

**REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF PHUMELELA LOCAL MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Phumelela Local Municipality which comprise the balance sheet as at 30 June 2008, and the income statement and the cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes, as set out on pages [1] to [36].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) 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.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Revenue

4. Due to material weaknesses in the financial accounting and management processes, management was unable to provide me with contracts or lease agreements with regard to the leasing of municipal properties. I was thus unable to obtain sufficient appropriate audit assurance as to the completeness, accuracy and occurrence of rental income to the value of R267 286 (2007: R158 511) that were included in the community services income as disclosed in the income statement. Due to a lack of supporting documentation, I could not perform reasonable alternative procedures.
5. Capital grants received amounted to R10 392 975 as disclosed in notes 24.2.1 and 24.3.2 to the financial statements. Due to material weaknesses in the financial

accounting and management processes, management was unable to provide me with adequate supporting documentation with regard to capital grants received. Consequently, I was unable to obtain sufficient appropriate evidence as to the completeness and accuracy of capital grants received. Due to a lack of supporting documentation, I could not perform reasonable alternative procedures.

6. With reference to accounting policy note 12.1, the municipality should recognise electricity and water charges when they are read and billed every month. Where meters cannot be read during a particular month a provision is made and the necessary adjustments are made in the month that the meters are read. Contrary to the accounting policy, the municipality did not make estimates where meters have not been read. Furthermore, a significant number of differences were identified between meter readings and the readings that were recorded in the accounting records. I could not perform alternative procedures to obtain sufficient appropriate audit assurance as to the completeness and accuracy of trade services income. Due to a lack of sufficient appropriate audit evidence I was unable to quantify the extent of the misstatement.
7. Paragraph 52 of GA100, *Framework for the preparation and presentation of financial statements by local government* states, that to be reliable, information must represent faithfully the transactions and other events it purports to either represent or could reasonably be expected to represent. Contrary to this requirement, the equitable share allocation was incorrectly allocated to trading services, economic services and subsidised services income. Consequently, community services income, as disclosed in the income statement, is understated by R14 521 667 (2007: R16 165 247) and trading services, economic services and subsidised services income as disclosed in the income statement is overstated by R7 382 500 (2007: R8 200 000), R6 217 136 (2007: R7 300 000) and R922 031 (2007: R665 247), respectively.
8. Management was unable to provide me with the title deed listing of the municipality. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the completeness, accuracy and occurrence of assessment rates income amounting to R1 917 469 as disclosed in the income statement. Because the relevant information was not available I could not perform reasonable alternative procedures.
9. A difference of R1 902 314 was identified between the amount recognised as interest on arrear debtors and the recalculated amount. Consequently, interest on arrear debtors that is included in the income statement and consumer debtors as disclosed in note 7 to the financial statements are understated by R1 902 314.
10. Due to material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with appropriate supporting evidence in respect of prepaid electricity income and sale of stands. I was thus unable to obtain sufficient appropriate audit assurance as to the completeness, accuracy and classification of income from prepaid electricity that is included in the trade services income as disclosed in the income statement and sale stands. Because the relevant information is not available I could not determine the amount of prepaid electricity and sale of stands that are included in the income statement. A similar matter was reported in the prior year audit report with regard to prepaid electricity that amounted to R939 222. Because the relevant information is not available I could not perform reasonable alternative procedures.

11. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R1 870 693 on income as disclosed in the income statement. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the accuracy, occurrence and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Fixed assets

12. For the reasons detailed below I was unable to obtain sufficient appropriate audit assurance as to the existence, rights, completeness and valuation of fixed assets to the value of R158 148 325 (2007: R143 418 696), and loans redeemed and other capital receipts to the value of R156 269 450 (2007: R141 352 763) as disclosed in note 4 to the financial statements:

- a) The descriptions, serial numbers, location and condition of items as indicated in the fixed asset register were inadequate. Consequently, assets amounting to R62 528 971 (2007: R31 111 110) could not be physically verified. Therefore I was unable to perform all the audit procedures that I considered necessary to obtain sufficient appropriate audit evidence with regard to the existence, valuation and completeness of fixed assets or to the rights thereto. Due to the weaknesses in internal control and the lack of supporting documentation, I could not perform reasonable alternative procedures.
- b) The listing of all land belonging to the municipality as per the valuation roll could not be agreed to the land included in the fixed asset register. Due to the lack of sufficient appropriate audit evidence, I was unable to quantify the extent of the limitation. Due to the lack of supporting documentation, there were no reasonable alternative audit procedures that could be performed to obtain reasonable audit assurance as to the completeness, valuation and existence of land included in the fixed asset register.
- c) During the physical verification of assets in the prior year, damaged assets with a cost of R305 635 were identified. Because the relevant information was not available, I could not determine the amount of the provision that should have been made against loans redeemed and other capital receipts for the impairment of these assets in the prior year. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation of loans redeemed and other capital receipts in the prior year. Due to the lack of supporting documentation, there were no reasonable alternative audit procedures that could be performed.
- d) During the prior year's audit, supporting documentation and contracts could not be submitted with regard to capital expenditure of R13 575 776 that was included in note 4 to the financial statements in the prior year. Due to material weaknesses in the financial accounting and management processes it was not possible to perform alternative procedures to obtain sufficient appropriate audit evidence as to the occurrence, accuracy, classification and completeness of infrastructure project payments made during the prior year and that irregular expenditure was not incurred.

13. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R14 729 633 on fixed assets and a net credit impact of R15 924 204 on loans redeemed as disclosed in note 7 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Expenditure

14. Total expenditure as disclosed in the income statement amounted to R35 029 541. The total expenditure recorded in the general ledger amounted to R35 696 141. A difference of R666 600 existed. Due to a lack of detail there were no satisfactory audit procedures that I could perform to obtain reasonable assurance pertaining to the difference. Consequently, I was unable to obtain sufficient appropriate evidence as to the completeness and accuracy of total expenditure disclosed in the income statement.
15. Due to the material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with sufficient appropriate audit evidence regarding expenditure amounting to R724 514 (2007: R1 808 560). I was unable to perform reasonable alternative procedures as no other supporting documentation existed to obtain reasonable assurance as to the occurrence, accuracy and classification with regard to these expenditure transactions that are included in actual expenditure in the income statement.
16. The management of the municipality could not supply proof that goods and services amounting to R3 456 557 had been delivered to the municipality before the relevant payments were made. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the occurrence of these expenditure transactions that are included in actual expenditure in the income statement. Because the relevant information was not available, I could not perform reasonable alternative audit procedures.
17. The management of the municipality could not provide me with sufficient explanations pertaining to differences amounting to R197 041 between the lease expenditure recorded and the lease agreements obtained. I was unable to obtain sufficient appropriate evidence for the completeness, classification and accuracy of the lease expense included in community services expenditure as disclosed in the income statement. Due to the lack of supporting documentation, there were no reasonable alternative audit procedures that could be performed.
18. Paragraph 52 of GA100, *Framework for the preparation and presentation of financial statements by local government*, states that, to be reliable, information must represent faithfully the transactions and other events it purports to either represent or could reasonably be expected to represent. Contrary to this requirement, in the prior year the municipality credited grants that it received from the Thabo Mofutsanyana District Municipality to the amount of R372 000 to expenditure and not to revenue. Consequently, expenditure and revenue as disclosed in the income statement if the prior year are understated by R372 000.

19. The management of the municipality was unable to provide me with adequate supporting documentation regarding differences amounting to R229 368 identified with regard to the remuneration of managers as disclosed in note 25.2 (R54 100), note 25.4(R30 948) and note 25.5(R144 320) to the financial statements. I was unable to determine the accuracy and completeness of the remuneration as disclosed in the note to the financial statements. Due to the lack of supporting documentation, there were no reasonable alternative audit procedures that could be performed.
20. Due to the material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with sufficient appropriate supporting documentation for salaries amounting to R668 700. Consequently, I was unable to obtain sufficient appropriate evidence as to the completeness and accuracy of salaries as included in actual expenditure in the income statement. Because the relevant information was not available, I could not perform reasonable alternative audit procedures.
21. Contrary to the service employment and SALBC agreements, leave pay gratuities amounting to R81 354 (2007: R65 332) were incorrectly paid out to employees. Consequently, expenditure is overstated by R81 354 (2007: R65 332) and debtors are understated by the same amount.
22. No supporting documentation could be submitted by management with regard to journals that have a net debit impact of R1 896 485 on expenditure as disclosed in the income statement. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the accuracy, occurrence and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Creditors

23. Due to an oversight by management the municipality has included certain expenditure that occurred during the next financial year in the transactions and balances of the year under review. Had the expenditure been excluded and recorded appropriately, actual expenditure as disclosed in the income statement and creditors as disclosed in note 9 to the financial statements would both have decreased by R137 779.
24. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R1 306 738 on creditors as disclosed in note 9 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Long-term liabilities

25. No supporting documentation could be submitted by management with regard to journals that had a net credit impact of R782 632 on creditors as disclosed in note 2 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification

of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Debtors

26. Council meeting minutes of 29 January 2009 included approval for the write-off of bad debts amounting to R13 896 636. The management of the municipality could not supply the list of bad debts that were approved to be written off. Therefore, I was unable to determine whether the bad debts of R6 458 181 that were written off during the year under review were authorised. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the occurrence and accuracy of the bad debts written off as disclosed in note 7 to the financial statements. The municipality's records did not permit the performance of reasonable alternative audit procedures.
27. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R1 473 068 on debtors as disclosed in note 7 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Inventory

28. Due to the material weaknesses in the financial accounting and management processes, the municipality did not have an appropriate inventory register. No inventory reconciliations were performed for the inventory amounting to R389 618. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance pertaining to inventory. Consequently, I was unable to obtain sufficient appropriate evidence to the completeness, classification and valuation of inventory as disclosed in note 6 to the financial statements.
29. No supporting documentation could be submitted by management with regard to journals that have a net debit impact of R399 679 on inventory as disclosed in note 6 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Investments

30. The management of the municipality was unable to provide me with adequate documentation for investments amounting to R986 954. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance pertaining to the investments. Consequently, I was unable to obtain sufficient appropriate audit evidence for the existence and valuation of the investments as disclosed in note 5 of the financial statements.

31. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R675 065 on investments as disclosed in note 5 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Statutory funds

32. In the prior year it was reported that statutory funds were understated by R639 825 as the necessary transfers had not been made to statutory funds. No corrections were made in the current year. Consequently, statutory funds as disclosed in note 1 to the financial statements are understated by R639 825 and accumulated surplus as disclosed in the income statement is overstated by the same amount for the current and previous financial years.

33. No supporting documentation could be submitted by management with regard to journals that had a net credit impact of R206 420 on provisions as disclosed in note 8 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Accumulated deficit

34. No supporting documentation could be submitted by management with regard to journals that had a net credit impact of R6 281 148 on the accumulated deficit as disclosed in the balance sheet and income statement. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Provisions

35. Section 7(4) of the South African Local Bargaining Council Agreement requires that leave accumulated subsequent to 1 January 2004 may be accumulated to a maximum of 48 days inclusive of those days referred to in clause 7.3.3. Contrary to this no leave days were forfeited and the accrued leave was not limited to 48 days due to the fact that no funds were available to compensate employees for leave accrued in excess of 48 days. Employee-related costs as disclosed in note 25 to the financial statements and leave provision as disclosed in note 8 to the financial statements are thus overstated by R757 988 (2007: R603 250).

36. The standards laid down by the Institute of Municipal Treasurers and Accountants in its Code of Practice for Local Government Accounting (1997) and the Published Annual Financial Statements for Local Authorities (second edition 1996, as amended) require the note on provisions to exclude the provision made for bad debts. Had the disclosure been made in accordance with the said accounting

framework, bad debts amounting to R42 831 829 would not be included in note 8 to the financial statements.

37. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R314 237 on provisions as disclosed in note 8 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Bank

38. No supporting documentation could be submitted by management with regard to journals that had a net debit impact of R528 804 on bank as disclosed in note 10 to the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation, rights and obligations, and classification of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Municipal entity

39. According to section 86B of the Municipal Systems Act, 2000 (Act 32 of 2000) (MSA) the Krynaawslust Boerdery Trust is defined as a municipal entity of the municipality. The accounts and financial statements of Krynaawslust Boerdery Trust were not included in the final financial statements of the municipality. Due to the lack of financial information included in the financial statements I was unable to determine the valuation, existence, completeness, accuracy and rights and obligations of the municipal entity and the impact thereof on the financial statements of the municipality.

Capital commitments

40. The municipality did not maintain a contract register which provides particulars of all approved capital contracts, the expenditure incurred to date and the municipality's future capital commitment in respect of each contract. Furthermore, the municipality did not retain records of all capital contracts awarded. Contrary to the requirement of the IMFO Specimen Financial Statements no capital commitments were disclosed in the financial statements for the year under review. There were no satisfactory alternative audit procedures that I could perform to determine the value of capital commitments that should have been disclosed. I was unable to obtain sufficient appropriate audit evidence for the completeness and valuation of capital commitments.

Contingent liabilities

41. The municipality was unable to provide me with audit evidence pertaining to contingent liabilities amounting to R14 931 172 as disclosed in note 22 to the financial statements. There was no satisfactory audit procedures that I could

perform pertaining to the disclosure made. I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness and valuation of contingent liabilities.

Irregular expenditure

42. Irregular expenditure is defined in the MFMA as expenditure incurred by the municipality in contravention of, or that is not in accordance with, a requirement of this act, and which has not been condoned in terms of section 170; expenditure incurred by a municipality in contravention of, or that is not in accordance with, a requirement of the MSA, and that has not been condoned in terms of that act.
43. The following irregular expenditure was not disclosed in the financial statements as stipulated by section 125 of the MFMA:
- a) Payments of R4 738 882 that individually exceeded R200 000 were made without inviting tenders.
 - b) Payments amounting to R4 712 336 (2007: R614 677) were made without obtaining the required number of quotations.
 - c) Payments to service provider amounting to R400 164 were made before the required documentation to initiate the payment was completed.
 - d) Payments amounting to R97 730 (2007:R479 103) were not authorised by an official with the necessary delegations.
 - e) Contrary to the municipality's procurement policy, additions to assets to the value R2 719 746 in the prior year that are included in assets as disclosed in note 7 to the financial statements in the prior year, were paid although invoices were not issued to Phumelela Local Municipality.

Fruitless and wasteful expenditure

44. Fruitless and wasteful expenditure as defined in section 1 of the Municipal Finance Management Act of R380 573 (2007: R132 579) was incurred due to the following:
- a) Payments amounting to R160 739 were made to the internal auditor who has not performed any of his functions in accordance with the MFMA.
 - b) A double payment amounting to R219 834 was made to a service provider and the amount has not been recovered from the supplier.

The fruitless and wasteful expenditure was not disclosed as required by section 125(2)(d) of the MFMA.

Unauthorised expenditure

45. Actual expenditure for certain votes exceeded the budgeted expenditure for those votes, which resulted in unauthorised expenditure totalling R13 337 573 (2007: R11 870 717) in terms of the definition as set out in section 1 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). The municipality did not disclose this unauthorised expenditure, as required by section 125(2)(d) of the

MFMA. Furthermore, I could not be provided with evidence that the expenditure was approved by the council in terms of section 29 of the MFMA as unforeseen and unavoidable expenditure.

46. The municipality could not provide evidence that expenditure in respect of additions to property, plant and equipment was incurred in terms of the approved budget. Although this matter was referred to the council, I could not be provided with evidence that the council ratified the expenditure. Due to the fact that this expenditure was incurred in contravention of section 15 of the MFMA, the expenditure amounting to R702 981 is considered to be unauthorised. The municipality did not disclose this unauthorised expenditure, as required by section 125(2)(d) of the MFMA.

Comparative figures

47. Due to material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with sufficient appropriate audit evidence in respect of limitations reported in the prior year audit report and corrections that had to be made to the financial statements. Furthermore, since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to obtain reasonable assurance that the financial position, results and cash flow information of Phumelela Local Municipality as at 30 June 2006 are fairly presented in the accompanying financial statements.

Disclaimer of opinion

48. Because of the significance of the matter(s) described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter(s) on which I do not express a disclaimer of opinion:

Basis of accounting

49. The entity's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Other matters

50. I draw attention to the following matters that relates to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

51. The supplementary information set out on pages [30] to [36] does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

52. Municipal Finance Management Act

- Contrary to section 11(4) of the MFMA the accounting officer did not submit quarterly reports on withdrawals from the municipal bank account to the council, the provincial treasury or the Auditor General.
- Contrary to section 111 of the MFMA, the municipality only approved and implemented the supply chain management policy on 25 March 2008.
- Contrary to section 64(3) of the MFMA the municipality did not inform the National Treasury regarding a number of accounts belonging to organs of state, which have been outstanding for longer than 30 days amounting to R2 876 513.
- Contrary to section 66 of the MFMA, the accounting officer did not report to the council on all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits, and in a manner that discloses such expenditure per type of expenditure.
- Contrary to section 65 of the MFMA, payments amounting to R3 297 641 (2007: R5 811 816) were not paid within 30 days.

53. Municipal Systems Act

- Contrary to section 75 of the MSA no by-law which would give affect to the implementation and enforcement of the tariff policy could be submitted.
- Contrary to section 7 of schedule 1 of the MSA no supporting documentation could be submitted that councillors had declared their financial interests within 60 days after being appointed.
- Contrary to section 57 of the MSA the performance agreements of the municipal manager and managers directly accountable to the municipal manager were not signed.

Governance framework

54. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

55. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the local municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the

root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control (the number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4 - 11	Revenue	7		3;6		1
12 - 13	Fixed assets	7		3;6		1
14 - 22	Expenditure	7		3;6		1
23 - 24	Creditors	7		3;6		1
25	Long-term liabilities	7		3;6		1
26 - 27	Debtors	7		3;6		1
28 - 29	Inventory	7		3;6		1
30 -31	Investments	7		3;6		1
32 - 33	Statutory funds	7		3;6		1
34	Accumulated deficit	7		3;6		1
35 - 37	Provisions	7		3;6		1
38	Bank	7		3;6		1
39	Municipal entity	7		3;6		1
40	Capital commitments	7		3;6		1
41	Contingent liabilities	7		3;6		1
42 - 43	Irregular expenditure	7		3;6		1
44	Fruitless and wasteful expenditure	7		3;6		1
45 - 46	Unauthorised expenditure	7		3;6		1
47	Comparative figures	7		3;6		1

Overall reflections on the governance framework based on internal control deficiencies

56. As can be seen from the table above, the matters that are reported under the basis for disclaimer were a result of the following root causes:

- a) A lack of knowledgeable staff in the finance department
- b) A lack of policies and procedures that will ensure the safeguarding of documentation, the completeness of transactions processed in the accounting records and compliance with the accounting framework and relevant legislation

- c) A lack of ongoing monitoring and supervision of the effectiveness of internal control over financial reporting

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

57. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
2.	The financial statements were not subject to any material amendments resulting from the audit.		X

No.	Matter	Y	N
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.		X
5.	Key officials were available throughout the audit process.		X
6.	Audit committee		
	<ul style="list-style-type: none"> • The municipality had an audit committee in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> • The audit committee operates in accordance with approved, written terms of reference. 		X
	<ul style="list-style-type: none"> • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		X
7.	Internal audit		
	<ul style="list-style-type: none"> • The municipality had an internal audit function in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> • The internal audit function operates in terms of an approved internal audit plan. 		X
	<ul style="list-style-type: none"> • The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c) of the MFMA.		X
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	X	
13.	The prior year audit findings have been substantially addressed.		X
14.	PROPAC resolutions have been substantially implemented.		X
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Phumelela Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.	X	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

Overall reflections on the governance framework based on other key governance requirements

58. Key governance requirements pertaining to the financial statements were not met due to the fact that the prior two years were only subjected to auditing much later than prescribed by legislation, and due to the provincial intervention and the fact that financial staff consultants had to be appointed because of a lack of knowledgeable staff.
59. Key governance requirements pertaining to the audit committee and internal audit are a direct result of the fact that the district-based audit committee was used and this committee did not convene on request of the internal auditor of the specific municipality. Furthermore, the internal auditor appointed during the year under review did not have an audit mandate or charter and did not perform any work, and therefore none of the requirements of the MFMA were met.
60. Key governance requirements regarding risk assessment and internal control were not met since the internal audit unit did not function during the year under review and there were vacancies in key positions. Due to the provincial intervention no steps were taken to fill these positions and to address the shortcomings.
61. Prior year audit findings were not addressed due to the fact that key positions were vacant and the municipality was subject to the audit of the two years prior to the year under review as well as the current period under review. There was only one PROPAC resolution that was still not implemented.
62. Performance information requirements were not met due to the fact that there were no personnel in key positions during the year under review to attend to the requirements.

Investigations

63. A special investigation on request of the MEC for Local Government and Housing is being conducted to probe alleged irregularities with regard to expenditure and the administration of VAT. No report has been issued at the reporting date.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

64. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

65. In terms of section 121(3)(c) of the MFMA the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

66. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
67. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
68. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the review findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

69. The Phumelela Local Municipality did not adopt 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 in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations.
70. No annual performance report of the municipality was prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA
71. The municipality did not appoint a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations.
72. The Phumelela Local 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 in terms of section 45 of the MSA.
73. The integrated development plan of the Phumelela 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.
74. Contrary to section 53 of the MFMA the service delivery budget implementation plan was submitted 60 days late.

APPRECIATION

75. The assistance rendered by the staff of the Phumelela Local Municipality during the audit is sincerely appreciated.

Auditor-General

Bloemfontein

19 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence