



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

The Accounting Officer
Nelson Mandela Bay Metropolitan Municipality
P O Box 834
Port Elizabeth
6000

14 December 2010

Reference: 04554REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Nelson Mandela Bay Metropolitan Municipality for the year ended 30 June 2010

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) you are required to include the audit report in the municipality's annual report to be tabled.
4. **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.**
5. 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.
6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
 7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



Ch
Senior Manager: Eastern Cape

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AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL AND THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE NELSON MANDELA BAY METROPOLITAN MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying consolidated financial statements of the Nelson Mandela Bay Metropolitan Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2010, the consolidated and separate 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, as set out on pages ... to

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) reporting framework and in the manner required by the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) read with section 4 of the Public Audit Act of South Africa, 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 International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. 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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

7. In my opinion, the financial statements present fairly, in all material respects, the consolidated and separate financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2010 and its consolidated and separate financial performance and cash flows for the year then ended, in accordance with the GRAP reporting framework and in the manner required by the MFMA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Significant uncertainties

9. As disclosed in note 45 to the financial statements, the municipality is the defendant in a number of lawsuits to the value of R73.8 million. The municipality is currently opposing these claims and the ultimate outcome of these matters cannot presently be determined.

Fruitless and wasteful expenditure

10. As disclosed in note 44 to the financial statements, fruitless and wasteful expenditure amounting to R4 million was incurred during the financial period. This was as a result of payments made in vain and where reasonable care was not exercised.

Irregular expenditure

11. As disclosed in note 44 to the financial statements, irregular expenditure to the amount of R23.3 million was incurred as a result of contracts awarded without following the Supply chain management regulations and including payments to suppliers in which councillors have business interests.

Material losses

12. As disclosed in note 35.11 to the financial statements, the municipality suffered a significant water loss of 27 561 megalitres (29.3%), amounting to R145.5 million, during the year under review. This loss was incurred as a result of water bursts, corrosion of cast iron fittings, leaking valves and pipes failing due to adverse ground conditions as a result of severe dry weather conditions.

Financial sustainability

13. While the municipality prepared its financial statements on the going concern basis, there are a number of indicators that its financial sustainability is under pressure. The municipality has disclosed in note 46.2 to the financial statements the principal events or conditions that may cast doubt on the municipality's financial sustainability and also disclosed their plans to deal with those events or conditions.

Additional matters

14. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

15. The supplementary appendices A to F, set out on pages x to x do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), Division of Revenue Act of South Africa, 2009 (Act No 12 of 2009) (DoRA) the Municipal Supply Chain Management Regulations of South Africa, 2005 (GNR 868 of 30 May 2005) (SCM regulations), the Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 24 August 2001) (MPPM Regulations) and financial management (internal control).

Predetermined objectives

17. Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirements

Inadequate content of Municipal entity's Business plan

18. The municipality as parent municipality of the Mandela Bay Development Agency (MBDA) did not ensure that specific performance indicators were set for the entity against which the performance of the entity can be measured as required by section 93C(a)(iv) of the MSA.

Internal auditing of performance measurements

19. The internal audits of the performance measurements of the municipality were not performed in a timely manner to enable quarterly reports on their audits to be submitted to the municipal manager and audit committee, as required by MPPM regulation 14(1)(c).

Reasons for major variances between planned and actual reported targets were not supported by adequate and reliable corroborating evidence

20. Adequate and reliable corroborating evidence to support the reasons for major variances between the planned and actual reported performance targets could not be obtained. 25% of the reasons for major variances could not be verified for audit purposes.

Compliance with laws and regulations

The financial statements were not prepared in accordance with applicable legislation

21. In order for the financial statements to meet the requirements of section 122(1) of the MFMA, material misstatements identified during the audit were corrected by management.

The accounting officer did not adhere to his statutory responsibilities

22. The accounting officer did not submit the draft service delivery and budget implementation plan for the budget year and drafts of the annual performance agreements of the municipal manager and all senior managers to the executive mayor within 14 days of the approval of the annual budget as required by section 69(3) of the MFMA.

Monthly budget to actual reports were not submitted in a timely manner

23. Contrary to the requirements of section 87 (11) of the MFMA, five monthly management accounts of the MBDA were not submitted to the accounting officer of the parent municipality within seven working days after the end of each month within the financial year.

Fruitless and wasteful expenditure

24. Contrary to the requirements of section 102 of the MFMA the MBDA did not promptly submit reports to the mayor, and municipal manager of the parent municipality or the Auditor General,

with details of the fruitless and wasteful expenditure incurred. To date no steps have been taken to recover the expense.

INTERNAL CONTROL

25. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the acts as indicated above, but not for the purpose of expressing an opinion on the effectiveness of internal control.
26. The matters reported below are limited to the significant deficiencies regarding the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

It is evident from findings during the audit process that the accounting officer and in turn management, did not exercise effective oversight over compliance with laws and regulations, in all instances. A key indicator at this level is the fact that not all the external audit findings of the prior year have been addressed, resulting in repetitive findings and unattended weaknesses in the control environment.

Leadership did not ensure that an appropriate approach towards reporting against predetermined objectives was implemented. As a result, there were inadequate controls to ensure that reporting of actual performance against targets is valid.

- **Financial and performance management**

The financial and performance management control objective relates mainly to the preparation of quality financial statements and performance reports which are supported by appropriate record keeping and information systems. The fact that manual and automated controls, although designed, were not in all instances adequately implemented to ensure that all transactions occurred, are authorised and are completely and accurately processed is reason for concern. This resulted in material amendments to the financial statements resulting from the audit. Consequently the financial statements initially submitted did not fairly present the state of affairs of the Municipality and its entity, the financial results and the financial position at the end of the financial year.

- **Governance**

The governance control objective relates mainly to the involvement of the audit committee and internal audit in the identification and management of risk (including information technology) and fraud prevention. Although cognisance is taken of the work done by both the internal audit and the audit committee, the material amendments to the financial statements as well as the findings on reporting against predetermined objectives show that there is still room for improvement. One specific area that is cause for concern is the fact that, due to the late submission of the quarterly performance reports to internal audit, their reviews were not conducted in a timely manner to enable quarterly reports to be submitted to the municipal manager and audit committee.

The fraud prevention plan of the municipality has not been effective in actually preventing fraud and alleged fraud that has taken place during the financial period under review.

OTHER REPORTS

Investigations

27. As disclosed in note 44.18 to the annual financial statements, investigations into several alleged transgressions are currently in progress and may result in unauthorised, irregular or fruitless and wasteful expenditure upon conclusion of the investigations. The investigations range from tender irregularities, housing irregularities, procurement irregularities, theft and abuse of municipal assets, payroll related transactions, fronting and assistance to the poor irregularities.
28. In addition, note 44 to the annual financial statements, discloses investigations into fruitless, wasteful and irregular expenditure to the amount of R27.3 million, which were completed during the year.
29. Of the above amount, R4 million related to fruitless and wasteful expenditure of which R2.3 million was incurred due to payments made in vain and R1.7 million was as a result of fraudulent transactions.
30. The remaining amount of R23.3 million relates to irregular expenditure incurred due to deviations with the Supply chain management policy.

Auditor - General

East London

14 December 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence