



Auditing to build public confidence

**AUDITOR-GENERAL
SOUTH AFRICA**

Amahlati Municipality

Audit Report

For the year ended 30 June 2015

Report of the auditor-general to the Eastern Cape Provincial Legislature and the 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 ... to ..., which comprise the statement of financial position as at 30 June 2015, 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 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 municipality'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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Amahlathi Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Unauthorised expenditure

8. As disclosed in note 41 to the financial statements, unauthorised expenditure amounting to R23,9 million has been incurred due to overspending on the budget. No disciplinary action has been taken yet with regards to the expenditure.

Irregular expenditure

9. As disclosed in note 43 to the financial statements, irregular expenditure amounting to R40,3 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.

Material losses

10. As disclosed in note 44 to the financial statements, material losses on electricity distribution of R2,1 million were incurred due to environmental and technical factors.

Restatement of corresponding figures

11. As disclosed in notes 45 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors only corrected during the year ended 30 June 2015 in the financial statements at, and for the year ended, 30 June 2014.

Additional matters

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

Unaudited disclosure notes

13. 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 we do not express an opinion thereon.

Report on other legal and regulatory requirements

14. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and 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

15. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Development priority: Service Delivery and Institutional Development KPA 4 on pages x to x
16. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
17. 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 priorities. 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).
18. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
19. The material findings in respect of the selected development priority is as follows:

Service delivery and Institutional Development

Usefulness of reported performance information

20. Section 41(c) of the Municipal Systems Act (Act No. 32 of 2000) (MSA) requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 100% of all planned development objectives, 28% of indicators and 20% of targets specified in the integrated development plan for the year under review.
21. This was due to inadequate review of the completeness of reporting documents by management, the audit committee and the internal audit unit. There is no formal policy in place to govern the performance of and reporting of predetermined objectives.

22. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 33% of the targets were not specific.
23. Performance targets should be measurable as required by the FMPPI. We could not measure the required performance for 33% of the targets.
24. The period or deadline for delivery of targets should be specified as required by the FMPPI. A total of 29% of the targets were not time bound.
25. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 69% of the indicators were not well defined.
26. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 69% of the indicators were not verifiable.
27. This was due to a lack of proper systems and processes for the indicators and targets. Furthermore, management did not adequately apply the SMART criteria when producing the performance indicators set out in the SDBIP.

Reliability of reported performance information

28. 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. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of standard operating procedures or documented system descriptions for the accurate recording and monitoring of actual achievements. In addition this was due to a lack of frequent review of the validity of reported achievements against source documentation.

Additional matters

29. I draw attention to the following matters:

Achievement of planned targets

30. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraphs x to xx of this report.

Unaudited supplementary information

31. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on 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

33. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan.
34. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
35. 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 IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
36. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
37. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement 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 Municipal planning and performance management regulations.
38. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of electricity and solid waste removal were not set by the municipality as required by section 43(2) of the MSA and the Municipal planning and performance management regulation 10(a).

Revenue Management

39. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1) (f) (iii) of MFMA.

Expenditure Management

40. Reasonable steps were not taken to prevent unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

Annual report and Annual financial statements

41. 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, expenditure and disclosure items identified by

the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Consequences management

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

Asset management

43. 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.
44. 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.

Conditional grants

45. The Municipal Infrastructure Grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the DoRA.
46. Municipal Infrastructure Grant funds were retained or rollover to the next financial year without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.

Internal control

47. 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 findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

48. The implementation of the code conduct was not effective due to a lack of management oversight to ensure that instances of irregular, fruitless and wasteful as well as unauthorised expenditure do not occur.
49. Furthermore, management did not put measures in place to ensure that appropriate consequences are taken against officials responsible for instances of non-compliance. Management has not set the correct tone at the top with regards to the importance of compliance with all laws and regulations by the municipal officials.

Financial and performance management

50. Management has not effectively implemented daily and monthly controls as designed for the municipality's business processes, resulting in significant misstatements not being detected or corrected.

51. Significant errors were identified through a high-level review of the financial statements which should have been identified through management's own review processes.
52. Documented processes and systems over the reporting of predetermined objectives did not exist during the financial year. In addition, the performance information reporting template in use at the municipality does not cover the level of detail required to report on each indicator. Consequently, the performance information reporting system cannot be relied upon to produce reliable, complete and accurate information.

Governance

53. The implementation of the risk assessment processes has been ineffective as the audit recommendations by internal and external auditors have not been fully addressed. Furthermore, the fraud prevention plan was approved late in the financial year and was therefore not implemented and effective for the majority of the financial year.
54. The internal audit did not adequately review the financial statements to supporting documents and scrutinise the validity of supporting information.
55. The internal audit review of the quarterly performance reports did not have the desired impact as material findings were identified on the annual performance report. This was due to a lack of understanding of the requirements.
56. The internal control recommendations identified by external and internal auditors have not been adequately implemented by management and the audit committee has not been effective in monitoring the action plan.

Other reports

Investigations

57. The Department of Co-operative Governance and Traditional Affairs is conducting an investigation in to the purchase of plant in the previous financial year. The investigation is still ongoing and the expected completion date is not known.

Auditor-General

East London

30 November 2015



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