

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of Emalahleni 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, the cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages x to x.

**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 basis of accounting determined by the National Treasury, 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 the financial statements based on conducting the 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*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Comparatives**

4. In my previous audit report dated 30 November 2008, I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2008. The qualification matters have not been adequately resolved and my audit report is modified regarding the corresponding figures.

## **Revenue**

5. The rates revenue of R2 million is disclosed in the statement of financial performance and note 22 to the financial statements. The valuation roll required to verify this amount could not be obtained for audit purposes. Consequently, I am unable to verify this amount.
6. Interest charged on outstanding consumer debtors as disclosed in the statement of financial performance is R1.4 million. The municipality did not apply the basis for calculating interest consistently. The estimated effect of the below prime interest charge is an understatement of revenue and consumer debtors of R1.8 million.
7. The amount of revenue generated from rental of municipal facilities could not be confirmed as the municipality have not enter into agreements. Therefore I am unable to verify that the amount of R509 281 as disclosed in the statement of financial performance has been completely recorded.

## **Trade and other receivables from exchange transactions**

8. The existence of the amount of R30.7 million for municipal debtors as disclosed in note 12 of the financial statements could not be verified, as a deeds search failed to provide evidence over certain debtors. No alternative procedures could be performed.
9. Due to the break in sequence of receipts, it could not be ascertained if all monies received have been banked and processed to the relevant debtors accounts. Therefore I could not confirm that the amounts of R9 million collected as revenue which is disclosed in the statement of financial performance is complete and accurate. As a result, the related debtors of R30.7 million and cash and cash equivalents of R12.5 million as disclosed in the statement of financial position and note 12 and 13 respectively, may not be complete and accurate
10. As a result of the above findings, I am unable to verify if the amount raised as a provision for bad debts as disclosed in note 12 of R22.2 million is adequate.

## **Other current asset**

11. The functions of water and sewerage were transferred in 2003 to the district municipality. However, the municipality continues to deliver the services to the community. The financial statements in note 9 discloses assets, liabilities, income and expenditure relating to the water and sewerage function totalling R27.5 million. A service level agreement with the district municipality has not been concluded and a confirmation of the assets, liabilities, income and expenditure to be transferred has not been received. I am also not able to conclude if this amount is correct as not all debtors may exist, all assets have been identified and transferred, all revenue and related expenditures have been accounted for correctly. No alternative procedures could be performed.

### **Value added tax**

12. In the year under review, value added tax was not charged for vat-able supplies for services rendered. It is estimated that the municipality has not accounted for value added tax totalling R2.1 million and the value added tax not claimed for expenditure incurred on taxable supplies could amount to R619 982.
13. As a result of the above findings, I am unable to verify if the adequacy of the value added tax payable amount of as disclosed in note 18 of R2.1 million is correct.

### **Expenditure**

14. Documentation to support transactions to verify the correctness of entries processed in the accounting records of the municipality to the value of R655 943 was not submitted for audit purposes. The overall effect of the non submission to the financial statements is unknown. No alternative procedures could be performed to verify if these transactions were authorised.
15. The municipality has claimed value added tax deductions based on invoices that are not in terms of the requirements of the value added tax legislation. Consequently, I am unable to conclude on the correctness of general expenditure as disclosed in the statement of financial performance and in note 26 of R7.6 million.
16. As a result of the findings above I am unable to conclude if any unauthorised expenditure has been incurred.

### **Operating grant expenditure**

17. Documentation to support transactions to verify the correctness of entries processed in the accounting records of the municipality to the value of R5.6 million was not submitted for audit purposes. The overall effect of the non submission to the financial statements is unknown. No alternative procedures could be performed to verify if transactions were authorised. Consequently, I am unable to verify DORA grant expenditure of R10.4 million as disclosed in the statement of financial performance.

### **Trade and other payables from exchange transactions**

18. The leave balance of employees could not be verified as the leave records of the municipality have not been adequately maintained, therefore, I am unable to conclude if the accrual of R629 085, as disclosed in the statement of financial position and note 17 is adequate and related employee cost as disclosed in the statement of financial performance and note 26 is misstated.

## **Property, plant and equipment**

19. Ownership of land and buildings as recognised in the statement of financial position and in note 4 of the financial statements of R24.9 million could not be confirmed as title deeds for these assets could not be obtained.
20. Ownership of capital works in progress (roads) of R5.6 million not registered on the geographical information system and vehicles to the value of R571 980 for which proof of registration could not be obtained, could not be ascertained.
21. The existence of roads amounting to R22.7 million included in the infrastructure assets in note 4 to the financial statements could not be confirmed as not all roads have been captured on the municipalities information systems.
22. The physical existence of other property, plant and equipment of R3.6 million as disclosed in note 4 in the notes to the financial statements could not be verified. In addition, all assets were not recorded in the fixed assets register. No alternative procedures could be performed to verify if all assets have been accounted for.
23. As a result of the findings above, I am unable to conclude if the amount of R74.5 million as disclosed in note 4 to the financial statements is correct.

## **Irregular expenditure**

24. Management did not monitor the implementation of the requirements of the Municipal Supply Chain Management Regulations issued in terms of Chapter 4 of the MFMA. As a result expenditure transactions to the value of R4.3 million (2008: R11.8 million) were not procured in accordance with these regulations and are therefore irregular. This irregular expenditure is not disclosed in the financial statements.

## **Disclaimer of opinion**

25. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## **Emphasis of matter(s)**

I draw attention to the following matters on which I do not express a disclaimer of opinion:

## **Going concern**

26. Note 39 to the financial statements states that the municipality will continue as a going concern for the foreseeable future. The entity is reliant on the continued funding received from national and provincial government.

### **Basis of accounting**

27. As set out in accounting policy note 1, the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of General Notice 522 of 2007, issued in Government Gazette No. 30013 of 29 June 2007.

### **Other matters**

#### **Material inconsistencies in information included in the annual report**

28. The draft annual report was not received and it was therefore not possible to determine whether there were any material inconsistencies in the report.

#### **Unaudited supplementary schedules**

29. 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**

30. Tenders documents for contracts of R18.1 million awarded during the year could not be presented to confirm that the process of procurement as required by Section 111 of the MFMA has been complied with. Consequently, I am unable to determine the full extent of irregular expenditure that may be incurred.
31. Unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality has not been reported to the MEC for Local Government and the Auditor-General as required by Section 32 (4) of the MFMA.
32. No quotations obtained from approved financial institutions as required in terms of the Code of Investment Practice for investments made during the year.
33. The Municipality has not submitted the required signed returns to National Treasury on their Conditional Grant spending for the period ending 30 June 2009 as required by section 74(1).

#### **Environmental matters**

34. Physical inspections conducted during the audit revealed the following health and environmental hazards. The Municipality utilises a quarry as their landfill site. The ownership of this quarry could not be confirmed. The state of this landfill site poses a health risk to the local community and is a hazard to the surrounding environment.

## Governance framework

35. 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

36. 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 disclaimer of 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 disclaimer of opinion	CE	RA	CA	I C	M
4	Comparatives	5;	5	5; 6	3	1; 2; 3
5-7	Revenue	5; 7	5	5; 6	3	1; 2; 3
8-10	Trade and other receivables from exchange transactions	5; 7	5	5; 6	3	1; 2; 3
11	Other current assets	5; 7	5	5; 6	3	1; 2; 3
12-13	Value added tax	5; 7	5	5; 6	3	1; 2; 3
14-16	Expenditure	5; 7	5	5; 6	3	1; 2; 3
17	Operating grant expenditure	5; 7	5	5; 6	3	1; 2; 3
18	Trade and other payables from exchange transactions	5; 7	5	5; 6	3	1; 2; 3
19-23	Property, plant and equipment	5; 7	5	5; 6	3	1; 2; 3
24	Irregular expenditure	5; 7	5	5; 6	3	1; 2; 3
<b>Legend</b>						
<b>CE = Control environment</b>						
The organizational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.						1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.						2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.						3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.						4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.						5
Management's philosophy and operating style do not promote effective control over financial reporting.						6
The entity does not have individuals competent in financial reporting and related matters.						7
<b>RA = Risk assessment</b>						

Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyze the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
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 authorized, 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
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

37. 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
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
<b>Quality of financial statements and related management information</b>			

No.	Matter	Y	N
2	The financial statements were not subject to any material amendments resulting from the audit.		X
3	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
<b>Timeliness of financial statements and management information</b>			
4	The annual financial statements were submitted for auditing as per the legislated deadlines (Section 126 of the MFMA).	X	
<b>Availability of key officials during audit</b>			
5	Key officials were available throughout the audit process.		X
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6	Audit committee		
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	X	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA.</li> </ul>		X
7	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA/</li> </ul>		X
8	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10	The information systems were appropriate to facilitate the preparation of the financial statements.	X	
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.	X	
12	Delegations of responsibility are in place, as set out in Section 79 of the MFMA.	X	
<b>Follow-up of audit findings</b>			
13	The prior year audit findings have been substantially addressed.		X
14	SCOPA/Oversight resolutions have been substantially implemented.		N/A
<b>Issues relating to the reporting of performance information</b>			
15	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X



No.	Matter	Y	N
16	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
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 Emalahleni Municipality against its mandate, predetermined objectives, outputs, indicators and targets Section 67 of the MFMA municipalities.	X	
18	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	X	

**Overall reflections/conclusion on the governance framework based on other key governance requirements**

38. Monitoring of controls are not in place to ensure that all information disclosed in the annual financial statements are valid, accurate and complete. The lack of availability of key officials has contributed to the delays experienced throughout the audit.
39. Emalahleni Municipality and Chris Hani District Municipality have a shared audit committee. There have been no meetings held during the year under review where this committee has an oversight role. The shared audit committee function is assessed as ineffective and internal audit did not exist for the period under review.
40. The control environment within the municipality is not conducive to good governance and accountability as management have not ensured that the risk management processes and internal audit function have received the appropriate attention.
41. Due to the matters that give rise to the limitation of scope, the extent of non compliance with relevant government prescripts, the lack of controls and risk management and fraud prevention strategies, the possibility that the financial statements are materially misstated resulting from fraud and errors, either on individual balances or the financial statements taken as a whole, cannot be excluded.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

**Report on performance information**

42. I was engaged to review the performance information.

**The accounting officer's responsibility for the performance information**

43. 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).

44. 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.
45. 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.
46. 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)**

#### **Performance information not received**

47. I was not able to complete an evaluation of the quality of the reported performance information as set out on pages xx to xx of the annual report, since the municipality did not submit its performance report as part of its financial statement submission, as required by section 46 of the MSA.

#### **Key Performance Indicators**

48. No performance management system was in place as required in terms of the MSA and GNR. 796 of 24 August 2001: Local Government: Municipal Planning and Performance Management Regulations, 2001.
49. According to section 41 and regulation 13 of the MSA, a process of regular reporting to council, at least twice a year, and other political structures, political office bearers, staff, the public and appropriate organs of state must be in place. For the year under review, only one performance assessment report for the section 57 employees was performed.

#### **Development priorities and objectives**

50. Section 6 of the MSA requires the municipality to establish, develop and monitor its performance management systems. The municipality did not collect, record and process information or monitor and report on development priorities and objectives for the performance management systems. As a result key performance indicators had not been set for each of the development priorities and objectives as set out in the integrated development plan. Development priorities and objectives of the municipality's integrated development plan are neither consistent with the budget nor clear and concise. Furthermore these development priorities and objectives are not measurable.

#### **Integrated Development Plan and budget**

51. The municipality did not comply with the following sections of the following legislation relating to performance information:
- Section 13(2) of the Regulations to the MSA provides that the municipality must, after consultation with the local community, develop and implement mechanisms, systems and processes for the monitoring, measurement and review of performance in respect of the key performance indicators and

performance targets set by it. Furthermore, the mechanisms, systems and processes for monitoring in terms of sub regulation (1) were not provided for reporting to the municipal council.

- Section 32(1) of the MSA requires a copy of the integrated development plan as adopted by the council of the municipality, and any subsequent amendment to the plan, to be submitted to the MEC for local government in the province within 10 days of the adoption or amendment of the plan.

### **Internal auditing of performance measurements**

52. Emalahleni Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of Section 45 of the MSA.

### **Lack of implementation of a performance management system**

53. Emalahleni Municipality did not implement a framework that describes and represents how the municipality's cycle and processing 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 Regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

54. In addition to this, quarterly performance reports were not prepared as required in terms of Section 41 of the MSA.

### **APPRECIATION**

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

EAST LONDON

30 November 2009



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*