

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements of Amathole District Municipality (ADM) which comprise the statement of financial position as at 30 June 2009, 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 Local Government: 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)(d) 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 ADM 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.

Basis for qualified opinion

Revenue and receivables

8. *Government Notice 849* transferred all the rights, obligations, assets and liabilities in respect of water and sanitation services of seven local municipalities to the ADM as from 1 July 2006. As disclosed in note 7 to the annual financial statements, the ADM undertook a multi-year project to update the consumer database of the municipality's accounting system (Venus.) This project was still in progress at 30 June 2009 and extended into the next financial year. The valuation roll has not been reconciled with the consumer database and a number of accounts existed in the database that had no meter linked in order to quantify consumption. The extent of the misstatement in these instances could not be quantified even through performing alternative audit procedures. Vacant stands added after year-end were not billed for basic services during the year under review and adjustments made to the database during the current year were not billed for the entire period. Consequently, service charges revenue to the amount of R12,83 million was not recorded in the statement of financial performance.
9. In addition to the above project, meters already captured to the database were not monitored in accordance with the accounting policy. Numerous meters were not read for the entire period under review and faulty meters were not fixed timeously. In both these instances estimates were not always billed. Consequently, service charges revenue to the amount of R10,12 million was not recorded in the statement of financial performance.
10. As a result of the above findings it was not possible to confirm that service charges revenue of R80,30 million and trade receivables of R34,51 million as disclosed in the statement of financial performance and note 7 to the annual financial statements, respectively, were accurately recorded or that all service charges were included in the amounts disclosed.

Commitments

11. According to note 34 of the annual financial statements approved and contracted capital commitments at 30 June 2009 amounted to R109,82 million. However, not all contractual commitments existing at year-end were included in the commitments register and the payment information used to determine the stage of completion and outstanding commitment amounts were found to be inaccurate. Consequently, commitments of R8,38 million are not included in the amount as disclosed in the note.

Qualified opinion

12. In my opinion, except for the possible 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 Amatole District Municipality and group as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the Statements of GRAP reporting framework and in the manner required by the MFMA.

Emphasis of matters

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

Restatement of corresponding figures

13. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of corrections made in respect of prior year findings during 2009 in the financial statements of the ADM at, and for the year ended, 30 June 2008.

Unauthorised expenditure

14. As disclosed in note 29.1 to the financial statements, the ADM has incurred unauthorised expenditure of R53,91 million during the year under review relating to over-expenditure of budget amounts due to accounting for the impairment of debtors and post-employment benefit obligations.

Fruitless and wasteful expenditure

15. As disclosed in note 29.2 to the financial statements, the ADM has incurred R1,12 million in fruitless and wasteful expenditure relating to legal costs incurred due to the council appointing a municipal manager contrary to the recommendation of a panel appointed by the council and rental costs incurred while the ADM had not occupied the leased premises.

Irregular expenditure

16. As disclosed in note 29.3 to the financial statements, the ADM has incurred irregular expenditure of R16,34 million during the year under review relating to expenditure on contracts in excess of amounts awarded through the approved supply chain management policy. In addition, irregular expenditure of R7,53 million reported in my 2007-08 audit report has not yet been written off or recovered as at the date of this report.

Other matters

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

Unaudited supplementary schedules

17. 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

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
8 - 10	Revenue and receivables			3		
11	Commitments			3		

Legend	
CE = Control environment	
The organisational 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
RA = Risk assessment	
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 analyse 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
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	2

security of the data.	
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
IC = Information and communication	
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
M = Monitoring	
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

20. Management oversight and control activities for commitments such as maintaining a complete register and monitoring of payments made per contract were not performed during the period. Review of data integrity and capturing of information was year-end driven and as a result did not support the implementation of regular control activities to ensure the information is adequate.

Key governance responsibilities

21. 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 (section 126 of the MFMA).	✓	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	✓	
Development of 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. 	✓	

No.	Matter	Y	N
	<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(c)(i) of the MFMA.	✓	
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	✓	
14.	Oversight resolutions have been substantially implemented.	✓	
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 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.	✓	

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

- There was a lack of monitoring over financial accounting processes. This resulted in material amendments to the financial statements to avoid qualifications. Financial accounting processes had not been assessed and adjusted to ensure that all the processes supported the disclosure requirements of the GRAP framework.
- Internal audit only completed half of the projects as reflected in their internal audit plan and a signed internal audit charter could not be produced.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

23. I have reviewed the performance information as set out on pages XX to XX.

The accounting officer's responsibility for the performance information

24. 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

25. 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.

26. 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.

27. 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

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 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?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

29. The baseline indicator and the targeted performance for the objective, *To provide adequate potable water to all by 2010*, as shown in the annual performance report are not in agreement with the integrated development plan.
30. The objective, *To facilitate the development of sustainable and viable settlements within the district by 2014*, according to the integrated development plan was not included in the annual performance report.

Other observations

Water and electricity losses

31. In contravention of section 62(1)(a) of the MFMA, the municipality has not quantified or investigated water losses incurred during the period under review.

APPRECIATION

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

East London

11 December 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence