



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

FAX

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Date 20/01/2010

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| From | MR HLATSHWAYO |
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Message

Please find the attached documents.

Thank you

CONFIDENTIALITY CLAUSE

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AUDITOR - GENERAL
SOUTH AFRICA

The Accounting Officer
OR Tambo District Municipality
Private Bag X6043
Mthatha
5100

19 January 2010

Reference: 60082REG08/09

Dear Sir

Final Draft report of the Auditor-General on the financial statements and performance information of OR Tambo District Municipality for the year ended 30 June 2009

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004) read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).
2. In terms of section 121(4) of the MFMA you are required to include the audit report in the municipal entity's annual report to be tabled.
3. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
4. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
5. Please notify the undersigned Business Executive / Senior Manager well in advance of the date on which the annual report containing this audit report, will be tabled.
6. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely



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Operations Leader: ECPA

Enquiries: Sandile Hlatshwayo
Telephone: (043) 709 7200
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REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE O.R. TAMBO DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE ANNUAL FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements and financial statements of the O.R. Tambo District Municipality which comprise the consolidated and separate statement of financial position as at 30 June 2009, and the consolidated and separate statement of financial performance, and the consolidated and separate statement of changes in net assets and the consolidated and separate 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 annual 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), *Auditor-General audit circular 1 of 2007* 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), 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 O.R. Tambo 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 qualified opinion

Revenue, trade receivables and water distribution losses

8. The municipality did not take water meter readings for all consumers or calculate the estimated water usage for the consumers where the water meter readings were not taken and did not bill those consumers on a monthly basis.
As a result, revenue and receivables is understated by R22.1 million.
9. Water distribution losses amounting to R27.8 million disclosed in note 45 of the annual financial statements were not supported by appropriate documentation and calculations. In addition, water meters were not installed for all water consumers. There were no alternative procedures that could be applied to verify this disclosure
10. As a result I was unable to determine whether this water distribution loss disclosure in note 45 related to water supplied to consumers that has not been billed and recorded as revenue or that the amount was calculated correctly and related to valid distribution losses.
11. The accounting records for the municipality's debtors were inadequate. As a result, I was unable to confirm, even after performing alternative procedures that the balance of the gross trade receivables of R129.3 million as disclosed in note 2 of the annual financial statements was due to the municipality and that it was recorded at the correct amount.

Leave pay provision

12. The municipality's leave management process does not have an adequate basis for the management and recording of leave transactions. I was unable to agree the leave schedules provided to the manual leave forms. I was unable to confirm these transactions by any other means.
13. As a result, I was not able to determine whether any adjustments might be necessary to the provision for leave balance of R17.6 million as disclosed in note 12 of the consolidated annual financial statements.
14. This matter was reported in the prior year audit report and this error has not been corrected resulting in corresponding figures also being misstated.

Opinion

Qualification

15. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, these financial statements present fairly, in all material respects, the consolidated and separate financial position of the O.R. Tambo District Municipality as at 30 June 2009 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended, in accordance with Statements of Generally Recognised Accounting Practice and in the manner required by the MFMA.

Other matters

Material inconsistencies in other information included in the annual report

16. The annual report has not yet been issued therefore this could not be inspected for material inconsistencies.

Unaudited supplementary schedules

17. The supplementary information set out on pages xx to xx does not form part of the consolidated financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal Finance Management Act (MFMA)

18. Section 65(2)(e) of the MFMA has not been complied with as payments totalling R3.5 million were identified where payments were not made to suppliers within 30 days of receipt of the invoice.
19. Section 75(1)(a) - S75(1)(l) of the MFMA has not been complied with as the accounting officer did not place the required documents on the Municipality's website. These include performance agreements, budget-related policies, service delivery agreements, supply chain management contracts and quarterly reports.
20. Section 132(1) and (2) of the MFMA has not been complied with as the annual report was not submitted to the provincial legislature within seven days after the municipal councils adoption.

Municipal Systems Act (MSA)

21. Section 97(1) of the MSA and paragraph 4.1 of the indigent policy has not been complied with as indigents did not receive a rebate on their water and sanitation accounts. In addition, paragraph 5.1 of the indigent policy has not been complied with as indigent consumers were charged interest on their arrear accounts.

Water Services Act

22. Section 18(1) and (2) of the Water Services Act has not been complied with as the municipality did not report on the implementation of its development plan during each

financial year. The report is required to be made within four months after the end of each financial year.

Supply Chain Management Policy and Regulations

23. Paragraph 5 of the Municipal Supply Chain Management Policy has not been complied with as the bid adjudication committee did not submit monthly reports containing the particulars of each final award.
24. Paragraph 6(2) of the Municipal Supply Chain Management Policy has not been complied with as the accounting officer did not submit the required reports to the council of the municipality within 30 days of the end of the financial year.
25. Paragraph 14(a) of the Municipal Supply Chain Management Policy has not been complied with as the Municipality did not maintain a list of accredited prospective providers of goods and services that must be used for the procurement requirements of the municipality.
26. Paragraph 18(a) of the Municipal Supply Chain Management Policy has not been complied with as service providers are not invited to submit quotations on a rotation basis.
27. Paragraph 18(d) of the Municipal Supply Chain Management Policy has not been complied with as the accounting officer or CFO was not notified in writing on a monthly basis of all written quotations and formal written price quotations accepted by an official acting in terms of a sub delegation.
28. Paragraph 46(1)(b) of the Municipal Supply Chain Management Policy has not been complied with as a code of ethical standards as set out in the National Treasury's code of conduct for supply chain management practitioners and other role players involved in supply chain management has not been established.
29. Paragraph 26(1)(a) of the Municipal Supply Chain Management Policy has not been complied with as the municipality does not have a functioning bid specification committee.

Governance framework

30. 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

31. 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 | Revenue | | | X | | |
| 9 & 10 | Revenue and water distribution losses | | | X | X | |
| 11 & 12 | Trade receivables | | | X | | |
| 13 - 15 | Provisions - Provision for leave pay | | | X | X | |

32. The municipality has established control activities at the municipality. However, these controls are not always performed, which results in these controls not being effective. Further, there is a lack of adequate and timeous monitoring by senior management to identify instances of controls being not being adhered to and ensure that corrective action is taken timeously.

| 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 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 |

Key governance responsibilities

33. 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. (Not required by legislation) | | ✓ |
| 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 | | | |

| No. | Matter | Y | N |
|--|--|-----|---|
| 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 77 of the PFMA and Treasury Regulation 3.1.10/27.1.8]/[section 166(2) of the M | | ✓ |
| 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 municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68/87 of the MFMA (municipalities) | ✓ | |

| No. | Matter | Y | N |
|-----|---|---|---|
| 18. | There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance. | ✓ | |

Conclusion on the governance framework based on other key governance requirements

34. Delays were experienced during the execution of our audit due to the municipality not providing certain documentation and explanations required for audit purposes. A structured process was followed in an attempt to obtain the documentation and explanations. A number of documents and explanations required were only submitted after several requests.
35. A number of material errors were identified in the financial statements during the audit and as a result four versions of the financial statements were submitted to correct these errors.
36. The municipality did not submit the annual report before the 31st of December as this is not required by legislation.
37. The audit committee was not functioning for the whole year as it was only appointed in January 2009, as a result it did not perform all of its responsibilities.
38. 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 year under review and to key internal controls and processes that were either not in place or not functioning as intended. Furthermore, material weaknesses in internal controls identified by internal audit were not addressed by management
39. The significant deficiencies in the design and implementation of internal control in respect of the compliance with applicable laws and regulations were attributed to a lack of implemented controls not being adhered to and a lack of monitoring and supervision by management.
40. The information system was not appropriate as management could not extract the required reports to facilitate the preparation of the financial statements.
41. Not all the issues reported in the prior year audit and management report were addressed as these issues were also reported on in the 2008/2009 audit.
42. The reliability of the source information and systems utilised to gather the information was found not to be reliable.
43. There are no documented and approved policies and procedures in place for the reporting of performance information. There is also a lack of monitoring by management to ensure that their policies and procedures are being adhered to.

Investigations

44. I am not aware of any other investigations which are currently underway at the agency.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

45. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

46. 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

47. 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.
48. 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.
49. 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

Submission of strategic/corporate/annual performance plan

50. The municipal manager did submit a copy of the Integrated Development Plan to the MEC for Local Government, however, it was not submitted within ten days after the adoption of the Integrated Development Plan by the municipal council as required by Section 32 of the Municipal Systems Act.

Content of integrated development plan

51. The integrated development plan of the O.R Tambo District Municipality did not include the key performance indicators and performance targets for certain objectives determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

52. Evidence was not supplied to prove that notice was given to the public regarding the adoption of the Integrated Development Plan. Therefore it could not be determined whether section 26 (4) of the Municipal Systems Act was complied with.

No service level agreement for the municipal entity

53. The service level agreement with Ntinga Development Agency does not include annual performance objectives and indicators to measure the performance of the municipal entity as required by section 76(b) and 93B of the Municipal Systems Act. Furthermore, there is no direct link of the performance objectives with the municipality's key performance indicators.

Existence and functioning of a performance audit committee

54. The audit committee functioned as the performance audit committee, however, the audit committee was not operational for the full financial year. Therefore they could not perform their duties as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

55. The internal auditors of the O.R Tambo District Municipality did not submit quarterly reports on their audits to the external auditors therefore I am not able to determine whether section 14(1) of the Local Government: Municipal Planning and Performance Management Regulations, 2001 has been complied with.

Performance information not received in time

56. An assessment could not be performed of the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

APPRECIATION

57. The assistance rendered by the staff of the O.R Tambo District Municipality during the audit is sincerely appreciated.

East London

31 December 2009



**AUDITOR-GENERAL
SOUTH AFRICA**

Auditing to build public confidence

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