

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON ELUNDINI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

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

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with Standards of Generally Recognised Accounting Practice Standards of GRAP) and in the manner required by the Municipal Finance Management Act of South Africa. 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.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 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 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.

Basis for qualified opinion

Distribution losses

7. Section 125(2)(d)(i) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of any material losses. The municipality did not disclose losses related to water distribution, and does not have adequate systems and controls to measure and monitor such losses. As a result, there were no alternative procedures that could be applied to obtain audit assurance that all distribution losses that should have been recorded were actually recorded.

Qualified Opinion

8. 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 financial position of the Elundini Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the Standards of Generally Recognised Accounting Practice and in the manner required by the MFMA.

Emphasis of matters

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

Amendment to the applicable basis of accounting

10. During the year under review, the municipality adopted the Standards of Generally Recognised Accounting Practice (Standards of GRAP). The corresponding figures for the year ended 30 June 2009 have been restated as a result of the change in accounting policy. Details of the restatements and re-classification of certain amounts is disclosed in notes 2 and 39 to the financial statements.

Restatement of corresponding figures

11. As disclosed in note 37 to the financial statements, the corresponding figures for the year ended 30 June 2009 have been restated as a result of errors discovered during the year ended 30 June 2010 in the financial statements of the Elundini Local Municipality at, and for the year ended, 30 June 2009.

Unauthorised expenditure

12. As disclosed in note 42 to the annual financial statements, unauthorised expenditure amounting to R79 000 was incurred as a result of two purchases made in the current financial year for which there was no approved budget.

Irregular expenditure

13. Irregular expenditure totalling R2,8 million is disclosed in note 44 to the financial statements. This irregular expenditure relates to irregularities in the supply chain management process and grants not utilized for its intended purpose.

Fruitless and wasteful expenditure

14. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R491 000 was incurred on late payments by the municipality.

Material losses

15. As disclosed in note 48 to the financial statements, material losses to the amount of R2,9 million were incurred as a result of electricity distribution losses.

Going concern

16. The detailed income statement for the year ended 30 June 2010 indicates that the Elundini Local Municipality recognised government grants and subsidies amounting R69,7 million. Revenue from other sources amounted to R50,7 million and may be inadequate to fund the annual expenditure which amounted to R107,3 million for the year ended 30 June 2010. These conditions, along with other matters as set forth in note 41 to the financial statements, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to operate as a going concern.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. 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 Municipal Finance Management Act and the Municipal Systems Act, and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

Municipal Systems Act, No 32 of 2000 (MSA)

Inadequate content of integrated development plan

19. The integrated development plan of Elundini Local Municipality did not include the key performance indicators and performance targets 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.
20. The integrated development plan of municipality did not include a financial plan, as required by sections 26(h) of the MSA.
21. The key performance indicators set by the Municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.

Usefulness of information

The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?

- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

Inadequate presentation of reported information

22. The reported performance information that is included in the annual report is not presented in a simple, accessible format, that is relevant and useful to the intended user, and which is in accordance with the requirements of MFMA Circular 11 and the relevant guidance applicable to reporting on pre-determined objectives.

Planned and reported indicators not well defined

23. The planned and reported indicators were not clear, with an unambiguous definition to allow for data to be collected consistently. This was the case for all indicators selected and tested.

Reported information not consistent with planned objectives, indicators and targets

24. Elundini Local Municipality has not reported throughout the year on its performance against predetermined targets which is consistent with the approved service delivery, budget and implementation plan. Of the selected performance targets, 87% of the targets were not reported on.

Planned and reported performance targets not specific and measurable

25. For the objectives selected and tested, 100% of the planned and reported targets were not specific in clearly identifying the nature and the required level of performance and measurable in identifying the required performance.

Reliability of information

The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit findings relate to the above criteria:

Reported targets not reliable as inadequate supporting source information was provided

26. The validity and accuracy of 20% of the reported targets could not be established as sufficient appropriate audit evidence could not be provided for audit purposes.

Compliance with laws and regulations

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

Expenditure was not paid within the parameters set by the applicable legislation

27. Section 65(2)(e) of the MFMA has not been complied with as payments totalling R1,2 million were identified where payments were not made to suppliers within 30 days of receipt of the invoice.
28. The municipality did not comply with section 15 of the MFMA as the municipality incurred expenditure of R79 000 which was not budgeted for and for which approval was not obtained.

The financial statements were not prepared in accordance with applicable legislation

29. The financial statements submitted for audit did not comply with section 122(3) of the MFMA. Material misstatements were identified during the audit, certain of these were corrected by management and those that were not are included in the basis for qualified opinion paragraphs.

Division of Revenue Act, Act No. 12 of 2009 (DORA)

The accounting officer did not adhere to his statutory responsibilities

30. As indicated in paragraph 13 above, the receiving officer did not comply with sections 11(1) and 22 of DORA relating to the manner in which the municipality allocated and spent the schedule 4 allocation.

Supply Chain Management (SCM) legislative requirements were not implemented or not adhered to

31. The municipality did not compile a prospective supplier list that contained the commodity and type of service as required by section 14(1)(a)(i) and (3) of the Supply Chain management regulations.
32. Prospective suppliers were not invited in the specified manner to apply for evaluation and inclusion on the suppliers list as required by section 14(1)(ii) of the Supply Chain Management regulations.

INTERNAL CONTROL

33. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the Municipal Finance Management Act, Municipal Regulations, Division of Revenue Act, and Municipal Systems Act, but not for the purpose of expressing an opinion on the effectiveness of internal control.
34. The matters reported below are limited to the significant deficiencies regarding the basis for the audit opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• Leadership

The municipality has established adequate controls and processes for operations, reporting and to ensure compliance with applicable legislation. However, the monitoring by management of such controls and processes to ensure correct application thereof was deficient.

- **Financial and performance management**

The annual financial statements submitted for audit were subject to numerous amendments to ensure achievement of fair presentation. The systems or processes for the preparation and reporting of performance against predetermined objectives are not adequate or sufficient as the municipality has no formally adopted, and tailored, system or procedure manual which sets out processes to follow, controls in place, as well as responsible officials for the preparation, collation, reporting and monitoring of performance against predetermined objectives.

- **Governance**

The internal audit division was not effective in performing its duties and responsibilities as its annual plan did not cover important risks to the municipality's operations such as predetermined objectives. This contributed to the findings mentioned in the preceding paragraphs.

OTHER REPORTS

Investigations in progress

35. An investigation by the municipality is being conducted to probe the underbanking of cash amounting to R55 000 as disclosed in note 10 to the financial statements. The investigation is still ongoing and the report on the investigation is still to be tabled to the council of Elundini Municipality at the date of this report.

Auditor - General.

East London

30 November 2010



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence