

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE AMATHOLE DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2010

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying consolidated financial statements and financial statements of the Amathole District Municipality (ADM), which comprise the consolidated and separate statement of financial position as at 30 June 2010, and the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, as set out on pages XX to XX.

Accounting officer's responsibility for the consolidated financial statements

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

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)(d) 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.

Basis for qualified opinion

Infrastructure, plant and equipment

7. Section 63 of the MFMA states that the accounting officer must ensure that the municipality has and maintains a management, accounting and information system that accounts for the assets of the municipality. Infrastructure assets of the municipality amount to R1 271.5 million as disclosed in note 1 of the financial statements. These assets were valued by the municipality over the past three years while the accounting for assets was still incomplete under the allowable transitional provisions of directive 3. Upon completion of a valuation the relevant amount was then raised in the general ledger.
8. However, a comparison of the valuations performed in 2007 and 2008 to the current year general ledger opening balance revealed a difference of R273.2 million, indicating that despite the current year valuation being raised correctly, the amounts raised in respect of the 2007 and 2008 valuations appear incomplete. Management could not provide adequate explanation for this difference.
9. As a result of the above, sufficient appropriate audit evidence relating to the completeness of the infrastructure assets amounting to R1 271.5 million as disclosed in note 1 to the financial statements could not be obtained.
10. In addition the municipality has not separately disclosed for each class of assets the carrying amount, accumulated depreciation and the depreciation rate as required by GRAP 17, *Property, plant and equipment*.

Revenue and receivables

11. *Government Notice 849* transferred all the rights, obligations, assets and liabilities in respect of water and sanitation services of seven local municipalities to the ADM as from 1 July 2006. As disclosed in note xx to the financial statements, the ADM undertook a multi-year project to correct and complete the consumer databases transferred as a result of the above. This project was still in progress at 30 June 2010.
12. Revenue from services amounts to R86.8 million as reported in note 17 to the financial statements. The ADM did not apply the requirements of their accounting policy with the result that unread meters were identified, faulty meters were not fixed timeously and new accounts were not always billed timeously. In addition, there were a number of accounts that had no meter linked in order to quantify consumption and not all vacant stands had been billed the basic charge. The extent of the misstatement in these instances could not be quantified even through performing alternative audit procedures.
13. The billing file requested for audit purposes did not reconcile to the general ledger by an amount of R7.6 million. The report requested was used in previous years to audit service revenue. On communication with management regarding the difference, it was indicated that it is not possible in the current year to reconcile this specific billing report back to the general ledger. I was therefore not able to obtain adequate explanation for this difference.
14. As a result of the above I was unable to obtain sufficient appropriate evidence relating the completeness, occurrence and accuracy of service charges revenue amounting to R86,8 million and the completeness of trade receivables amounting R49,7 million as disclosed in note 17 and note 7 to the financial statements, respectively.

Qualified opinion

15. In my opinion, except for the effects of the matters described in the Basis of qualified opinion paragraph, the consolidated and separate financial statements present fairly, in all material

respects, the consolidated and separate financial position of the Amathole District Municipality as at 30 June 2010 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended are prepared, in all material respects, in accordance with GRAP and in the manner required by the MFMA.

Emphasis of matters

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

Matters important to the users of the financial statements

Fruitless and wasteful and irregular expenditure

17. The municipality has disclosed fruitless and wasteful expenditure totalling R967 795 in disclosure note 29.2 to the financial statements. This was incurred due to rental for unoccupied buildings and interest incurred on non-payment of contractors.
18. The municipality has disclosed irregular expenditure totalling R16.8 million in disclosure note 29.3 to the financial statements. The irregular expenditure was incurred due to procurement processes that were not in line with the municipality's supply chain management policy.

Material losses / Impairments

19. Impairments of debtors were recognised with a value of R53.3 million during the year under review.
20. In contravention of section 62(1)(a) of the MFMA, the municipality has not quantified or investigated water losses incurred during the period under review.

Additional matter

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

Unaudited supplementary schedules

22. Appendices A to F and annexures 1 and 2 were not audited and no opinion is expressed on the fair presentation of these schedules.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. 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 MFMA sections 121(3)(c) and 121 (4)(d) and the Municipal Systems Act, 2000 (Act No. 32 of 2000) section 46 and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

Measures taken to improve underperformance not reported

25. Reported indicators with underperformance do not reflect measures taken to improve performance as required in terms of section 46(1)(c) of the Municipal Systems Act.

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:

Planned and reported performance targets not specific or time bound

26. For the selected objectives, 24% of the planned and reported indicators were not specific in clearly identifying the nature and the required level of performance; and 37% were not time bound in specifying the time period or deadline for delivery.

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 indicators not reliable as inadequate supporting source information was provided

27. For the following reported indicators that are material by nature, the validity, accuracy and completeness of the reported performance could not be established as sufficient appropriate audit evidence and relevant source documentation could not be provided for audit purposes.

Material by nature:

- No. of people with access to water
- No. of people with access to RDP toilets

Material by amount:

- No. of [housing] projects accumulatively implemented
- % of settlements within 2 km of a public transport service/facility

Reported indicators not reliable when compared to source information

28. The following reported indicators were not completed on the basis of the source information and evidence provided to support the reported amounts

- No. of water treatment works refurbished
- No. of regional waste sites maintained
- Capital projects exceeding R1 million

Compliance with laws and regulations

Municipal Finance Management Act

Non-adherence to requirements

29. Accounting officers and municipal officials have adhered to their statutory responsibilities (Compliance focus area)
30. Contrary to the requirements of section 62 of the MFMA, the accounting officer did not prevent irregular and fruitless and wasteful expenditure.
31. Contrary to the requirements set out in section 71 (1) of the MFMA, the accounting officer did not submit all reports during the year to the mayor on the state of the municipality's budget within 10 days after each month.
32. The mid-year budget was not submitted to the National Treasury by 25 January as required by section 72 of the MFMA.
33. Contrary to section 74 (1) of the MFMA, signed returns of conditional grant spending for the period ended 30 June was not submitted timeously to the National Treasury.
34. In contravention of section 62(1)(a) of the MFMA, the municipality has not quantified or investigated water losses incurred during the period under review.
35. The financial statements submitted for audit purposes did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit, some of which were corrected by management and those that were not are included in the basis for qualified opinion paragraphs.

INTERNAL CONTROL

36. 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, section 121(3)(c) and 121 (4)(d) and the Municipal Systems Act, section 46, but not for the purpose of expressing an opinion on the effectiveness of internal control.
37. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• Leadership

Management did not always set a tone conducive to solving the serious financial reporting issues. Although significant progress can be acknowledged with respect to the debtor data cleansing exercise, the extended project deadlines impact on the next financial year. In addition, effective control over, and commitment to, quality over the reporting of assets are not evident, that is, reconciliations of the asset register to ledger were not done regularly.

Due to a lack of business process continuity planning on the resignation of the senior accountant for assets, numerous differences between the recorded amounts in the general ledger, fixed asset register and the financial statements could not be explained.

Inadequate analysis and interrogation of the debtors ledger resulted in a lack of proper understanding of the completeness of the automated billing processes for water and sewerage revenue.

Findings on non-compliance and a lack of measurability relate to a lack of required actions to address risks relating to the achievement of adequate performance reporting

- **Financial and performance management**

Due to a lack of adequate reconciliations, large differences were identified between the revenue billing file and the general ledger. These differences could not be adequately explained. Despite review of the debtors ledger during the year anomalies existed in the debtors database such as unmetered, unbilled or inconsistent billings on accounts.

Depreciation in the current year was misstated due to prior year audit journals not being processed in the asset module. Also, as a result of inadequate review the assets reported did not reconcile with the asset register or general ledger.

In contravention of section 62(1)(a) of the MFMA, the municipality has not quantified or investigated water losses incurred during the period under review. There is no metering system in place to measure the water losses through network leakages, illegal connections, spillages, burst pipes, damaged reservoirs, evaporation, consumption of indigent communities.

There was a lack of review, reconciliation and record keeping of supporting documentation for the reporting on predetermined objectives.

OTHER REPORTS

- **Investigations**

An investigation is being conducted based on the allegation of possible irregularities relating to awarded tenders. This investigation was still in progress at the date of the report.

Auditor - General

East London

14 December 2010



AUDITOR - GENERAL
SOUTH AFRICA

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