

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ukhahlamba District Municipality which comprise the Statement of Financial Position as at 30 June 2009, statement of financial performance, statement of changes in net assets and cash flow statement 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 Statements of Generally Recognised Accounting Practice (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 Ukhahlamba District 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.

Basis for adverse opinion

Property, Plant and Equipment

Infrastructure Assets

8. On 1 July 2003, Ukhahlamba District Municipality assumed responsibility for the provision of water and sanitation services in its district in terms of Government Notice 852 issued in terms of section 84(3)(a) of the Municipal Structures Act, 1998 (Act No.117 of 1998). In terms of the agency agreements entered into with the local municipalities, the water and sanitation Infrastructure Assets of the local municipalities within the district were transferred to Ukhahlamba District Municipality. Infrastructure Assets, belonging to the Municipality, with a net book value of R 319 million, were not recorded in the Annual Financial Statements. Furthermore, I could not determine whether this amount is correct as we did not have the information available to audit it.
9. Included in Property, Plant and Equipment of R 38 million is an amount of R 22 million in respect of Infrastructure Assets administered by external parties. We did not obtain the information required to confirm whether the assets exist, whether all these assets are included in the records of the Municipality and whether the assets were in good working order. These assets were also not valued in accordance with the relevant accounting framework, as the assets were recognised at actual or estimated actual cost at date of construction and were brought into the books of account at a net book value as opposed to being recognised at the fair value of the assets as at date of transfer of functions. In addition, the useful lives of these assets were incorrectly estimated at date of the unbundling of the fixed asset register as assets with a cost of R 7.2 million were

already fully written off on this date. These assets are still in use. This is indicative of a misstatement in the entire population of Infrastructure assets as the useful lives assigned to assets do not represent the period of time over which an asset is expected to be used by the entity. Depreciation of R 1.8 million was recognised on Infrastructure assets in the current year. I am unable to quantify the extent of misstatement in the population. As a result, I am unable to determine whether the amount recorded in respect of Infrastructure Assets administered by external parties is correct. In addition, it was found that these assets are not insured by the Municipality. This matter was also reported on in the prior year audit report.

Land and Buildings

10. The Land on which the unrecorded Infrastructure Assets, as referred to in paragraph 8 above, are situated has not been recorded by the Municipality, contrary to the intention of Government Notice 852 and the agency agreements. The amount of this Land cannot be quantified. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result I am unable to determine whether all the Land belonging to the Municipality has been recorded in the Annual Financial Statements.
11. Included in Property, Plant and Equipment of R 38 million is an amount of R 9.7 million in respect of Land and buildings. It was noted that a large number of items are being carried at what appears to be nominal amounts as opposed to having been valued at the fair value on date of acquisition. A valuation by a qualified valuer is required for valuation purposes on adoption of the relevant reporting framework. In addition, Land recorded in the fixed asset register could not be reconciled to that confirmed by the deeds registry. As a result of this, it was not possible to trace the Land and buildings to title deeds to confirm ownership in the name of the Municipality. As a result, I am unable to determine whether the amount as disclosed in the Annual Financial Statements is correct.
12. Investment properties of R 1 million has been incorrectly classified and disclosed as Property, Plant and Equipment. The valuation of these properties may be material if fairly valued in terms of the relevant accounting framework.

Other Assets

13. Included in Property, Plant and Equipment of R 38 million is an amount of R 6 million in respect of Other Assets. The fixed asset register used to prepare the financial statements was not updated with the results of the asset count. Furthermore, numerous assets were not tagged, asset descriptions were not sufficiently detailed to facilitate positive identification and in some instances no unique identification numbers were recorded in the fixed asset register. Depreciation to the value of R 1.7 million was recognised in the Statement of Financial Performance in respect of Other Assets. It was found that residual values and useful lives assigned to these assets were not correctly determined in accordance with the relevant accounting framework resulting in the amount of depreciation being incorrectly reflected. The amount of the misstatement could not be quantified. As a result, we were unable to determine whether depreciation and the value of Property, Plant and Equipment have been correctly stated in the Annual Financial Statements.
14. In the category of Other Assets is a variety of different classes of assets namely, furniture and fittings, motor vehicles, computer equipment, office equipment, fire

engines, special vehicles and tools. In terms of the relevant accounting framework all different classes of assets should be separately disclosed.

Inventory

15. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record Water Stock as at year-end. The amount of Water Stock cannot be quantified. Consequently, I am unable to determine the amount that should have been recorded in respect of water stock.

Other Receivables from Non-Exchange Transactions

16. Included in Other Receivables from Non-Exchange transactions of R 31 million are receivables to the value of R 7.9 million. We were unable to confirm whether these receivables exist and whether they pertain to the entity, as they relate to debts prior to 2006, and as such have prescribed and should have been adjusted through the Accumulated Surplus account. The full amount has been included in the Provision for the Impairment of Receivables. As a result, there is a misclassification between Other Receivables from Non-Exchange transactions, Provision for Impairment and Accumulated Surplus. This matter was also reported on in the prior year audit report.
17. No evidence could be provided to substantiate Other Receivables from Non-Exchange Transactions to the value of R 2.7 million. A significant amount of this debt has been included in the Provision for the Impairment of Receivables. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount is correctly stated. This matter was also reported on in the prior year audit report.
18. In the current year, a net bad debt write-off of R 18 million was processed through the Provision for the Impairment of Receivables account. It related both to receivables in debit as well as receivables with credit balances. A significant portion of this write-off related to receivables that did not exist in the prior year. We were unable to quantify the amount that should have been recorded and disclosed as a prior period error in terms of the relevant accounting framework. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures.
19. We were unable to verify an amount of R 7.7 million of the total amount disclosed in the Statement of Financial Performance in respect of the Reversal of Provisions for Impairment to the amount of R 30 million. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result we cannot determine whether or not the reversal of the impairment relates to the current and / or prior periods.
20. A prior period error, increasing Other Receivables from Non-Exchange transactions of R 7.7 million was disclosed in the current year. This item does not meet the definition of an error in accordance with the relevant accounting framework. The amount should have been recognised in the Statement of Financial Performance in the current year.

Value Added Taxation

21. Value Added Taxation is stated as a receivable to the amount of R 5.7 million. We could not satisfy ourselves as to the appropriate recording of this receivable, due to the numerous instances of non-compliance with the Value Added Taxation Act. Consequently, I was unable to determine the impact on amounts recorded in respect of expenditure, accounts payable and Value Added Taxation, due to the incorrect processing thereof. A similar matter was also reported on in the prior year audit report.

Unspent Conditional Grants

22. The Municipality has entered into agency agreements with the Department of Water Affairs and Forestry in respect of two projects, namely: Working for Water and Working for Wetlands. There is a misclassification between Unspent Conditional Grants and Trade and Other Payables of R 1.5 million and R 6 million respectively.
23. Included in Unspent Conditional Grants are receipts totalling R 5.9 million and a grant expense of R 3 million that we were not able to verify to supporting documentation. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures.

Trade and Other Payables

24. Included in Trade and Other Payables of R 22.5 million is an amount of R 3.1 million relating to payables in respect of the deficit between water and sanitation revenue and expenditure in the local municipalities. These amounts could not be confirmed. In addition the revenue and expense transaction streams from which the balance is derived was qualified on by the auditors of some of the local municipalities.
25. Supporting documentation related to Unknown Receipts of R1.9 million was not presented for audit purposes and as a result it was not possible to carry out all the required audit procedures or to obtain all the information and explanations considered necessary to verify the amount. As a result, I am unable to determine the correct and complete recording of any related revenue, conditional grant receipts and / or payment by debtors.
26. Creditors statements and reconciliations were not presented for audit purposes and as a result it was not possible to carry out all the required audit procedures or to obtain all the information and explanations considered necessary to verify an amount of R 8.5 million or to confirm whether all necessary amounts were included in the creditors balance.
27. As a result I am unable to verify whether all Trade and Other Payables are recorded at the correct amounts in the financial statements.

Revenue

28. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record Revenue in respect of the water and sanitation services rendered on their behalf by the local municipalities. The amount of the related revenue cannot be quantified.
29. Included in Government Grants and Subsidies revenue of R 256 million is an amount of R 7.9 million that could not be verified. The Municipality does not have adequate accounting records to permit the application of alternative auditing

procedures. As a result, I am unable to determine whether the amount is correctly recorded and classified in the current year.

30. As a result of the matter raised in paragraph 22 above, the Municipality incorrectly recognised Government Grant Revenue and Government Grant Expenditure in the amount of R 15.7 million and R 2 million respectively. This has resulted in the Municipality having overstated Government Grant Revenue and Government Grant Expenditure.
31. Adjustments were made to the Annual Financial Statements submitted on 15 September 2009. An updated general ledger showing all journal entries passed between the first and final submission was not received from the Municipality. We were unable to verify an increase in Other Assets of R 1 million, as well as an increase of R 0.5 million in Other Operating Grant Expenditure and General Expenses. As a result, Government Grant Revenue may also be overstated by R 1.6 million. This matter appears to be related to the matter reported in paragraph 23.

Expenditure

32. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record expenditure in respect of the water and sanitation services rendered on their behalf by the local municipalities. The amount of the related Expenditure cannot be quantified.
33. Included in Contracted Services is an amount of R 74 million for the current year and R 116 million for the prior year that was recognised as a result of the disagreement referred to in paragraph 8 above. Contracted Services are thus overstated by the respective amounts. Furthermore, the Municipality failed to provide supporting documentation to substantiate the relevant amounts. As a result, I am unable to determine whether the amounts are correctly stated.
34. Supporting documentation relating to Expenditure to the estimated value of R 4.3 million could not be provided for audit purposes. This amounts to a scope limitation for which no alternative audit procedures were available. As a result, I am unable to determine whether the amounts are recorded at the correct amount and classified correctly.

Employee Related Costs

35. Employee Related Costs per the payroll do not agree to that recorded in the Annual Financial Statements by R 1.2 million. No reconciliation was provided. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount reflected in the Statement of Financial Performance is correctly stated and correctly classified.

Employee Benefits

36. Due to inadequate leave records and discrepancies in such records, I am unable to verify the accrual for leave pay in the amount of R 3.9 million, included in the

Current Employee Benefits of R 7 million as disclosed in the Statement of Financial Position and note 4 of the Annual Financial Statements. In addition, we were unable to verify the amount to be recorded in the Statement of Financial Performance. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount disclosed in the Annual Financial Statement is complete and correct.

37. The Municipality failed to account for the obligation and / or disclose in accordance with the relevant accounting framework, the reasons for not recording the obligation in respect of the part defined benefit plan under the Cape Joint Pension and Cape Joint Provident funds.

Financial Instruments

38. The Municipality did not to comply with all the provisions of the International Accounting Standards (IAS) 32 and 39 in respect of the disclosure, classification and measurement of financial instruments. Due to a lack of documentation it was not possible to assess the impact of this non-disclosure on the financial statements. Furthermore, the Municipality did not disclose all items required by the International Financial Reporting Standard (IFRS) 7, either in the Statement of Financial Position or in the notes to the Annual Financial Statements.

Disclosure of retrospective adjustments

39. The Municipality did not comply with all the disclosure requirements of the relevant accounting framework for prior period errors and changes in accounting policies.

Irregular Expenditure

40. In terms of the definitions in chapter 1 of the MFMA, any Expenditure incurred in contravention of the Supply Chain Management Policy is regarded as Irregular Expenditure and should be reported as such. Goods and Services to an estimated value of R 65 million were identified as procured from suppliers without having followed the required Supply Chain Management Policy. These amounts were also not disclosed as Irregular Expenditure as required by section 125(2)(d)(i) of the MFMA.

Adverse Opinion

41. In my opinion, because of the significance of the matters described in the Basis for Adverse Opinion paragraphs, the financial statements do not present fairly the position of the Ukhahlamba District Municipality as at 30 June 2009 and its financial performance and cash flows for the year then ended, in accordance with the Statements of GRAP and in the manner required by the Municipal Finance Management Act.

Emphasis of Matters

Without further qualifying my audit opinion, I draw attention to the following matter:

Unauthorised Expenditure

42. Attention is drawn to the disclosure of Unauthorised Expenditure to the amount of R 75.7 million in note 29.1 of the Annual Financial Statements.

Restatement of Corresponding Figures

43. As disclosed in note 23 and 24 to the financial statements, the corresponding figures for 30 June 2009 have been restated as result of changes in accounting policies and errors discovered during the 30 June 2009 financial year in the financial statements of Ukhahlamba District Municipality.

OTHER MATTERS

Without further qualifying my audit opinion, I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

44. The supplementary information set out on pages XX to XX do 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

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

- 45.1. All monies owing by the Municipality were not paid within 30 days of receiving the relevant invoice or statement as required in terms of section 65 (2)(e) of the MFMA.
- 45.2. The Municipality failed to submit signed and electronic returns on conditional grant spending to National Treasury in terms of section 74 (1) of the MFMA.
- 45.3. The Municipality failed to make public the revenue and expenditure projections for each month and the service delivery targets and performance indicators for each quarter as well as to submit the performance agreements of the municipal manager, senior managers and any other categories of officials to council and the MEC for local government in terms of section 53 (3) (a) and (b) of the MFMA.
- 45.4. No reports were submitted in respect unauthorised and fruitless and wasteful expenditure as required by section 32(4) of the MFMA.
- 45.5. Disclosures of non-compliance with the MFMA were not made in the Annual Financial Statements as required by section 125.
- 45.6. Over-payments to councilors, section 57 managers and contract employees

In terms of section 164 (1) (c) (i) of the MFMA, loans to councillors or officers of the Municipality are forbidden. At year end a receivable of R 415 747 (included in Other Receivables from non-exchange transactions of R 30.6 million) is recognised in respect of salary overpayments to section 57 managers and contract employees over many years. Over-payments were also made to Councillors in

contravention of gazetted rates in prior years. At the time, the over-payments totalled R 158 150. However, due to lack of an audit trail, the amount of the outstanding balance at year-end could not be quantified.

46. Preferential Procurement Policy Framework Act, 2000 (Act No 5 of 2000)

46.1. Supply Chain Management Regulation 40 (2) (c) stipulates that a supply chain management policy must provide that immovable property is let at market related rates except when the public interest or the plight of the poor demands otherwise. Supply Chain Management Regulation 44 determine that a member of any municipal council or a municipal official is regarded as “in the service of the state” and that the Supply Chain Management policy of a municipality must state that awards to a person “in the service of the state” is prohibited. The mayor occupies a house owned by the Municipality and does not pay market related rentals. In addition, the Income Taxation Act, Schedule 7 (9) requires that the cash equivalent of the value of the taxable benefit derived from the occupation of residential accommodation be added to the taxable income of a staff member. This benefit is included as a nil benefit in the taxable income of the mayor, contrary to this Act.

Internal Control Deficiencies

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 adverse 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 adverse opinion	CE	RA	CA	IC	M
8 - 14	Property, Plant and Equipment				1	
15	Inventory				1	
16 - 20	Other receivables from non-exchange transactions				1	
21	Value added taxation			5		
22 – 23	Unspent Conditional Grants				1	
24 – 27	Trade and Other Payables			5		
28 – 31	Revenue				1	

Par. no.	Basis for adverse opinion	CE	RA	CA	IC	M
32 – 34	Expenditure			5		
35	Payroll				1	
36 – 37	Employee Benefits				1	
38	Financial instruments				1	
39	Disclosure of retrospective adjustments				1	
40	Irregular expenditure			5		

Control Activities

47. Basic control activities to ensure the accurate processing of expenditure and Value Added Taxation such as independent checks, isolation of responsibilities and the performance of data integrity checks were found to be either ineffective or non-existent.
48. Basic control activities to ensure the complete processing of accruals such as creditor reconciliations were found to be non-existent. There were no controls in place and insufficient oversight of management to identify the risks associated with the completeness of transactions.
49. The lack of isolation of responsibility in the finance department in the past year led to numerous control breakdowns.
50. In addition, the Municipality did not prepare a risk assessment which should have identified the weaknesses.

Information and communication

51. Adequate financial information is either not available, is not reliable or when available is not interpreted in a manner to ensure that the accounting substance of transactions are accounted for in all instances.
52. Vacancies, limited training and exposure in the finance department resulted in the numerous instances of non-compliance with the relevant accounting framework (having failed to interpret and utilise financial information correctly).
53. In addition, the level of reliance placed on consultants without adequate oversight by management impacted on the accurate recording of balances and transactions.

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 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
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
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Matters of Governance

54. The Municipal Finance Management Act 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	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 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.		✓

No.	Matter	Y	N
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)/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
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 Ukhahlamba District 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.	✓	

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

56. Significant delays were experienced during the execution of our audit as a result of the absence of the core finance staff component during key periods of the audit process, the Municipality not providing documentation and explanations required for audit purposes on a timely basis. A structured process was followed in an attempt to obtain the documentation and explanations. Management was regularly informed of the delays experienced. Most documentation and explanations required were only submitted after several attempts. This was due to inadequate systems, monitoring and supervision in place throughout the financial year. Material adjustments were made to the Annual Financial Statements after first submission. These related to the processing of material items on the bank reconciliation, recognising obligations in respect of gratuities and bonuses and correcting disclosures so as to be aligned with the requirements of the relevant accounting framework.

57. The annual report has not been submitted for consideration prior to the audit report being signed as the Municipality is still in the process of preparing the annual report.

58. The Annual Financial Statements were submitted on 15 September 2009, due to failure by the Municipality to keep full and proper records throughout the financial year.
59. As mentioned above, we experienced difficulties with staff availability throughout the audit process. The accounting officer and mayor did not attend a sufficient number of audit steering committee meetings.
60. The audit committee was ineffective in the performance of its duties in terms of its mandate. Amongst other things, the audit committee failed to identify the numerous instances of non-compliance with Statements of GRAP in the Annual Financial Statements, the effectiveness of the internal control function was not assessed, the chairman of the audit committee did not attend meetings regularly, the risk of fraud and error was not considered and the audit committee did not reprimand management for failure to respond to the findings of internal audit on a timely basis.
61. The Internal Audit function was ineffective in performance of its duties in terms of the Internal Audit Charter. The main concerns are that Internal Audit did not report quarterly on the Performance Management System, no reports were submitted detailing performance against annual plans and no follow-up audits were performed mainly due to failure by management to respond timeously to internal audit findings.
62. The significant deficiencies in the design and implementation of internal control in respect of financial and risk management were attributed to a lack of approved and implemented policies being in place for the whole of the year under review, isolation of responsibility and to key internal controls and processes that were either not in place or not functioning as intended.
63. As reported in "Other Matters" above, as well as in the Management Report, numerous instances of non-compliance with legislation were identified. This is due to a lack of monitoring of compliance by management.
64. The fraud prevention plan was not in force throughout the financial year. In addition, the top 20 risks identified during the risk assessment process did not sufficiently address the numerous financial risks identified throughout the audit process. Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on Performance Information

65. I was engaged to review the Performance Information.

The accounting officer's responsibility for the Performance Information

66. 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

67. 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.

68. 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.

69. 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

70. Contrary to the requirements of Sections 23 – 34 of the MSA, the Municipality did not ensure that the amendments to the Integrated Development Plan (IDP) were discussed in the mid-year budget and performance review.

71. Contrary to the requirements of Section 25 (4) of the MSA, the Municipality did not, within 14 days, after adoption of its IDP, give notice to the public of the adoption, however it did provide the document on its website.

72. Contrary to the requirements of Section 26 (i) of the MSA, the key performance indicators in the IDP did not relate logically and directly to the development priority and / or objectives. Furthermore, the key performance indicators are not consistent between the IDP and the SDBIP, the targets are not consistent between the IDP and the SDBIP and the inconsistencies have not been approved.

73. Contrary to the requirements of Section 32 (1) (a) of the MSA, the Municipality did not have proof that it submitted a copy of the adopted IDP to the Member of the Executive Council for Local Government in the Eastern Cape, within 10 days of the adoption or the amendment of the plan.
74. Contrary to the requirements of Section 38 (a) of the MSA, the Municipality did not ensure that the Performance Management System that was being implemented was fully commensurate with its resources and best suited to its circumstances as it only adopted a policy near the end of the financial year.
75. Contrary to the requirements of Section 38 (c) of the MSA, the Municipality did not ensure that the Performance Management System was designed to administer its affairs in an economical, effective, efficient manner as it only adopted a policy near the end of the financial year.
76. Contrary to Section 40 of the MSA, the Municipality did not ensure that it had council adopted mechanisms in place to monitor and review its Performance Management System as prescribed in terms of section 40 of MSA.
77. Contrary to Section 41 (b) and regulation 12 (2) (c-d) of the MSA, it was noted that the Municipality did not ensure that the performance targets set in the Integrated Development Plan corresponded with available resources and with the Municipality's capacity as reflected by the lack of linkage between the IDP and the budget of that year.
78. Contrary to Section 41 (2) of the MSA, the Municipality did not ensure that there were sufficient staff and support for the efficient and effective implementation of Performance Management System as well as the fact that there is no operational performance audit committee at the Ukhahlamba District Municipality. Therefore the Performance Management System applied by the Municipality is not devised in such a way that it serves as an early warning indicator of under-performance as prescribed in terms of section 41 (2) of MSA.
79. Contrary to the requirements of Section 43 (1) of the MSA, the Municipality did not include certain specific required key performance indicators within their Integrated Development Plan.
80. Contrary to the requirements of Section 46 of the MSA, the Municipality did not ensure that a comparison of performance with targets set for the current and previous financial years was disclosed in the annual performance report, nor was mention made of the measures to improve the performance.
81. Contrary to section 72 (1) of the MFMA, no evidence could be found in the Half Yearly Narrative Report that the past year's annual report and progress on resolving problems were identified and discussed as prescribed in terms of section 72 (1) of the MFMA.

Usefulness and reliability of reported Performance Information

82. 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 IDP:
 - 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 finding relate to the above criteria:

Performance Information not easily verified

83. An assessment could not be performed of the reliability of the Performance Information, since it was found that the actual performance reported in the performance report could not be accurately verified in all instances as there is a poor audit trail, due to a lack of electronic audit evidence that links the different reporting structures.

APPRECIATION

84. The assistance rendered by the staff of the Ukhahlamba District Municipality during the audit is sincerely appreciated.

15 December 2009

The Auditor-General's responsibility

85. 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.
86. 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.

87. 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.
88. 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 Ukhahlamba District Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
89. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for adverse opinion

Property, Plant and Equipment

Infrastructure Assets

90. On 1 July 2003, Ukhahlamba District Municipality assumed responsibility for the provision of water and sanitation services in its district in terms of Government Notice 852 issued in terms of section 84(3)(a) of the Municipal Structures Act, 1998 (Act No.117 of 1998). In terms of the agency agreements entered into with the local municipalities, the water and sanitation Infrastructure Assets of the local municipalities within the district were transferred to Ukhahlamba District Municipality. Infrastructure Assets, belonging to the Municipality, with a net book value of R 319 million, were not recorded in the Annual Financial Statements. Furthermore, I could not determine whether this amount is correct as we did not have the information available to audit it.
91. Included in Property, Plant and Equipment of R 38 million is an amount of R 22 million in respect of Infrastructure Assets administered by external parties. We did not obtain the information required to confirm whether the assets exist, whether all these assets are included in the records of the Municipality and whether the assets were in good working order. These assets were also not valued in accordance with the relevant accounting framework, as the assets were recognised at actual or estimated actual cost at date of construction and were brought into the books of account at a net book value as opposed to being recognised at the fair value of the assets as at date of transfer of functions. In addition, the useful lives of these assets were incorrectly estimated at date of the unbundling of the fixed asset register as assets with a cost of R 7.2 million were

already fully written off on this date. These assets are still in use. This is indicative of a misstatement in the entire population of Infrastructure assets as the useful lives assigned to assets do not represent the period of time over which an asset is expected to be used by the entity. Depreciation of R 1.8 million was recognised on Infrastructure assets in the current year. I am unable to quantify the extent of misstatement in the population. As a result, I am unable to determine whether the amount recorded in respect of Infrastructure Assets administered by external parties is correct. In addition, it was found that these assets are not insured by the Municipality. This matter was also reported on in the prior year audit report.

Land and Buildings

92. The Land on which the unrecorded Infrastructure Assets, as referred to in paragraph 8 above, are situated has not been recorded by the Municipality, contrary to the intention of Government Notice 852 and the agency agreements. The amount of this Land cannot be quantified. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result I am unable to determine whether all the Land belonging to the Municipality has been recorded in the Annual Financial Statements.
93. Included in Property, Plant and Equipment of R 38 million is an amount of R 9.7 million in respect of Land and buildings. It was noted that a large number of items are being carried at what appears to be nominal amounts as opposed to having been valued at the fair value on date of acquisition. A valuation by a qualified valuer is required for valuation purposes on adoption of the relevant reporting framework. In addition, Land recorded in the fixed asset register could not be reconciled to that confirmed by the deeds registry. As a result of this, it was not possible to trace the Land and buildings to title deeds to confirm ownership in the name of the Municipality. As a result, I am unable to determine whether the amount as disclosed in the Annual Financial Statements is correct.
94. Investment properties of R 1 million has been incorrectly classified and disclosed as Property, Plant and Equipment. The valuation of these properties may be material if fairly valued in terms of the relevant accounting framework.

Other Assets

95. Included in Property, Plant and Equipment of R 38 million is an amount of R 6 million in respect of Other Assets. The fixed asset register used to prepare the financial statements was not updated with the results of the asset count. Furthermore, numerous assets were not tagged, asset descriptions were not sufficiently detailed to facilitate positive identification and in some instances no unique identification numbers were recorded in the fixed asset register. Depreciation to the value of R 1.7 million was recognised in the Statement of Financial Performance in respect of Other Assets. It was found that residual values and useful lives assigned to these assets were not correctly determined in accordance with the relevant accounting framework resulting in the amount of depreciation being incorrectly reflected. The amount of the misstatement could not be quantified. As a result, we were unable to determine whether depreciation and the value of Property, Plant and Equipment have been correctly stated in the Annual Financial Statements.
96. In the category of Other Assets is a variety of different classes of assets namely, furniture and fittings, motor vehicles, computer equipment, office equipment, fire

engines, special vehicles and tools. In terms of the relevant accounting framework all different classes of assets should be separately disclosed.

Inventory

97. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record Water Stock as at year-end. The amount of Water Stock cannot be quantified. Consequently, I am unable to determine the amount that should have been recorded in respect of water stock.

Other Receivables from Non-Exchange Transactions

98. Included in Other Receivables from Non-Exchange transactions of R 31 million are receivables to the value of R 7.9 million. We were unable to confirm whether these receivables exist and whether they pertain to the entity, as they relate to debts prior to 2006, and as such have prescribed and should have been adjusted through the Accumulated Surplus account. The full amount has been included in the Provision for the Impairment of Receivables. As a result, there is a misclassification between Other Receivables from Non-Exchange transactions, Provision for Impairment and Accumulated Surplus. This matter was also reported on in the prior year audit report.

99. No evidence could be provided to substantiate Other Receivables from Non-Exchange Transactions to the value of R 2.7 million. A significant amount of this debt has been included in the Provision for the Impairment of Receivables. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount is correctly stated. This matter was also reported on in the prior year audit report.

100..... In the current year, a net bad debt write-off of R 18 million was processed through the Provision for the Impairment of Receivables account. It related both to receivables in debit as well as receivables with credit balances. A significant portion of this write-off related to receivables that did not exist in the prior year. We were unable to quantify the amount that should have been recorded and disclosed as a prior period error in terms of the relevant accounting framework. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures.

101..... We were unable to verify an amount of R 7.7 million of the total amount disclosed in the Statement of Financial Performance in respect of the Reversal of Provisions for Impairment to the amount of R 30 million. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result we cannot determine whether or not the reversal of the impairment relates to the current and / or prior periods.

102..... A prior period error, increasing Other Receivables from Non-Exchange transactions of R 7.7 million was disclosed in the current year. This item does not meet the definition of an error in accordance with the relevant accounting framework. The amount should have been recognised in the Statement of Financial Performance in the current year.

Value Added Taxation

103..... Value Added Taxation is stated as a receivable to the amount of R 5.7 million. We could not satisfy ourselves as to the appropriate recording of this receivable, due to the numerous instances of non-compliance with the Value Added Taxation Act. Consequently, I was unable to determine the impact on amounts recorded in respect of expenditure, accounts payable and Value Added Taxation, due to the incorrect processing thereof. A similar matter was also reported on in the prior year audit report.

Unspent Conditional Grants

104..... The Municipality has entered into agency agreements with the Department of Water Affairs and Forestry in respect of two projects, namely: Working for Water and Working for Wetlands. There is a misclassification between Unspent Conditional Grants and Trade and Other Payables of R 1.5 million and R 6 million respectively.

105. Included in Unspent Conditional Grants are receipts totalling R 5.9 million and a grant expense of R 3 million that we were not able to verify to supporting documentation. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures.

Trade and Other Payables

106..... Included in Trade and Other Payables of R 22.5 million is an amount of R 3.1 million relating to payables in respect of the deficit between water and sanitation revenue and expenditure in the local municipalities. These amounts could not be confirmed. In addition the revenue and expense transaction streams from which the balance is derived was qualified on by the auditors of some of the local municipalities.

107..... Supporting documentation related to Unknown Receipts of R1.9 million was not presented for audit purposes and as a result it was not possible to carry out all the required audit procedures or to obtain all the information and explanations considered necessary to verify the amount. As a result, I am unable to determine the correct and complete recording of any related revenue, conditional grant receipts and / or payment by debtors.

108. Creditors statements and reconciliations were not presented for audit purposes and as a result it was not possible to carry out all the required audit procedures or to obtain all the information and explanations considered necessary to verify an amount of R 8.5 million or to confirm whether all necessary amounts were included in the creditors balance.

109. As a result I am unable to verify whether all Trade and Other Payables are recorded at the correct amounts in the financial statements.

Revenue

110. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record Revenue in respect of the water and sanitation services rendered on their behalf by the local municipalities. The amount of the related revenue cannot be quantified.
111. Included in Government Grants and Subsidies revenue of R 256 million is an amount of R 7.9 million that could not be verified. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount is correctly recorded and classified in the current year.
- 112..... As a result of the matter raised in paragraph 22 above, the Municipality incorrectly recognised Government Grant Revenue and Government Grant Expenditure in the amount of R 15.7 million and R 2 million respectively. This has resulted in the Municipality having overstated Government Grant Revenue and Government Grant Expenditure.
- 113..... Adjustments were made to the Annual Financial Statements submitted on 15 September 2009. An updated general ledger showing all journal entries passed between the first and final submission was not received from the Municipality. We were unable to verify an increase in Other Assets of R 1 million, as well as an increase of R 0.5 million in Other Operating Grant Expenditure and General Expenses. As a result, Government Grant Revenue may also be overstated by R 1.6 million. This matter appears to be related to the matter reported in paragraph 23.

Expenditure

114. As a result of the disagreement referred to in paragraph 8 above, the Municipality failed to record expenditure in respect of the water and sanitation services rendered on their behalf by the local municipalities. The amount of the related Expenditure cannot be quantified.
- 115..... Included in Contracted Services is an amount of R 74 million for the current year and R 116 million for the prior year that was recognised as a result of the disagreement referred to in paragraph 8 above. Contracted Services are thus overstated by the respective amounts. Furthermore, the Municipality failed to provide supporting documentation to substantiate the relevant amounts. As a result, I am unable to determine whether the amounts are correctly stated.
116. Supporting documentation relating to Expenditure to the estimated value of R 4.3 million could not be provided for audit purposes. This amounts to a scope limitation for which no alternative audit procedures were available. As a result, I am unable to determine whether the amounts are recorded at the correct amount and classified correctly.

Employee Related Costs

117. Employee Related Costs per the payroll do not agree to that recorded in the Annual Financial Statements by R 1.2 million. No reconciliation was provided. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount reflected in the Statement of Financial Performance is correctly stated and correctly classified.

Employee Benefits

118. Due to inadequate leave records and discrepancies in such records, I am unable to verify the accrual for leave pay in the amount of R 3.9 million, included in the Current Employee Benefits of R 7 million as disclosed in the Statement of Financial Position and note 4 of the Annual Financial Statements. In addition, we were unable to verify the amount to be recorded in the Statement of Financial Performance. The Municipality does not have adequate accounting records to permit the application of alternative auditing procedures. As a result, I am unable to determine whether the amount disclosed in the Annual Financial Statement is complete and correct.

119. The Municipality failed to account for the obligation and / or disclose in accordance with the relevant accounting framework, the reasons for not recording the obligation in respect of the part defined benefit plan under the Cape Joint Pension and Cape Joint Provident funds.

Financial Instruments

120. The Municipality did not to comply with all the provisions of the International Accounting Standards (IAS) 32 and 39 in respect of the disclosure, classification and measurement of financial instruments. Due to a lack of documentation it was not possible to assess the impact of this non-disclosure on the financial statements. Furthermore, the Municipality did not disclose all items required by the International Financial Reporting Standard (IFRS) 7, either in the Statement of Financial Position or in the notes to the Annual Financial Statements.

Disclosure of retrospective adjustments

121. The Municipality did not comply with all the disclosure requirements of the relevant accounting framework for prior period errors and changes in accounting policies.

Irregular Expenditure

122. In terms of the definitions in chapter 1 of the MFMA, any Expenditure incurred in contravention of the Supply Chain Management Policy is regarded as Irregular Expenditure and should be reported as such. Goods and Services to an estimated value of R 65 million were identified as procured from suppliers without having followed the required Supply Chain Management Policy. These amounts were also not disclosed as Irregular Expenditure as required by section 125(2)(d)(i) of the MFMA.

Adverse Opinion

123..... In my opinion, because of the significance of the matters described in the Basis for Adverse Opinion paragraphs, the financial statements do not present fairly the position of the Ukhahlamba District Municipality as at 30 June 2009 and its financial performance and cash flows for the year then ended, in accordance with the Statements of GRAP and in the manner required by the Municipal Finance Management Act.

Emphasis of Matters

Without further qualifying my audit opinion, I draw attention to the following matter:

Unauthorised Expenditure

124..... Attention is drawn to the disclosure of Unauthorised Expenditure to the amount of R 75.7 million in note 29.1 of the Annual Financial Statements.

Restatement of Corresponding Figures

125..... As disclosed in note 23 and 24 to the financial statements, the corresponding figures for 30 June 2009 have been restated as result of changes in accounting policies and errors discovered during the 30 June 2009 financial year in the financial statements of Ukhahlamba District Municipality.

OTHER MATTERS

Without further qualifying my audit opinion, I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

126..... The supplementary information set out on pages XX to XX do 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

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

- 45.7. All monies owing by the Municipality were not paid within 30 days of receiving the relevant invoice or statement as required in terms of section 65 (2)(e) of the MFMA.
- 45.8. The Municipality failed to submit signed and electronic returns on conditional grant spending to National Treasury in terms of section 74 (1) of the MFMA.
- 45.9. The Municipality failed to make public the revenue and expenditure projections for each month and the service delivery targets and

performance indicators for each quarter as well as to submit the performance agreements of the municipal manager, senior managers and any other categories of officials to council and the MEC for local government in terms of section 53 (3) (a) and (b) of the MFMA.

- 45.10. No reports were submitted in respect unauthorised and fruitless and wasteful expenditure as required by section 32(4) of the MFMA.
- 45.11. Disclosures of non-compliance with the MFMA were not made in the Annual Financial Statements as required by section 125.
- 45.12. Over-payments to councilors, section 57 managers and contract employees

In terms of section 164 (1) (c) (i) of the MFMA, loans to councillors or officers of the Municipality are forbidden. At year end a receivable of R 415 747 (included in Other Receivables from non-exchange transactions of R 30.6 million) is recognised in respect of salary overpayments to section 57 managers and contract employees over many years. Over-payments were also made to Councillors in contravention of gazetted rates in prior years. At the time, the over-payments totalled R 158 150. However, due to lack of an audit trail, the amount of the outstanding balance at year-end could not be quantified.

128. Preferential Procurement Policy Framework Act, 2000 (Act No 5 of 2000)

- 46.2. Supply Chain Management Regulation 40 (2) (c) stipulates that a supply chain management policy must provide that immovable property is let at market related rates except when the public interest or the plight of the poor demands otherwise. Supply Chain Management Regulation 44 determine that a member of any municipal council or a municipal official is regarded as “in the service of the state” and that the Supply Chain Management policy of a municipality must state that awards to a person “in the service of the state” is prohibited. The mayor occupies a house owned by the Municipality and does not pay market related rentals. In addition, the Income Taxation Act, Schedule 7 (9) requires that the cash equivalent of the value of the taxable benefit derived from the occupation of residential accommodation be added to the taxable income of a staff member. This benefit is included as a nil benefit in the taxable income of the mayor, contrary to this Act.

Internal Control Deficiencies

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 adverse 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 adverse opinion	CE	RA	CA	IC	M
8 - 14	Property, Plant and Equipment				1	
15	Inventory				1	
16 - 20	Other receivables from non-exchange transactions				1	
21	Value added taxation			5		
22 – 23	Unspent Conditional Grants				1	
24 – 27	Trade and Other Payables			5		
28 – 31	Revenue				1	
32 – 34	Expenditure			5		
35	Payroll				1	
36 – 37	Employee Benefits				1	
38	Financial instruments				1	
39	Disclosure of retrospective adjustments				1	
40	Irregular expenditure			5		

Control Activities

129. Basic control activities to ensure the accurate processing of expenditure and Value Added Taxation such as independent checks, isolation of responsibilities and the performance of data integrity checks were found to be either ineffective or non-existent.

130. Basic control activities to ensure the complete processing of accruals such as creditor reconciliations were found to be non-existent. There were no controls in place and insufficient oversight of management to identify the risks associated with the completeness of transactions.

131. The lack of isolation of responsibility in the finance department in the past year led to numerous control breakdowns.

132. In addition, the Municipality did not prepare a risk assessment which should have identified the weaknesses.

Information and communication

- 133..... Adequate financial information is either not available, is not reliable or when available is not interpreted in a manner to ensure that the accounting substance of transactions are accounted for in all instances.
- 134..... Vacancies, limited training and exposure in the finance department resulted in the numerous instances of non-compliance with the relevant accounting framework (having failed to interpret and utilise financial information correctly).
- 135..... In addition, the level of reliance placed on consultants without adequate oversight by management impacted on the accurate recording of balances and transactions.

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 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
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

Matters of Governance

136..... The Municipal Finance Management Act 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	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.		✓

No.	Matter	Y	N
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(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
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 Ukhahlamba District 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.	✓	

137. Management's attention is specifically drawn to the following key governance responsibilities which, according to the above table, have not been effectively addressed:
- 138..... Significant delays were experienced during the execution of our audit as a result of the absence of the core finance staff component during key periods of the audit process, the Municipality not providing documentation and explanations required for audit purposes on a timely basis. A structured process was followed in an attempt to obtain the documentation and explanations. Management was regularly informed of the delays experienced. Most documentation and explanations required were only submitted after several attempts. This was due to inadequate systems, monitoring and supervision in place throughout the financial year. Material adjustments were made to the Annual Financial Statements after first submission. These related to the processing of material items on the bank reconciliation, recognising obligations in respect of gratuities and bonuses and correcting disclosures so as to be aligned with the requirements of the relevant accounting framework.
139. The annual report has not been submitted for consideration prior to the audit report being signed as the Municipality is still in the process of preparing the annual report.
- 140..... The Annual Financial Statements were submitted on 15 September 2009, due to failure by the Municipality to keep full and proper records throughout the financial year.
- 141..... As mentioned above, we experienced difficulties with staff availability throughout the audit process. The accounting officer and mayor did not attend a sufficient number of audit steering committee meetings.
- 142..... The audit committee was ineffective in the performance of its duties in terms of its mandate. Amongst other things, the audit committee failed to identify the numerous instances of non-compliance with Statements of GRAP in the Annual Financial Statements, the effectiveness of the internal control function was not assessed, the chairman of the audit committee did not attend meetings regularly, the risk of fraud and error was not considered and the audit committee did not reprimand management for failure to respond to the findings of internal audit on a timely basis.
- 143..... The Internal Audit function was ineffective in performance of its duties in terms of the Internal Audit Charter. The main concerns are that Internal Audit did not report quarterly on the Performance Management System, no reports were submitted detailing performance against annual plans and no follow-up audits were performed mainly due to failure by management to respond timeously to internal audit findings.
144. The significant deficiencies in the design and implementation of internal control in respect of financial and risk management were attributed to a lack of approved and implemented policies being in place for the whole of the year under review, isolation of responsibility and to key internal controls and processes that were either not in place or not functioning as intended.
145. As reported in "Other Matters" above, as well as in the Management Report, numerous instances of non-compliance with legislation were identified. This is due to a lack of monitoring of compliance by management.

146..... The fraud prevention plan was not in force throughout the financial year. In addition, the top 20 risks identified during the risk assessment process did not sufficiently address the numerous financial risks identified throughout the audit process. Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on Performance Information

147..... I was engaged to review the Performance Information.

The accounting officer's responsibility for the Performance Information

148..... 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

149..... 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.

150..... 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.

151..... 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

152..... Contrary to the requirements of Sections 23 – 34 of the MSA, the Municipality did not ensure that the amendments to the Integrated Development Plan (IDP) were discussed in the mid-year budget and performance review.

153..... Contrary to the requirements of Section 25 (4) of the MSA, the Municipality did not, within 14 days, after adoption of its IDP, give notice to the public of the adoption, however it did provide the document on its website.

- 154..... Contrary to the requirements of Section 26 (i) of the MSA, the key performance indicators in the IDP did not relate logically and directly to the development priority and / or objectives. Furthermore, the key performance indicators are not consistent between the IDP and the SDBIP, the targets are not consistent between the IDP and the SDBIP and the inconsistencies have not been approved.
- 155..... Contrary to the requirements of Section 32 (1) (a) of the MSA, the Municipality did not have proof that it submitted a copy of the adopted IDP to the Member of the Executive Council for Local Government in the Eastern Cape, within 10 days of the adoption or the amendment of the plan.
- 156..... Contrary to the requirements of Section 38 (a) of the MSA, the Municipality did not ensure that the Performance Management System that was being implemented was fully commensurate with its resources and best suited to its circumstances as it only adopted a policy near the end of the financial year.
- 157..... Contrary to the requirements of Section 38 (c) of the MSA, the Municipality did not ensure that the Performance Management System was designed to administer its affairs in an economical, effective, efficient manner as it only adopted a policy near the end of the financial year.
- 158..... Contrary to Section 40 of the MSA, the Municipality did not ensure that it had council adopted mechanisms in place to monitor and review its Performance Management System as prescribed in terms of section 40 of MSA.
- 159..... Contrary to Section 41 (b) and regulation 12 (2) (c-d) of the MSA, it was noted that the Municipality did not ensure that the performance targets set in the Integrated Development Plan corresponded with available resources and with the Municipality's capacity as reflected by the lack of linkage between the IDP and the budget of that year.
- 160..... Contrary to Section 41 (2) of the MSA, the Municipality did not ensure that there were sufficient staff and support for the efficient and effective implementation of Performance Management System as well as the fact that there is no operational performance audit committee at the Ukhahlamba District Municipality. Therefore the Performance Management System applied by the Municipality is not devised in such a way that it serves as an early warning indicator of under-performance as prescribed in terms of section 41 (2) of MSA.
- 161..... Contrary to the requirements of Section 43 (1) of the MSA, the Municipality did not include certain specific required key performance indicators within their Integrated Development Plan.
- 162..... Contrary to the requirements of Section 46 of the MSA, the Municipality did not ensure that a comparison of performance with targets set for the current and previous financial years was disclosed in the annual performance report, nor was mention made of the measures to improve the performance.
- 163..... Contrary to section 72 (1) of the MFMA, no evidence could be found in the Half Yearly

Narrative Report that the past year's annual report and progress on resolving problems were identified and discussed as prescribed in terms of section 72 (1) of the MFMA.

Usefulness and reliability of reported Performance Information

164..... 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 IDP:

- 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 finding relate to the above criteria:

Performance Information not easily verified

165..... An assessment could not be performed of the reliability of the Performance Information, since it was found that the actual performance reported in the performance report could not be accurately verified in all instances as there is a poor audit trail, due to a lack of electronic audit evidence that links the different reporting structures.

APPRECIATION

166. The assistance rendered by the staff of the Ukhahlamba District Municipality during the audit is sincerely appreciated.

15 December 2009



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence