

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND COUNCIL ON AMAHLATHI LOCAL MUNICIPALITY
REPORT ON THE FINANCIAL STATEMENTS**

Introduction

1. I have audited the financial statements of the Amahlathi Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), 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.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. 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.
4. 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.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

6. The municipality has not maintained a complete investment property register that included all vacant land parcels over which it exercises control due to inadequate review of the register. This has resulted in land held for currently undeterminable use not being included as investment property, as required by GRAP 16, *Investment property*. Consequently, investment property as disclosed in note 10 is understated in the current and prior year by R11,8 million with a corresponding understatement of accumulated surplus.

Qualified opinion

7. In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Amahlathi Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Unauthorised expenditure

9. As disclosed in note 44 to the financial statements, unauthorised expenditure amounting to R78,6 million has been incurred due to plant acquired that was not approved. This has resulted in overspending on the operating and capital budget. No disciplinary action has been taken with regard to this expenditure.

Irregular expenditure

10. As disclosed in note 46 to the financial statements, irregular expenditure amounting to R7,1 million has been incurred in the current year due to the supply chain management (SCM) processes not being followed. No disciplinary action has been taken with regard to this expenditure.

Fruitless and wasteful expenditure

11. As disclosed in note 45 to the financial statements, fruitless and wasteful expenditure amounting to R3,4 million has been incurred due to excessive interest being paid on the lease agreements, penalties and interest. No disciplinary action has been taken with regard to this expenditure.

Material losses

12. As disclosed in note 47 to the financial statements, material losses to the amount of R2,3 million have been incurred as a result of environmental and technical factors as well as illegal connections.

Restatement of corresponding figures

13. As disclosed in notes 3, 40 and 41 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors and changes in accounting policy only corrected during the year ended 30 June 2014 in the financial statements at, and for the year ended, 30 June 2013.

Additional matter

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

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Development objective 1: Infrastructure and service delivery, on pages x to x.
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected development objectives are as follows:

Development priority 1: Infrastructure and service delivery

Usefulness of reported performance information

Consistency of objectives and indicators

22. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 71% of the reported development objectives and indicators were not consistent with those in the approved integrated development plan. This was due to inadequate review processes and systems over the collation and reporting function.

Changes to targets not approved

23. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to inadequate review processes being implemented which monitor performance against service delivery targets.

Measurability of indicators and targets

24. The FMPPI requires the following:

- Performance targets must be measurable. I could not measure the required performance for 26% of the targets.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 21% of the indicators were not well defined.
- Performance indicator must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator/measure. A total of 29% of the indicators were not verifiable.

This was because management did not adhere to and was not adequately trained in the requirements of the FMPPI and did not institute the necessary review processes to ensure that all the reported indicators and targets are measurable.

Relevance of indicators

25. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. A total of 35% of the indicators did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the five-year integrated development plan. This was because proper performance planning and management practices had not been developed and implemented to provide for the development of performance indicators and targets included in the integrated development plan and aligned to the goal of the specific programme.

Reliability of reported performance information

26. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to a limitation placed on my work due to the absence of information systems and the auditee's records not permitting the application of alternative audit procedures.

Additional matter

27. I draw attention to the following matter:

Achievement of planned targets

28. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on usefulness and reliability of the reported performance information in paragraphs 22 to 26 of this report.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

30. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan before adoption, as required by section 42 of the MSA and regulations 9, 13(1), 13(4)(c) and 15(3) of the *Municipal planning and performance management regulations* (MPPR).
31. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not relate to the employee's performance management processes, as required by section 38(a) of the MSA and regulation 7(2)(f) of the MPPR.
32. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
33. Key performance indicators, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the integrated development plan, as required by section 41(1)(a) of the MSA and regulations 1 and 9(1)(a) of the MPPR.
34. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the integrated development plan, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the MPPR.
35. The annual performance report for the year under review did not include a comparison with the previous financial year as required by section 46 (1)(b) of the MSA.
36. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance monitoring/ measurement / reporting and how it is conducted, organised and managed, including determining the roles of the different role players, as required by sections 38 of the MSA and regulation 7 of the MPPR.

Budgets

37. Expenditure was not incurred in accordance with the approved budget and was in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual report and annual financial statements

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

39. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No.5 of 2000) (PPPFA) and its regulations.

Human resource management and compensation

40. Senior managers did not have the higher education qualification or prescribed competency areas as required by regulations 6 and 7 of the *Municipal regulations on minimum competency levels* (MRMCL).

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
42. Payments and withdrawals were made from the municipality's bank account without the approval of a properly authorised official, as required by section 11(1) of the MFMA.
43. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

44. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
45. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

46. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
47. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

48. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

49. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion and the findings on the annual performance report and compliance with legislation included in this report.

Leadership

50. The formal code of conduct established by the municipality was not effective in ensuring that instances of irregular, fruitless and wasteful as well as unauthorised expenditure do not recur. Management has also not instituted investigations into instances of irregular, unauthorised as well as fruitless and wasteful expenditure which, in turn, creates an environment that is not conducive to ensuring that there are appropriate consequences for those officials who fail to comply.
51. Management has not set the correct tone at the top to demonstrate the importance of performance information that should be reported reliably and consistently and based on information that will be useful to all stakeholders. The annual performance report is also

not adequately reviewed and no system of control over reported performance information has been established. This has resulted in material findings arising from the audit of predetermined objectives, similar to prior years.

52. The accounting officer did not institute adequate controls over review of all accounting records and did not develop an action plan that could address both internal and external audit findings, which has resulted in numerous material misstatements being corrected after submission for audit purposes. The lack of review of the completeness of the asset register has resulted in a material misstatement being identified which was not corrected.

Financial and performance management

53. The information in support of the reported performance information was not always available due to improper filing systems, combined with inadequate systems of information collection, which has resulted in information submitted that was inconsistent with reported performance information. This resulted in material findings on reported performance information as well as instances of non-compliance.
54. Management has not instituted the necessary controls to ensure that accurate, complete and reliable financial statements are prepared on a regular basis. Management makes use of consultants to prepare the financial statements and to maintain the fixed asset register, but have not implemented the required controls to ensure that effective oversight of the review of the quality, completeness and accuracy of this work can be assured. This has resulted in material misstatements identified in the fixed asset register not being corrected as well as numerous other material misstatements being corrected during the audit process.
55. The municipality has not instituted the necessary controls or systems to monitor full and effective compliance with laws and regulations nor did it have a compliance register in place. The current lack of systems as well as vacancies within the municipality is not conducive to an environment where duties can be effectively segregated to ensure that compliance can be effectively monitored, which has resulted in an increase in compliance findings compared to prior years.

Governance

56. The risk processes implemented, including the audit action plan, have proven largely ineffective in addressing emerging risks and risks highlighted in prior period audits. This has resulted in internal controls which are largely ineffective to prevent instances of non-compliance recurring and misstatements not being identified prior to financial statements being submitted for audit purposes. Management was therefore not able to address the misstatements identified in the fixed asset register. Furthermore, the inadequate risk identification processes resulted in reported performance information as well as material non-compliance not being prevented or detected.

57. Internal audit and the audit committee were not fully effective in ensuring that financial statements submitted for audit purposes were free from material misstatements. The review of the annual performance report also did not add any assurance to the usefulness and reliability of performance information, which has resulted in findings on predetermined objectives recurring. The recommendations made by internal audit and the audit committee are not implemented in all instances, resulting the findings on predetermined objectives and compliance not being adequately addressed.

Auditor - General

East London

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence