

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
INFORMATION OF THE FINANCIAL STATEMENTS AND PERFORMANCE
OF THE PHUMELELA LOCAL MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Phumelela Local Municipality which comprise the balance sheet as at 30 June 2009, the income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages XX to XX.

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 note 1 and in the manner required by the Local Government Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMMA) 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) and section 126(3) of the MFMA, 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

Income

4. For reasons listed below, I was unable to obtain sufficient appropriate audit evidence as to the occurrence, completeness, accuracy and cut-off of income of R59 658 645 as disclosed in the income statement:

(a) Rental or lease agreements to support rental income from municipal properties amounting to R305 433 (30 June 2008: R267 286) could not be provided. In the absence of sufficient appropriate audit evidence, I was unable to conclude on the occurrence, completeness and accuracy of the rental income included in community service income totalling R25 890 839. Due to the lack of documentation, no alternative procedures could be performed.

(b) In terms of accounting policy note 12, the municipality should recognise electricity and water charges when the meters are read and billed on a monthly basis. Where meters cannot be read during a particular month, charges are based on an estimate of the electricity and water consumption and the necessary adjustments are made in the next month that the meters are read. Contrary to the accounting policy, the municipality did not make estimates where meters were not read. Due to the lack of

- adequate records, I could not perform alternative procedures to obtain sufficient appropriate audit evidence to conclude on the completeness of income from trading services amounting to R17 488 793. This matter was also reported in the audit report for the year ended 30 June 2008.
- (c) Contrary to paragraph 52 of the Statement of Generally Accepted Accounting Practice for Local Government, GA 100 *Framework for the Preparation and Presentation of Financial Statements by Local Government*, equitable share was incorrectly classified in the income statement. Consequently, community services income as disclosed in the income statement was understated by R18 750 968 (30 June 2008: R14 521 667) and trading services income, economic services income and subsidised services income as disclosed in the income statement were overstated by R10 300 963 (30 June 2008: R7 382 500), R7 478 260 (30 June 2008: R6 217 136) and R922 031 (30 June 2008: R822 931), respectively.
- (d) I could not be provided with receipts for the proceeds from the sale of prepaid electricity amounting to R1 498 759, included in economic services income in the income statement. Due to lack of records and receipt documentation, no reasonable alternative procedures could be performed to confirm the completeness, occurrence and accuracy of prepaid electricity sales. This matter was also reported in the audit report for the year ended 30 June 2008.
- (e) An unexplained difference of R9 228 858 was identified between the approved valuation roll and the valuation roll on the system, which is used to levy property rates and taxes. I was thus unable to perform all the procedures that I deemed necessary to confirm the occurrence, completeness and accuracy of assessment rates amounting to R2 500 887 (30 June 2008: R3 117 469) included in rates and general services in the income statement.
- (f) A difference of R1 902 314 was identified between the amount recognised as interest on arrear debtors and the recalculated amount in the previous financial year, resulting in the corresponding figures being misstated. Interest disclosed in the income statement and consumer debtors as disclosed in note 7 to the financial statements were understated by this amount.
- (g) Supporting documentation could not be provided for journals with a net debit impact of R1 870 693 on the corresponding (due to prior year limitations) and current year's balance of income. Consequently, I could not confirm the accuracy, occurrence and classification of these journals. Due to a lack of documentation, I was unable to perform reasonable alternative audit procedures.
- Fixed assets**
5. For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness, valuation as well as rights and obligations of fixed assets with a cost of R168 237 495 (30 June 2008: R158 148 326) and related loans redeemed and other capital receipts to the value of R166 460 059 (30 June 2008: R156 269 450) as disclosed in note 4 to the financial statements:
- (a) The descriptions, serial numbers, locations and conditions of items as indicated in the fixed asset register were inadequate. Furthermore, I could not be provided with evidence to confirm that asset verifications had been conducted during the financial year. Consequently, I was unable to perform all the audit procedures that I deemed necessary to verify the existence, valuation and completeness of fixed assets or to confirm the rights and obligations thereof. This matter was also reported in the audit report for the year ended 30 June 2008.

- (e) A list of bad debts that had been approved to be written off could not be provided. Therefore, I was unable to determine whether the bad debts of R6 458 181 written off during the previous financial year had been authorised. Consequently, I could not confirm the occurrence and accuracy of the corresponding figures for bad debts written off as disclosed in note 7 to the financial statements. Material weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
- (d). Supporting documentation could not be submitted for journals that had a net debit impact of R1 473 068 on the corresponding (due to prior year limitations) and current year's balance as disclosed in note 7 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. Material weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
- (c) Included in debtors as disclosed in note 7 to the financial statements was a VAT receivable amounting to R346 174. Due to the lack of appropriate audit evidence for the VAT receivable, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of the amount receivable and to perform reasonable alternative audit procedures.
- (b) Included in cash and bank as disclosed in note 10 to the financial statements were unallocated deposits amounting to R519 277. Consequently, consumer debtors were overstated by R519 277 and cash and bank understated by the same amount. The value-added tax (VAT) implications on these unallocated deposits were also uncertain and had not been considered. Due to the lack of information on the unallocated receipts, no alternative procedures could be performed.
- (a) The debtors' aging as disclosed in note 7.2 to the financial statements reflected that outstanding days of debtors were in excess of 1 000 days. Inadequate provision for bad debts was made, resulting in consumer debtors being overstated by R12 295 422 and the provision for bad debt being understated by the same amount.
6. For reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, existence, valuation, allocation as well as rights and obligations of consumer debtors to the value of R13 810 624 as disclosed in note 7 to the financial statements:

Debtors

- (b) Municipal properties according to the title deed listing could not be agreed to a fixed asset register. Therefore, I was unable to confirm the rights and obligations of fixed assets. This matter was also reported in the audit report for the year ended 30 June 2008.
- (c) Supporting documentation could not be provided for journals that had a net debit impact of R14 729 633 on the corresponding (due to prior year limitations) and current year's balance of fixed assets and a net credit impact of R15 924 204 on loans redeemed as disclosed in note 4 to the financial statements for the financial year ended 30 June 2008. Consequently, I could not confirm the valuation, rights and obligations as well as allocation of these journals. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Creditors

7. For the reasons as detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation and allocation of trade and sundry creditors to the value of R6 673 184 as disclosed in note 9 to the financial statements:

(a) Included in creditors was an amount of R206 599 that represented cancelled cheques to creditors. These cancelled cheques were replaced and payments to the creditors were made, resulting in expenditure being duplicated. Creditors and expenditure were overstated by R206 599.

(b) Expenditure transactions to an amount of R298 567 were not recorded in the financial records of the municipality. Expenditure and creditors as disclosed in note 9 to the financial statements were understated by R298 567, resulting in the accumulated deficit being understated by this amount.

(c) Supporting documentation could not be provided for journals with a net debit impact of R1 306 738 on the corresponding (due to prior year limitations) and current year's balance for creditors as disclosed in note 9 to the financial statements, resulting in a limitation on the opening balance included in creditors for the current year. Consequently, the valuation, allocation as well as rights and obligations of these journals could not be confirmed. Material weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

(d) In terms of section 20 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991), a vendor may only claim a deduction for input VAT on the basis of a tax invoice that contains the details as required by the act. Contrary to the above, the municipality claimed input VAT to the value of R938 604 without valid tax invoices. Creditors and expenditure were understated by this amount.

Employee-related costs

8. Due to material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with appropriate supporting documentation for salaries amounting to R1 830 310 (30 June 2008: R668 700). Due to the lack of employee files, there were also no alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence pertaining to salaries paid.

Funds and reserves

9. Funds and reserves (capital development fund and erven trust fund) as disclosed in note 1 to the financial statements were not covered by investments. A deficit of R13 596 540 (30 June 2008: R8 068 967) existed between the statutory funds and the funds invested externally. The municipality is currently experiencing cash flow difficulties and it would appear that the municipality will not raise sufficient cash to be utilised for projects. I was unable to obtain sufficient appropriate audit evidence as to the existence and valuation of the statutory funds.

10. Supporting documentation could not be provided with regard to journals with a net credit impact of R206 420 on the corresponding (due to prior year limitations) and current year's balance of the accumulated deficit as disclosed in the balance sheet and income statement for the financial year ended 30 June 2008. Consequently, I could not obtain sufficient appropriate audit evidence with regard to the valuation,

17. 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

Provisions

16. Included in the investments disclosed in note 5 to the financial statements was a loan to the Krynaawwust Boerdery Trust amounting to R678 586. Due to a lack of supporting information to substantiate the loan, I was unable to confirm the valuation, existence and completeness of this loan as well as the municipality's rights regarding this loan.
15. Supporting documentation could not be provided for journals with a net debit impact of R675 065 on the corresponding (due to prior year limitations) and current year's balance of investments as disclosed in note 5 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
14. The municipality was unable to provide me with sufficient appropriate audit evidence for an investment amounting to R308 368 (30 June 2008: R308 378). Due to the absence of third-party confirmations, there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance pertaining to the valuation of this investment. Consequently, I was unable to obtain sufficient appropriate audit evidence regarding the valuation of this investment as disclosed in note 5 to the financial statements.

Investments

13. Supporting documentation could not be obtained for journals with a net debit impact of R399 679 on the corresponding (due to prior year limitations) and current year's balance of inventory as disclosed in note 6 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
12. As the municipality did not maintain a proper inventory system, I was unable to verify the existence, completeness and valuation of inventory items of R580 597 (30 June 2008: R389 618) as disclosed in note 6 to the financial statements. In the absence of proper documented registers, reconciliations and documentation on inventory movements, there were no reasonable alternative procedures that I could perform to obtain reasonable assurance pertaining to the disclosed inventory balance.

Inventory

11. Supporting documentation could not be provided for journals with a net credit impact of R6 281 148 on the corresponding (due to prior year limitations) and current year's balance for the accumulated deficit as disclosed in the balance sheet and income statement. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

Accumulated deficit

allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

24. Lease agreements for payments of R1 093 718 (30 June 2008: R197 041) could not be provided. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance to verify the terms of these agreements. Consequently, I was unable to confirm the accuracy, occurrence and classification of the lease expenses included in community services expenditure amounting to R31 429 088 as disclosed in the income statement.

Expenditure

23. Supporting documentation could not be provided for journals with a net debit impact of R528 804 on the corresponding (due to prior year limitations) and current year's balance of bank as disclosed in note 10 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

Bank

22. It is the municipality's policy to provide for retirement and post-retirement medical aid benefits for certain of its employees. I could not obtain an actuarial valuation to confirm that the pension fund and medical aid fund were financially sound and that the municipality had no liability in respect of unfunded benefits. Management could not provide me with detailed calculations or actuarial valuations to calculate the municipality's obligations in respect of these potential unfunded pension fund and post-retirement medical aid liabilities. As a result, I could not confirm the completeness and valuation of the pension fund and post-retirement medical aid liabilities at year-end.
21. A provision for annual bonuses was not made. The municipality was unable to provide me with a detailed calculation. Due to the reasons listed in paragraph 8, I did not confirm the completeness of the provision for annual bonuses at year-end.
20. Salary costs were used in the leave liability calculation. For the reasons listed in paragraph 8, I could not obtain reasonable assurance for salaries paid. As a result, I could not obtain sufficient appropriate audit evidence pertaining to the leave liability amounting to R3 067 982.
19. In terms of section 31A of the Environment Conservation Act, 1989 (Act No. 73 of 1989), any activity performed that causes the environment to be damaged or detrimentally affected should, at the expense of the municipality, be rehabilitated. The municipality did not provide for rehabilitation liabilities as a result of the damage caused to the environment due to the refuse removal site. The municipality was unable to provide me with a detailed calculation of the rehabilitation liability. As a result, I did not obtain sufficient appropriate audit evidence as to the completeness and valuation of the rehabilitation provision at year-end.
18. Supporting documentation could not be provided for journals with a net debit impact of R314 237 on the corresponding (due to prior year limitations) and current year's balance of provisions as disclosed in note 8 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
- Annual Financial Statements for Local Authorities (second edition 1996, as amended) require the note on provisions to exclude the provision made for bad debts. Provisions as disclosed in note 8 to the financial statements were therefore overstated by R41 222 245 (30 June 2008: R42 831 829).

The financial statements did not indicate that corresponding information had been restated. Management could not provide me with sufficient appropriate audit evidence to confirm the restatements. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

Income statement	2008 financial statements	2009 financial statements corresponding figures	Difference
Income – economic services	12 637 591	13 285 381	(647 790)
Expenditure – economic services	11 558 796	12 206 586	(647 790)
Note 24 – grants and subsidies			
Provincial government grants	3 000 000	3 032 751	(32 751)
Note 24.3.1 – provincial government grants			
Current year receipts	3 000 000	2 500 000	500 000
Transferred to income/expenditure	3 000 000	2 500 000	500 000

29. The following corresponding information was restated in the financial statements for the year ended 30 June 2009:

Corresponding information

- 28. Supporting documentation could not be provided for journals with a net debit impact of R1 896 485 on the corresponding (due to prior year limitations) and current year's balance of expenditure as disclosed in the income statement. Consequently, I could not confirm the accuracy, allocation and occurrence of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.
- 27. The municipality was unable to provide me with adequate supporting documentation regarding differences of R229 368 identified pertaining to the remuneration of managers for the year ended 30 June 2008. I was unable to determine the accuracy and completeness of the corresponding remuneration figures as disclosed in the note to the financial statements.
- 26. Due to material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with sufficient appropriate audit evidence regarding expenditure transactions of R7 230 174 for the year ended 30 June 2008. Consequently, I was unable to perform reasonable alternative procedures to obtain sufficient appropriate audit evidence as to the occurrence, accuracy and classification of the corresponding expenditure balance as disclosed in the income statement.
- 25. The municipality purchased stock amounting to R352 649 that had not been accounted for in the prior years. It was incorrectly recognised in the current financial statements as other general expenditure. Accordingly, both other general expenditure and the accumulated surplus/(deficit) were understated by R352 649.

34. The municipality incurred irregular expenditure of R4 366 598 (30 June 2008: R8 569 057) as a result of contravening legislative requirements. This resulted in irregular expenditure that was not disclosed in the notes to the financial statements as required by section 125(2)(d) of the MFMA.

Irregular expenditure

33. The municipality did not make any disclosure in the financial statements regarding the municipality's future capital commitments, as required by the IFRS standards. In the absence of an adequate contract register and records on capital contracts awarded, I was unable to determine the value of capital commitments that should have been disclosed. Therefore, the completeness of commitments could not be confirmed. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

Capital commitments

32. Supporting documentation could not be provided for journals with a net credit impact of R782 632 on the corresponding (due to prior year limitations) and current year's balance of long-term liabilities as disclosed in note 2 to the financial statements. Consequently, I could not confirm the valuation, allocation as well as rights and obligations of these journals. The weaknesses in the municipality's records did not permit the performance of reasonable alternative audit procedures.

Long-term liabilities

31. In accordance with disclosure note 22, the municipality disclosed contingent liabilities amounting to R23 263 831. Correspondence from the municipality's attorneys confirmed additional possible claims to the value of R1 582 587. In addition to these claims, a review of minutes of council meetings subsequent to year-end revealed a contingent liability of R579 818 relating to a possible claim against the municipality. Contingent liabilities are thus understated by the above claims not disclosed of R2 162 405.

Contingent liabilities

	Current disclosure	Classification errors	Fair presentation
Income	59 658 645	-	59 658 645
Community services	25 890 839	18 750 968	44 641 807
Subsidised services	979 241	(971 745)	7 496
Economic services	15 299 722	(7 478 260)	7 821 462
Trading services	17 488 793	(10 300 963)	7 187 830
Current assets	14 003 285	-	14 003 285
Cash and bank	192 661	519 277	711 938
Accounts receivable	13 810 624	(519 277)	13 291 347

30. The financial statements contained classification errors, of which the most significant are the following:

Disclosure errors

Fruitless and wasteful expenditure

35. The municipality incurred fruitless and wasteful expenditure of R486 775 (30 June 2008: R160 739) as this expenditure could have been avoided with reasonable care. This expenditure was not disclosed in the notes to the financial statements as required by section 125(2)(d) of the MFMA.

Unauthorised expenditure

36. The municipality incurred unauthorised expenditure of R 7 435 965 (30 June 2008: R13 337 573) due to overexpenditure on certain votes of the budget, which was not disclosed in the notes to the financial statements as required by section 125(2)(d) of the MFMA.

Going concern

37. As a result of the matters described in the basis for disclaimer of opinion paragraphs, the municipality may be in a worse financial position than the position reflected in the financial statements. The difficulties experienced by the municipality in recovering all debts due to it, as well as the potential negative effect of this tendency on the cash flows of the municipality, and the fact that liabilities exceeded assets by R3 781 298, indicated that there is a risk that the municipality may be exposed to serious financial problems.

Disclaimer of opinion

38. Because of the significance of the matters 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 on which I do not express a disclaimer of opinion:

Basis of accounting

39. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the MFMA.

Other matters

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

Material inconsistencies in information included in the annual report

40. I have not obtained the other information included in the annual report and have not been able to identify any possible material inconsistencies with the financial statements.

Unaudited supplementary schedules

41. The supplementary information set out on pages 30 to 37 (Annexures A to F) does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly do not express an opinion on them.

Par. no.	Basis for disclaimer of opinion				
	CE	RA	CA	IC	M
4	2		3,5	1	1
5	7		3	1	
6	7		2,6		
7	7		3,5		
8					1

49. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the 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. In some instances deficiencies exist in more than one internal control component.

Internal control deficiencies

48. 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:

Governance framework

47. Contrary to section 80 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), the municipality did not have service level agreements with all its service providers.

Municipal Systems Act, 2000 (Act No. 32 of 2000)

46. Contrary to section 62(c)(i) of the MFMA, the municipality had not implemented an approved fraud prevention plan.
45. All money owing by the municipality was not paid within 30 days of receiving the relevant invoice or statement as required by section 65(2)(e) of the MFMA.
44. The municipality did not disclose all areas of non-compliance with the MFMA in the notes to the financial statements in terms of section 125(e) of the MFMA.
43. Contrary to section 64(2)(a) of the MFMA, the municipality did not have an effective revenue collection system.
42. Contrary to section 64(3) of the MFMA, the municipality did not inform the National Treasury of accounts amounting to R4 605 734 (30 June 2008: R2 876 513) belonging to organs of state, which had been outstanding for more than 30 days.

Municipal Finance Management Act, 2003 (Act No. 56 of 2003)

Non-compliance with applicable legislation

Par. no	Basis for disclaimer of opinion					CE	RA	CA	IC	M
9	Funds and reserves	7		5						
11	Accumulated deficit	2		3,5	1					1
12	Inventory	7		4						
14	Investments			4						
17	Provisions	7								1
23	Bank	7		4,5						
24	Expenditure			3	1					
29	Corresponding information	7								1
30	Disclosure errors	7								1
31	Contingent liabilities	7								1
32	Long term liabilities	7								1
33	Capital commitments			4						
34	Irregular expenditure in terms of the MFMA	7		4						
35	Fruitless and wasteful expenditure in terms of the MFMA	7		4						
36	Unauthorised expenditure in terms of the MFMA	7		4						

Overall reflections on the governance framework based on internal control deficiencies

50. The disclaimer of opinion is attributed to the inability of the accounting officer to appoint a full-time chief financial officer to assume control over the finance section, resulting in the finance section not being adequately monitored and supervised. The finance staff were not adequately trained to ensure that transactions and events were appropriately recorded as they occurred. There was no proper system to ensure that documentation was appropriately filed and safely stored for audit purposes. As a result of frequent changes in management, financial delegations were amended and sometimes not implemented to ensure accountability. Although the municipality obtained the services of financial consultants, they had not been given appropriate authority and delegations to enable adequate monitoring and supervision required for accurate reporting.

Legend	
CE – Control environment	
1	The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.
2	Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.
3	Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.
4	Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.
5	The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.
6	Management's philosophy and operating style do not promote effective control over financial reporting.
7	The entity does not have individuals competent in financial reporting and related matters.
RA – Risk assessment	
1	Management has not specified financial reporting objectives to enable the identification of

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	X	
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.	X	
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	X	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	X	
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		X
	• The municipality had an audit committee in operation throughout the financial year.		

51. 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:

Key governance responsibilities

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 potential for material misstatement due to fraud is not considered.
4	The entity does not determine a risk strategy/action plan to manage identified risks.
5	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.
3	Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
4	Actions are not taken to address risks to the achievement of financial reporting objectives.
5	Control activities are not selected and developed to mitigate risks over financial reporting.
6	Policies and procedures related to financial reporting are not established and communicated.
7	Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.
IC = Information and communication	
1	Pertinent information is not identified and captured in a form and time frame to support financial reporting.
2	Information required to implement internal control is not available to personnel to enable internal control responsibilities.
3	Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.
M = Monitoring	
1	Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.
2	Neither reviews by internal audit or the audit committee nor self-assessments are evident.
3	Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.

55. A special investigation was conducted to probe alleged irregularities with regard to expenditure and the administration of VAT. No report had been issued at the reporting date.

Investigations

54. The municipal council had not appointed an audit committee and thus the internal audit section did not function effectively.

53. The post of chief financial officer has been vacant for an extended period of time, resulting in a lack of oversight, monitoring and supervision.

52. Key governance requirements were not met as a result of a lack of adequate skills in the finance section due to overreliance on consultants.

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

No.	Matter	Y	N
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 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. The internal audit function operates in terms of an approved internal audit plan. The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	X	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(1)(c)(i) of the MFMA.	X	
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	X	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	X	
14.	SCOPA/oversight resolutions have been substantially implemented.	X	
Issues relating to the reporting of performance information			
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 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	

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

56. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

57. 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 MSA.

The Auditor-General's responsibility

58. 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.

59. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgment.

60. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below

Findings (performance information)

Non-compliance with regulatory requirements

61. The municipality had not designed, adopted and implemented a performance management system that is commensurate with its resources, best suited to its circumstances and aligned to its priorities, objectives, indicators and targets; and did not monitor and review its performance management system as required by sections 38 and 40 of the MSA, as no performance information was submitted for auditing.

62. The deficiencies relating to performance information are due to the failure by the accounting officer to ensure that a performance management system was approved and adopted by the council and that appropriate skills were obtained to manage and implement the system effectively. The municipal council did not fulfill its oversight responsibility to ensure that the required systems were implemented.

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

APPRECIATION

Auditor-General
Bloemfontein

30 November 2009



**AUDITOR-GENERAL
SOUTH AFRICA**

Auditing to build public confidence