

# 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 accompanying financial statements of the Amahlathi Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

### 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 (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, 2010 (Act No. 1 of 2010 as amended) (DoRA), and for such internal control as management determines 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. As required by section 188 of the Constitution of the Republic 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 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. 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 qualified audit opinion.

## **Basis for qualified opinion**

### **Irregular expenditure**

7. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose material irregular expenditure that occurred during the financial year. Note 41 to the financial statements reflects irregular expenditure of R2,4 million, however, insufficient documentation was provided to support the procurement process followed for R9,5 million of expenditure and the use of the mayoral vehicle to the value of R67 671. The lack of a formalised system to account for procurement documentation and the use of the mayoral vehicle did not allow for the performance of alternative procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure disclosed by the municipality in note 41.

### **Receivables**

8. An amount of R30,2 million is disclosed as trade and other receivables in note 9 to the financial statements. This amount is understated by R1,4 million due to uncorrected misstatements, which, if corrected, would have resulted in an increase in motor vehicle registration, rendering of services revenue and interest income – debtors in the statement of financial performance. In addition, the municipality could not provide sufficient appropriate audit evidence for R7,8 million (2010: R6,8 million) of the trade and other receivables amount disclosed. Consequently, even after performing alternative procedures, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness and valuation of trade and other receivables as disclosed in note 9 to the financial statements. In addition, the valuation of trade debtors impairment of R27,4 million disclosed in note 9 to the financial statements could not be confirmed by R7,8 million (2010: R6,8 million) due to the limitation on receivables upon which the impairment is based.

### **Revenue**

9. Rates revenue to the value of R908 646 (2010: R814 991) included in R8,3 million disclosed in note 20 to the financial statements and rendering of services revenue of R3,9 million (2010: R3 million) included in R25,1 million disclosed in note 21 to the financial statements have been incorrectly recognised and classified due to management not reversing inter-departmental billing at year-end and recognising rebates related to free basic services as expenditure and not as a reduction in revenue. This does not constitute true revenue as per the definition in GRAP 9, *Revenue from Exchange Transactions*. Had this revenue been classified and recognised correctly, general expenditure included in R22,1 million as disclosed in note 23 to the financial statements would have been reduced by R4,8 million (2010: R3,8 million).

### **Aggregation of immaterial uncorrected misstatements**

10. The financial statements as a whole are materially misstated due to the cumulative effect of various individually immaterial uncorrected misstatements in the following elements making up the statement of financial performance:
- Personnel: Note 24 R230 239 (2010: R409 519)
  - Expenditure: Note 23 R169 812 (2010: R409 519)
  - Conditional grant revenue: Note 22 R355 196
  - Conditional grant expenditure: Note 22 R355 195

### **Qualified opinion**

11. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Amahlathi Local Municipality as at 30 June 2011 and its financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matter**

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

### **Restatement of corresponding figures**

13. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered in the financial statements of Amahlathi Local Municipality at, and for the year ended 30 June 2011.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

14. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages XX to XX and material non-compliance with laws and regulations applicable to the municipality.

### **Predetermined objectives**

#### **Presentation of information**

15. The following criteria is relevant to the finding below:

- Performance against predetermined objectives is reported using the National Treasury guidelines.

16. Audit finding:

### **Measures taken to improve performance were not provided in the performance report**

17. Measures taken to improve performance were not provided in the report on predetermined objectives submitted for audit purposes, as required in terms of section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total, 47% of the reported targets had no details of the measures taken to improve performance.

### **Usefulness of information**

18. The following criteria are relevant to the findings below:

- Consistency: The reported objectives, indicators and targets are consistent with the approved integrated development plan.
- Measurability: The indicators are well defined and verifiable, and targets are specific, measurable, and time bound.

19. Audit findings:

### **Planned and reported development priorities are not consistent between planning and reporting documents**

20. Fifty-six percent of reported development priorities were not consistent when compared with planned development priorities, as the reported priorities could not be traced back or differed to the priorities as per the approved integrated development plan (IDP).

### **Planned and reported indicators are not well defined**

21. Thirty-nine percent of planned and reported indicators were not well defined, in that the description was ambiguous and did not allow for a reasonable user to determine the required level of performance.

### **Planned and reported indicators are not consistent between planning and reporting documents**

22. Sixty-six percent of all reported indicators included in the report on predetermined objectives submitted for audit purposes were not consistent or not complete when compared with planned indicators in the IDP.

### **Planned and reported targets are not consistent between planning and reporting documents**

23. Sixty-nine percent of reported targets included in the report on predetermined objectives submitted for audit purposes were not consistent or not complete when compared with planned indicators in the IDP.

### **Planned and reported targets are not specific**

24. Forty percent of planned and reported targets are not specific in clearly identifying the nature and the required level of performance by the municipality.

### **Planned and reported targets are not measurable**

25. Thirty-four percent of planned and reported targets are not measurable in identifying the required performance of the municipality.

### **Reliability of information**

26. The following criteria are relevant to the findings below
  - Validity: Actual reported performance has occurred and pertains to the entity.
  - Accuracy: Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately.
  - Completeness: All actual results and events that should have been recorded have been included in the report on predetermined objectives submitted for audit purposes.

27. Audit finding:

### **Sufficient appropriate evidence was not submitted to support reported indicators and targets**

28. Sufficient appropriate evidence in relation to the selected programme, 'Infrastructure', could not be obtained. There were no satisfactory audit procedures or alternative procedures that we could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported performance against predetermined objectives for 92% of the reported indicators.

### **Compliance with laws and regulations**

#### **Strategic planning and performance management**

29. The municipality did not adopt and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted,

organised and managed, including determining the roles of the different role players as required by sections 38, 39, 40 and 41 of the MSA and regulations 7 and 8 of the Local Government Municipal Planning and Performance Management Regulations, 2001 (MPPR), published in *General Notice 796 of 24 August 2001*.

30. The mid-year budget and performance assessment report provided for audit purposes does not include information related to the municipality's service delivery performance and the service delivery targets and performance indicators set as required by section 72(1)(a) of the MFMA.

#### **Annual financial statements, performance and annual report**

31. 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 identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

#### **Audit committee**

32. The performance audit committee did not perform the following as required by regulation 14 of the MPPR:
  - Meet at least twice during the financial year;
  - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality;
  - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality; and
  - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

#### **Internal audit**

33. Internal audit did not report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation as required by section 165(2)(b) of the MFMA.
34. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes as required by section 45(1)(a) of the MSA and regulation 14 of the MPPR.
35. The internal audit processes and procedures did not include assessments of:
  - the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA as required by regulation 14 of the MPPR; and
  - the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators as required by regulation 14 of the MPPR.
36. The internal auditors of the municipality did not audit the performance measurements on a continuous basis as required by regulation 14 of the MPPR.

### **Procurement and contract management**

37. Sufficient appropriate audit evidence could not be obtained that awards were made to providers based on criteria that were similar to those stipulated in the original bid documents as per the requirements of Supply Chain Management (SCM) regulations 21(b) and 28(1).
38. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
39. Bids were not always evaluated by bid evaluation committees that were composed of officials from the departments requiring the goods or services as per the requirements of SCM regulation 28(2).
40. Final awards or recommendation of awards to the accounting officer were not always made by an adjudication committee that was constituted of at least four members as per the requirements of SCM regulation 29(2).
41. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPF) and its regulations.
42. The performance of contractors or providers was not monitored on a monthly basis as required by section 116(2)(b) of the MFMA.
43. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA.
44. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
45. Awards were made to providers whose principal shareholders are persons in the service of other state institutions, in contravention of the requirements of SCM regulation 44.
46. Contracts were extended/modified without tabling the reasons for the proposed amendment in the council of the municipality as required by section 116(3) of the MFMA.

### **Expenditure management**

47. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
48. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised expenditure when it was incurred and accounted for the creditors of the municipality, as required by section 65(2)(b) of the MFMA.
49. The accounting officer did not take reasonable steps to prevent irregular expenditure as required by section 62(1)(d) of the MFMA.
50. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

### **Transfer of funds and conditional grants**

51. The municipality did not always submit quarterly reports to the transferring national officer on non-financial performance in respect of the allocation received for the municipal infrastructure grant (MIG), the municipal systems improvement grant (MSIG) and the finance management grant (FMG), as required by section 11(2)(c) of the DoRA.
52. The accounting officer did not evaluate the performance of the municipality in respect of programmes funded or partially funded by a schedule 4 allocation within two months after the end of the financial year as required by section 11(6) of the DoRA.

### **Revenue management**

53. A credit control and debt collection policy was not implemented as required by section 96(b) of the MSA.
54. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it was earned, as required by section 64(2)(e) of the MFMA.
55. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.

### **INTERNAL CONTROL**

56. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

57. The leadership at the municipality does not set the correct ethical tone as no clear code of conduct is filtered down to all employees of the municipality. As a result, focus deviates from discharge of mandate to matters of self-interest. In turn, this lack of platform leaves a vacuum with regard to holding public officials and employees accountable for proper monitoring of municipal assets and public funds, distributing these funds in a manner that is transparent and fair and ensuring that service delivery is provided to the community which it serves.
58. Financial administration is the driving force behind the critical process of service delivery. However, the lack of senior management and leadership's accountability in terms of developing and implementing sufficient monitoring controls over the processes of planning, budgeting, implementation and reporting, as well as, ensuring adherence to internal policies and procedures at a department level, indicates serious deficiencies within the structures that govern the municipality, such as the following:

- Lack of adequate human resources

There is an identified shortage of human resources within the municipality, not only in managerial positions, but at all levels and within all departments. This has resulted in key officials performing primarily an operational role, as opposed to a monitoring and oversight role, which is not conducive to achieving future clean administration. This situation worsened in the current year due to the moratorium placed on appointments by the council, resulting in several key positions, including that of the municipal

manager, remaining vacant for extended periods. This contributed to the material findings in the current year as disclosed under the basis for qualification, predetermined objectives and non-compliance paragraphs.

- Resistance to change

Although action plans are formulated, they are not implemented and monitored, resulting in repeat audit findings with respect to non-compliance and predetermined objectives, and a regression to a qualified audit opinion in the financial year. In addition, management does not respond timeously to deficiencies identified within its own structures and appears to put measures in place simply to comply with legislative requirements and not to improve the governance and financial and performance management structures of the municipality. Examples of this would be properly enabling internal audit to perform its oversight functions, developing and implementing daily and monthly internal controls over processes, allowing for information technology to assist and not hinder the processes within the municipality and ensuring skills and knowledge transfer from consultants, be it financial or Information Technology (IT) experts.

### **Financial and performance management**

59. The municipality's manual and automated controls are not designed and implemented to ensure that the transactions have occurred, are authorised, and are completely and accurately processed, and are in compliance with the applicable laws and regulations that govern the municipality. This is partly due to the inadequate IT systems within the municipality and partly due to management not adequately managing the transaction process and flow between the different departments within the municipality. This is apparent in the fact that the municipality received a qualified opinion for the current year, irregular expenditure was identified for instances of non-compliance with SCM regulations as reported, and other non-compliance with laws and regulations were identified.

### **Governance**

60. The governance structures within the municipality are not adequate to reduce the risk of non-compliance with laws and regulations, deviations from internal controls, an inadequate performance management and reporting system and non-adherence to the financial reporting framework:
- No risk committee was established within the municipality to detect and respond to risks within the municipality and, although the draft fraud prevention plan, was approved and adopted by the council in June 2010 it was not rolled out to employees until September 2011.
  - Internal audit did not adequately discharge its mandate in providing an oversight function at the municipality for the year under review, as it was not governed by adequate plans and methodologies, did not provide meaningful reporting in the 2010-11 year, was not adequately staffed and was not sufficiently independent.
  - The performance audit committee did not meet regularly and did not submit the audit reports on performance management to the council during the financial year. Internal audit consisted of two members, as opposed to the required three in terms of legislation, as the council did not ensure that this quota was met through appointing an additional audit committee member to meet with the legislation requirements.

61. These governance structures have not been empowered to perform their oversight duties properly and the above findings indicate a 'minimum adherence approach' to good governance by leadership and management.

## **OTHER REPORTS**

### **Investigations**

62. Two investigations were conducted by an independent consulting firm. The first investigated any potential financial misconduct by various role players in the municipality (management level and up), while the second related to the suspected fraudulent activities of an employee with respect to procurement and payroll. The second investigation resulted in the individual being suspended with a disciplinary hearing still in progress, while the outcome of first investigation is still pending, as it was only recently tabled in the council (27 October 2011). Both investigations were completed after the 2010-11 financial year.

*Auditor-General*

East London

30 November 2011



AUDITOR - GENERAL  
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