to adequate management oversight, as a result, material amendments had to be made to the financial statements after submission for auditing.

19. Although the audit committee and internal audit function are essential elements in good governance, they were not effective during the year under review. The audit committee did not evaluate the effectiveness of internal audit or ensure that follow up audits were conducted on a timeous basis. Furthermore, the audit committee did not ensure that the internal audit unit addressed all the requirements of section 165 of the MFMA.

20. Information systems are not appropriate to facilitate the preparation of a complete and accurate performance report, as a number of discrepancies were identified between the source documentation used to prepare the annual performance report. This is due to the fact that the municipality does not store information required for performance assessments in a state that facilitates easy extraction of such information. In addition, insufficient detail is provided on the quantity and specifications of the target to facilitate alignment when reporting.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

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

The accounting officer's responsibility for the performance information

22. 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

23. 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.

24. 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.

25. 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

Content of the integrated development plan

26. The integrated development plan of Lukhanji Municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by section 26(i) and section 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

Lack of adoption or implementation of a performance management system

27. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulation 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Usefulness and reliability of reported performance information

28. 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 annual performance plan:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved annual performance 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?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

29. The Lukhanji Municipality has not reported throughout on its performance with regard to its targets as per the approved integrated development plan.
30. There are material differences between the measurable objectives reported in the annual performance report of Lukhanji Municipality and the predetermined objectives as per the integrated development plan. In addition, no mention is made of a time frame for performance targets.
31. The performance targets included in the service delivery budget implementation plan, budget and as reported on in the annual performance reports are not linked to the development priorities and objectives as per the integrated development plan.
32. There are differences between the budgeted capital expenditure amount per the integrated development plan, service delivery budget implementation plan, annual performance report and the approved budget of Lukhanji Municipality.

APPRECIATION

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

Auditor - General

East London

30 November 2009



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence