



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting Officer
Emalahleni Municipality
37 Indwe Street
Lady Frere
5410

30 November 2010

Reference: 21307REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Emalahleni 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. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality'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 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

Signed



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Rama Purushothaman (EL03)

Enquiries: Rama Purushothaman
Telephone: (043) 709 7200
Fax: (043) 709 7300

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON EMALAHLENI MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Emalahleni Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). 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), 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 conducting the audit in accordance with the International Standards on Auditing and General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
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 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.

Basis of disclaimer of opinion

7. I draw attention in respect of these matters:

Comparatives

8. In my previous report dated 30 November 2009, I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2009. This was as a result of significant uncertainties and a limitation on scope of the audit. No adjustments have been effected to the financial statements to correct the matters raised in the prior year audit report. As a result, the effect of the prior year uncertainties and scope restriction has an effect on the accumulated surplus and balance sheet items. The municipality has not addressed the issues raised in the previous audit report and as required by section 131 (1) of the Municipal Finance Management Act.

Revenue

9. The rates revenue of R 3.1 million is disclosed in the statement of financial performance and note 23 to the financial statements. As no reconciliation of the valuation roll was performed, the valuation roll did not agree to the details on the system. Consequently, I am unable to verify the completeness of this amount. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all properties were properly recorded and it was impractical to obtain the effect on rates income and consumer debtors.
10. Interest charged on outstanding consumer debtors as disclosed in the statement of financial performance is R365 013. The municipality did not apply the correct interest rate during the year on outstanding debtors. Additionally, the interest on debtors is being calculated by the debtors system without cognizance of the in duplum rule in the National Credit Act, Section 103(5), which holds that interest stops running when the unpaid interest equals the outstanding capital. As a result, the estimated effect of this is a misstatement of revenue and consumer debtors could not be determined. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all properties were properly recorded and it was impractical to obtain the effect on rates income.
11. Electricity revenue of R3.3 million is included in service charges of R5.7 million as disclosed in the statement of financial performance and note 24 to the financial statements. I could not verify this amount due to supporting documentation not being submitted for audit purposes. Also, distribution losses were not monitored during the year. Consequently, there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that electricity revenue is properly recorded and it was not possible to obtain the effect on electricity income and consumer debtors.

Trade and other receivables from exchange transactions

12. The existence of the amount of R30.8 million for municipal debtors as disclosed in note 13 to the financial statements could not be verified as a deeds search failed to provide evidence over certain debtors. No alternative procedures could be performed.

13. As a result of the above finding, I am unable to verify if the amount raised as a provision for bad debts as disclosed in note 13 to the financial statements of R27.1 million is adequate.
14. In terms of IAS 39, trade and other receivables should be stated at their present value in the financial statements as at year end, with the difference between the nominal amount and the present value recognized as interest income over the financing period. Receivables were not present valued at year end which has resulted in an overstatement of accounts receivables of R3.3 million.

Other receivables from non-exchange transactions

15. The functions of water and sanitation were transferred to the district municipality in 2003. However, the municipality continues to deliver the services to the community. Note 11 to the financial statements discloses the assets, liabilities, income and expenditure relating to the water and sewerage function totalling R32 million. I am unable to conclude if this amount is correct as not all debtors may exist, all assets have been identified and transferred and all revenue and related expenditure have been accounted for correctly. No alternative procedures could be performed.

Value added tax

16. Amounts reflected on the VAT returns for the year under review did not agree to the amounts reflected in the general ledger and I was unable to reconcile an amount of R4.3 million. Consequently, I was unable to verify the adequacy of the value added tax receivable of R3.9 million as disclosed in the statement of financial position and note 12 to the financial statements.

Expenditure

17. The municipality has claimed value added tax deductions based on invoices that are not in terms of the requirements of the value added tax legislation. Consequently, I am unable to conclude on the accuracy of the general expenditure as disclosed in the statement of financial performance and in note 27 to the annual financial statements of R8.7 million.
18. Documentation supporting transactions totalling R5.6 million was not submitted for audit purposes. Consequently, it was not possible to confirm the accuracy, validity and completeness of expenditure of R18.9 million as disclosed in the statement of financial performance and notes 34 and 27 to the financial statements.
19. As a result of the above findings, I am unable to conclude if any fruitless and wasteful expenditure has been incurred for the year ended.

Trade and other payables from exchange transactions

20. The leave balance of employees could not be verified as the leave records of the municipality have not been adequately maintained. Also, the attendance registers for employees and full time councillors was not adequately monitored. As a result, I am unable to conclude if the accrual of R1 million as disclosed in the statement of financial position and note 18 to the financial statements and the related employee cost as disclosed in the statement of financial performance and note 28 to the financial statements is misstated.

21. The municipality did not provide adequate documentation supporting transactions totalling R578 904. Consequently, it was not possible to verify the completeness, accuracy and validity of this amount.
22. An amount of R2.9 million was not included in the trade payables amount disclosed in the statement of financial position and note 18 to the financial statements. I am therefore unable to verify the completeness of the trade payables amount.
23. The municipality did not calculate PAYE accurately. The SARS accrual of R901 005 has not been raised with the corresponding staff debtors.
24. As a result of the above findings, I am unable to conclude the extent to which trade and other payables from exchange transactions of R3.3 million, as disclosed in note 18 to the financial statements, may be misstated.

Property, plant and equipment

25. Ownership of land and buildings as disclosed in the statement of financial position and in note 4 to the financial statements of R113 million could not be confirmed as title deeds could not be obtained for certain properties. Also, investment property is disclosed in the statement of financial position and in note 3 to the financial statements. The municipality has not identified and separately disclosed the number of such properties held in a note to the financial statements and is therefore included within the land and buildings as disclosed.
26. Infrastructure assets of R44 million as disclosed in note 4 to the financial statements could not be verified as the municipality has not captured all the relevant information on the geographical information system.
27. Supporting documentation to verify capital work in progress of R28.7 million as disclosed in note 4 to the financial statements was not provided. Consequently, it was not possible to verify the completeness, accuracy and validity of this amount. No alternative procedures could be performed.
28. As a result of the above findings, I am unable to conclude if the amount of R191 million as disclosed in the statement of financial position and note 4 to the financial statements is valid, accurate and complete.

Employee related costs

29. The municipality's payroll system failed to fully integrate with the accounting system which has resulted in a variance of R637 191. Consequently, it was therefore not possible to determine the validity, accuracy and completeness of employee related costs as disclosed in the statement of financial performance and notes 28 and 29 to the financial statements.

Retirement benefit obligation

30. Retirement benefit obligation of R1.2 million is disclosed in the statement of financial position and note 7 to the financial statements. The municipality adopted a resolution of SALGA which states that all current employees who are not covered by the provisions of resolutions 1 and 2 (of resolution 8: post retirement medical aid subsidies) with effect from 1 July 2003 will not be entitled to the subsidy after retirement. This resolution has not been legislated.

31. As a result of the above, I am unable to conclude on the full extent of the understatement of the liability and related employee costs.

Irregular expenditure

32. Expenditure made in contravention of the supply chain management requirements amounting to R18.3 million was identified. The amount was not included in irregular expenditure and disclosed in a note to the financial statements resulting in irregular expenditure being misstatement.

Unauthorised expenditure

33. Unauthorised expenditure was incurred during the current year of R257 950 as a result of overspending on compensation of employees in the Refuse Cleaning Services vote. This overspending is due to a grant not yet received from the district municipality before year end.

Disclaimer of opinion

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

Emphasis of matters

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

Going concern

36. Note 1.26 to the financial statements states that the municipality will continue as a going concern for the foreseeable future. The entity is reliant on the continued funding received from national and provincial government.

Councillors arrear consumer accounts

37. Councillors with arrear consumer accounts over 90 days of R11 065 are disclosed under note 46 of the financial statements.

Other matters

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

Unaudited supplementary schedules

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

40. 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 following key laws and regulations and financial management (internal control).

Predetermined objectives

I was unable to perform the required audit procedures on predetermined objectives as the performance report was not submitted as required by section 46 of the Municipal Systems Act.

Compliance with laws and regulations

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

Payments not made to creditors within 30 days

41. The municipality did not make all payments due to creditors within 30 days as required by section 65(2)(e) of the Municipal Finance Management Act.

Required documentation not submitted

42. The municipality did not submit all information, returns, documents, explanations and motivations a may be prescribed or may be required to the National Treasury, as required by section 74(1) of the Municipal Finance Management Act.

Overspending of budget not reported in writing

43. The municipality did not report in writing the overspending of the budget to municipal council in terms of section 70 of the Municipal Finance Management Act.

Report on implementation of SCM policy not submitted to mayor

44. A report on the implementation of the supply chain management policy was not submitted to the mayor of the municipality within 10 days of the end of each quarter as required by section 6(3) of the Municipal Finance Management Act.

No assessment made on performance of the municipality

45. There was no assessment made on the performance of the municipality by the 25 January 2010 as required by section 72(1)(a)(ii) of the Municipal Finance Management Act.

Prior year annual report was not presented to the local community

46. There was no evidence that the prior year annual report (2008/2009) was presented to the local community for discussion as required by section 127(5)(a) of the Municipal Finance Management Act.

Unauthorised, irregular and fruitless and wasteful expenditure non-compliance

47. The municipality did not comply with the requirements of section 32 of the Municipal Finance Management Act with regard to unauthorised, irregular, and fruitless and wasteful expenditure.

Non-reconciliation of amounts owing by government departments

48. The municipality did not reconcile amounts owing by government departments as required by section 98(b) of the Municipal Finance Management Act.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

Notice on the adoption the final IDP was not given

49. No notice on the adoption the final Integrated Development Plan (IDP) 2009/2010 was given to the public as required by the section 25(4)(a) Municipal Systems Act.

Copy of IDP not submitted to MEC

50. There was no evidence to indicate that the municipal manager submitted a copy of the IDP to the MEC for local government as required by section 32(1)(a) of the Municipal Systems Act.

Community not involved in setting of key performance indicators

51. There was no involvement of the community in the setting of the key performance indicators as required by section 42 of the Municipal Systems Act.

Performance targets not communicated

52. The municipality did not communicate the performance targets as per the IDP to the staff and to the public as required by section 44 of the Municipal Systems Act.

Core components of performance management system non-compliance

53. The municipality did not comply with the requirements of section 41 of the Municipal Systems Act with regard to the core components of the performance management system.

Performance management system not established

54. The municipality did not establish a performance management system as required by section 38 of the Municipal Systems Act.

Financial interests not declared

55. Councillors did not declare their financial interests as required by section 7 of the Municipal Systems Act.

Municipal Property Rates Act, 2004 (Act 6 of 2004) (MPRA)**Property register not maintained**

56. The municipality did not maintain a property register as required by section 23 of the Municipal Property Rates Act.

Environmental Conservation Amendment Act, 2003 (Act No. 50 of 2003) (ECAA)**No permit for disposal sites**

57. The municipality is operating disposal sites without a permit issued by the minister as required by section 20 of the Environmental Conservation Amendment Act.

National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA)**No provincial environmental plan and restoration plan in place**

58. The municipality does not have a provincial environmental plan and a proposed plan to restore their disposal sites as required by section 16 of the National Environmental Management Act.

Environmental matters

59. Physical inspections conducted on the landfill sites during the audit revealed health and environmental hazards. The state of the landfill sites pose a health risk to the local community and are a hazard to the surrounding environment.

INTERNAL CONTROL

60. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA but not for the purpose of expressing an opinion on the effectiveness of internal control.
61. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

A lack of monthly monitoring and oversight was noted resulting in additional actions to be taken after the financial year to improve the audit outcome. It is evident from findings during the audit process that the accounting officer and, in turn, management did not exercise effective oversight over reporting, compliance with laws and regulations and internal control. 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.

An appropriate attitude towards reporting against predetermined objectives was not demonstrated by the implementation of controls over the development of performance targets, processes and controls to ensure that reporting of actual performance against targets is accurate and complete.

- **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. With this in mind, it was evident during the audit process that pertinent information was not identified and captured in a form and time frame to support financial and performance reporting. This resulted in delays to provide requested information in a timely manner and material amendments to the financial statements resulting from the audit. These shortcomings are further indicative that the financial statements were not reviewed for completeness and accuracy prior to the submission for audit.

Adequate systems are not in place to ensure all suppliers are paid within the required 30 days from receipt of invoice.

Municipalities rely heavily on computerised information systems to perform their statutory, financial management, reporting and administrative functions. The fact that manual and automated controls, although designed, were not in all instances implemented to ensure that the transactions have occurred, are authorised and are completely and accurately processed is reason for concern. In addition it should be noted that systems are not appropriate in all instances to facilitate the preparation of financial statements and performance reports.

- **Governance**

The governance control objective relates mainly to 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 shows that

there is still much room for improvement and enhancing effectiveness. One specific area that is reason for concern is the fact that the entity did not have an updated risk management strategy or fraud prevention plan in place during the year. A lack of segregation of duties as well as a lack of approval by senior management was also noted during the course of the audit.

Auditor General

East London
30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence