



A U D I T O R - G E N E R A L

The Accounting Officer
Emalahleni Municipality
37 Indwe Street
Lady Frere
5410

30 November 2012

Reference: 21307REG11/12

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Emalahleni Municipality for the year ended 30 June 2012.

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and

the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

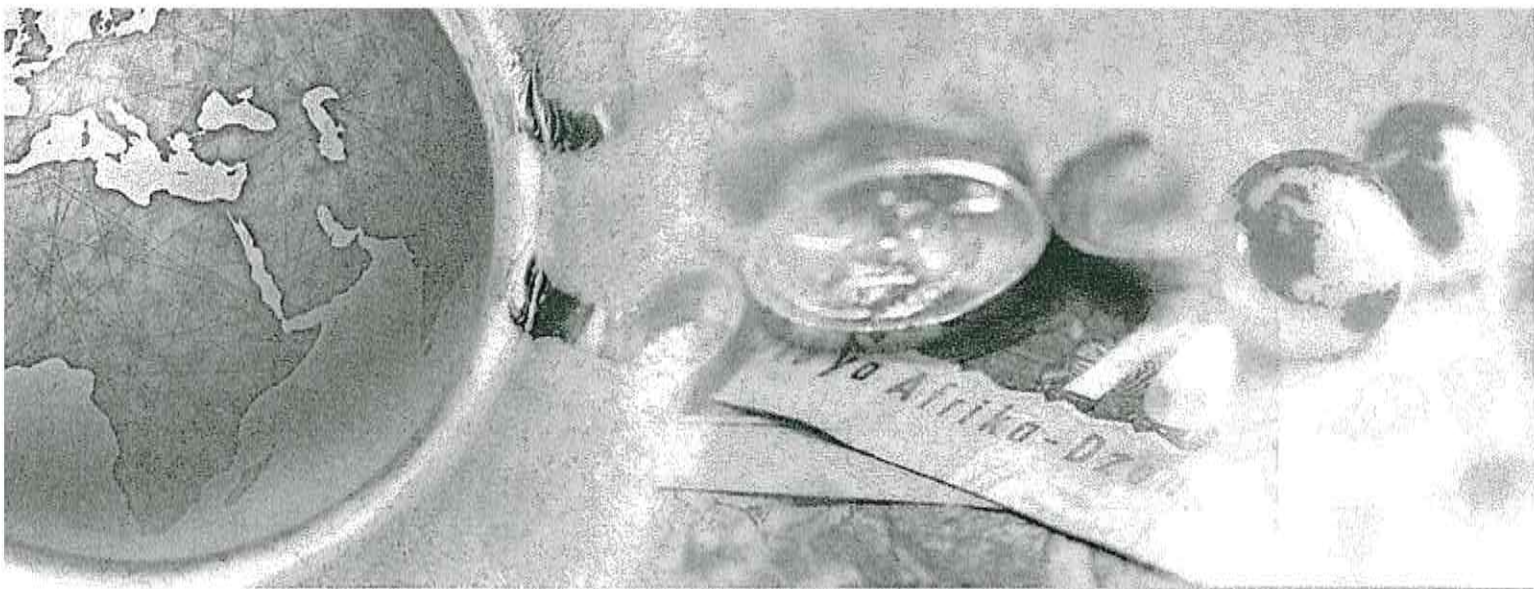
Yours sincerely

Signed



Rama Purushothaman (EL03)

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AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Audit Report

Emalahleni Municipality

For the Year ended 30 June 2012

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON EMALAHLENI MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Emalahleni Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa 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 the financial statements based on conducting the audit in accordance with the International Standards on Auditing and General notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

4. I draw attention in respect of these matters:

Corresponding figures

5. In my previous audit report dated 30 November 2011, I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2011. This was due to significant uncertainties and a limitation of scope on the audit. It is not known if adjustments have been effected to the financial statements to correct the matters raised in the previous audit report as sufficient appropriate audit evidence was not submitted. The prior year uncertainties and scope restrictions have an effect on the accumulated surplus and statement of financial position items. The municipality has not addressed the issues raised in the previous audit report as required by section 131 (1) of the MFMA.

Unauthorised expenditure

6. Unauthorised expenditure incurred during the current year of R74.7 million (2011: R2.5 million) is disclosed in note 35.1 to the financial statements. I am unable to verify this amount as sufficient appropriate documentation was not submitted. Additional unauthorised expenditure of R4.2 million was identified during the audit process. The municipality did not submit all requested information and numerous errors were

identified within the accounting records. The budget of the municipality was also not submitted for audit. I am unable to confirm this amount by alternative means. As a result, I am unable to conclude on the full extent of the unauthorised expenditure incurred during the year.

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. Audited payments amounting to R5.5 million (2011: R18.3 million) were irregular as they were made in contravention of the supply chain management requirements. The amount was not disclosed as irregular expenditure in note 35.3 to the financial statements. It was not practical to determine the full extent of the understatement as there was no system of control in place to identify all irregular expenditure incurred.

Fruitless and wasteful expenditure

8. Fruitless and wasteful expenditure incurred during the year of R24 824 is disclosed in note 35.2 to the financial statements. I am unable to verify this amount as sufficient appropriate documentation was not submitted. Additional fruitless and wasteful expenditure of R430 639 was identified during the audit process. The municipality did not submit all requested information and numerous errors were identified within the accounting records. I am unable to confirm this amount by alternative means. As a result, I am unable to conclude on the full extent of the fruitless and wasteful expenditure incurred during the year.

Cash and cash equivalents

9. Cash and cash equivalents is disclosed in the statement of financial position and note 16 to the financial statements. Cash at banks of R30.2 million indicated in the general ledger does not agree to the amount of R45.6 million confirmed by the banks and I am unable to reconcile an amount of R15.4 million by alternative means.
10. A cash suspense account of R12 million is included in call investment deposits in note 16 to the financial statements. The municipality did not clear this account during the year. This account is utilised to record transactions that could not be adequately identified and balance the bank reconciliations without any investigations into the nature of these transactions. In addition, these transactions could not be supported by sufficient and appropriate audit evidence. I am unable to confirm the cash suspense account by alternative means.
11. The municipality did not submit sufficient appropriate audit evidence for cheques presented for payment subsequent to year end amounting to R482 263. I am unable to confirm which financial year these payments relate to by alternative means.
12. As a result of the above findings, I am unable to determine the extent to which cash and cash equivalents of R42.4 million (2011: R43.8 million) may be misstated. I am also unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.

Revenue

13. Interest earned on outstanding receivables as disclosed in the statement of financial performance is R5.6 million (2011: R2.2 million). The municipality did not apply the correct interest rate during the year on outstanding receivables. The interest on receivables is also being calculated by the debtors system without taking into account the *in duplum* rule in section 103 (5) of the National Credit Act, 2005 (Act No. 34 of

2005), which states that interest stops accumulating when the unpaid interest equals the outstanding capital. I am unable to confirm the effect of the above on interest earned on outstanding receivables by alternative means.

14. The rates revenue of R3.4 million (2011: R2.3 million) is disclosed in the statement of financial performance and note 17 to the financial statements. As no reconciliation of the valuation roll was performed, the valuation roll did not agree to the details on the debtors' system. I am unable to confirm this amount by alternative means.
15. Water revenue of R3.1 million is included in service charges of R14.7 million as disclosed in the statement of financial performance and note 19 to the financial statements. I was unable to verify the amount due to supporting documentation not being submitted for audit purposes. I am unable to confirm if the water revenue is properly recorded by alternative means.
16. Interest earned on external investments disclosed in the statement of financial performance of R1.9 million does not agree to the amount of R2.5 million confirmed by the banks and I am unable to reconcile an amount of R600 000 by alternative means.
17. Electricity revenue amounting to R5.8 million (2011: R5.3 million) is included in service charges of R14.7 million as disclosed in the statement of financial performance and note 19 to the financial statements. The municipality's debtor's system failed to fully integrate with the accounting system. I am unable to confirm the electricity revenue by alternative means.
18. Documentation supporting transactions totaling R220 798 was not submitted for audit. I am unable to confirm these transactions by alternative means.
19. As a result of the above findings, I am unable to determine whether any adjustments relating to revenue of R125.7 million (2011: R97.7 million) as disclosed in the statement of financial performance and notes 17, 18, 19 and 20 to the financial statements is necessary.
20. GRAP 13, *Leases*, states that lease revenue from operating leases shall be recognised as revenue on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefit derived from the leased asset is diminished. The municipality did not account for operating lease revenue on the straight line basis during the financial year. Consequently, rental of facilities and equipment as disclosed in the statement of financial performance is understated by R896 697. Additionally, operating lease asset as disclosed in the statement of financial position and note 15 to the financial statements is understated by the same amount.

Receivables from exchange transactions

21. The net trade receivables from exchange transactions balance of R27.1 million is disclosed in the statement of financial position and note 13 to the financial statements. The municipality's debtors as disclosed in note 13 to the financial statements could not be verified as a title deed search failed to provide evidence over the existence of certain debtors. I am unable to confirm these debtors by alternative means.
22. As a result of the matter raised in paragraph 21 I am unable to verify if the amount raised as a provision for impairment as disclosed in note 13 to the financial statements of R71.4 million (2011: R22.4 million) and the relating debt impairment of R45.2 million as disclosed in the statement of financial performance and note 23 to the financial statements is adequate.

23. In terms of IAS 39, *Financial Instruments*, trade and other receivables should be stated at their present value in the financial statements as at year end, with the difference between the nominal amount and the present value recognised as interest income over the financing period. I am unable to determine the effect on receivables and accumulated surplus, even after performing alternative procedures, as not all debtors have been included on the municipality's debtors system and the debtors system failed to fully integrate with the accounting system.
24. Documentation supporting debtors' balances totalling R513 624 was not submitted for audit purposes. I am unable to confirm these balances by alternative means.
25. An amount of R25 million is disclosed in note 13 to the financial statements as owing by the district municipality. A confirmation obtained directly from the district municipality did not agree to this amount. The municipality did not reconcile the difference of R21.3 million. I am unable to confirm this debt by alternative means.
26. The water services contract between the municipality and the district municipality states that a management fee is payable by the district municipality for the services provided by the municipality. The management fee was not received or raised by the municipality in the current year. The preparer of the contract omitted the annexure which states the determination of the amount of the management fee. I am unable to confirm the amount of the management fee accrual by alternative means.
27. As a result of the above findings, I am unable to determine whether any adjustment relating to receivables from exchange transactions of R27.1 million (2011: R29.2 million) as disclosed in the statement of financial position and note 13 to the financial statements is necessary.
28. Debtors with credit balances amounting to R156 245 have been included in receivables from exchange transactions. The municipality did not reclassify these as payables from exchange transactions. Consequently, receivables from exchange transactions are understated by R156 245. Additionally, payables from exchange transactions are understated by the same amount.

Property, plant and equipment

29. Ownership of land and buildings disclosed in the statement of financial position and in note 9 to the financial statements of R13.9 million (2011: R14.2 million) could not be confirmed as title deeds could not be obtained for certain properties. I am unable to confirm these properties by alternative means.
30. Infrastructure assets included in the amount of R268.9 million (2011: R286.1 million) as disclosed in the statement of financial position and note 9 to the financial statements could not be physically verified. Some infrastructure assets were duplicated on the fixed asset register. The municipality could not provide confirmation of the rights to certain infrastructure assets. I am unable to obtain sufficient appropriate audit evidence for the cost per unit used in the fair valuing of infrastructure assets. I am unable to confirm these assets by alternative means.
31. Documentation supporting additions during the year of R740 535 was not submitted by the municipality. I am unable to confirm these transactions by alternative means.
32. Depreciation amounting to R19.8 million is included in the statement of financial performance, note 9 and note 24 to the financial statements. The municipality could not provide sufficient appropriate audit evidence to confirm some asset's useful lives and residual values. I am unable to confirm the depreciation charge by alternative means.

33. The municipality has incorrectly accounted for missing assets of R577 880 as impaired assets. This was due to council resolution not being obtained to dispose of the assets prior to the preparation of the financial statements. Infrastructure assets and land and buildings as disclosed in the financial statements do not agree to the amount per the general ledger. Both balances differ by R14.9 million. The municipality did not provide a reconciliation of this difference. I am unable to confirm this difference by alternative means.
34. GRAP 21, *Impairment of Non-Cash Generating Assets*, and GRAP 26, *Impairment of Cash Generating Assets*, prescribes that an entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable service amount of the asset. The municipality did not assess its assets for possible impairment at year end. I am unable to confirm if any assets are impaired at year end by alternative means.
35. As a result of the above findings, I am unable to determine whether any adjustments relating to property, plant and equipment in the financial statements is necessary.
36. Deregistered motor vehicles have been included in the municipality's fixed asset register. The municipality did not remove these motor vehicles from their fixed asset register upon disposal of the motor vehicles. Consequently, other assets included in property, plant and equipment is overstated by R3.8 million and expenditure is understated by the same amount.

Investment property

37. Ownership of investment properties disclosed in the statement of financial position and in note 10 to the financial statements of R6 million could not be confirmed as title deeds could not be obtained for certain properties. It is not possible to confirm these properties by alternative means.
38. Some properties identified during a title deeds search could not be traced to the investment properties register or the fixed assets register. I am unable to determine which of these properties are investment properties. It is not possible to confirm investment properties by alternative means.
39. GRAP 16, *Investment Property*, encourages entities to disclose the fair value of investment property when this is materially different from the carrying amount when accounting for investment properties on the cost model. The municipality did not perform a fair value calculation of their investment properties in the current year. As a result, I am unable to determine if the fair value of investment properties is materially different from the carrying amount and cannot conclude if the fair value should be disclosed in the financial statements.
40. As a result of the above findings, I am unable to determine if any adjustments relating to the amount of R25 million (2011: R25 million) as disclosed in the statement of financial position and note 10 to the financial statements is necessary.

Expenditure

41. Other expenditure comprising debt impairment, depreciation and amortisation, impairments, repairs and maintenance, actuarial losses, finance charges, bulk purchases, other operating grant expenditure and general expenses of R131.3 million as disclosed in the statement of financial performance and notes 23, 24, 2, 25, 26, 27 and 28 to the financial statements do not agree to the balance of R130.8 million per the general ledger. The municipality did not reconcile the difference of R500 000 between

the financial statements and the accounting records. The municipality's records did not permit the application of alternative procedures. I am unable to determine the effect on the other account balances or classes of transactions contained in the financial statements.

42. Documentation supporting transactions amounting to R7.6 million was not submitted for audit. I am unable to confirm these transactions by alternative means.
43. Sufficient appropriate documentation was not submitted to support the transfer of grant expenditure amounting to R6.7 million to revenue. I am unable to confirm this amount by alternative means.
44. The municipality did not disclose operating lease expenditure in accordance with the requirements of GRAP 13, *Leases*, which prescribes certain additional disclosures to that of GRAP 104, *Financial Instruments*. I am unable to determine how the municipality's operating lease expenditure should be disclosed as sufficient appropriate audit evidence was not submitted.
45. As a result of the above findings, I am unable to determine whether any adjustment to other expenditure of R131.3 million (2011: R62.9 million) in the financial statements is necessary.
46. The municipality did not claim input VAT on some transactions. The full value of the tax invoice was processed to expenditure. Consequently, expenditure is overstated and VAT is understated by R49 339.
47. GRAP 17, *Property, Plant and Equipment*, prescribes that the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the entity. General expenditure is disclosed in the statement of financial performance and note 28 to the financial statements. Included in this amount is an amount of R3.5 million, incurred in respect of an electrification project for the construction of electricity assets. This amount has been incorrectly expensed and should be capitalised as the revenue associated with the assets is an economic benefit that flows to the municipality. The municipality has recognised revenue from the sale of prepaid electricity in the accounting records derived from these electricity assets and property, plant and equipment is, thus, understated by the above amount.

Payables from exchange transactions

48. Sufficient appropriate audit evidence was not submitted to support payables from exchange transactions of R6.5 million (2011: R3.7 million) disclosed in the statement of financial position and note 6 to the financial statements. I am unable to confirm this balance by alternative means. Consequently, I am unable to determine whether any adjustment relating to payables from exchange transactions in the financial statements is necessary.

Value added taxation (VAT)

49. VAT receivable of R3 million is disclosed in the statement of financial position and note 8 to the financial statements. The municipality's debtor's system failed to fully integrate with the accounting system. In addition numerous uncorrected misstatements were identified during the audit due to disagreements or limitations placed on the audit. I am unable to confirm the balance for VAT receivable by alternative means. Consequently, I am unable to determine whether any adjustments to VAT receivable of R3 million (2011: R12.1 million) in the financial statements is necessary.

Employee related costs

50. Employee related costs of R40.6 million and remuneration of councillors of R8.3 million is disclosed in the statement of financial performance and notes 21 and 22 to the financial statements. The municipality's payroll system reflecting an amount of R19.3 million failed to fully integrate with the accounting system which reflects a credit amount of R65 508. I am unable to reconcile the difference of R19.3 million by alternative means.
51. Sufficient appropriate audit evidence was not submitted for contributions to pension funds amounting to R76 370. I am unable to confirm these transactions by alternative means.
52. Leave payouts to employees during the year amounted to R553 262. Some leave payouts were calculated using the incorrect salary rates. Consequently, employee related costs is overstated by R115 308 and staff debtors are understated by the same amount. The requested applications for leave payouts by staff were not submitted in all cases. I am unable to confirm the leave payouts by alternative means.
53. As a result of the above findings, I am unable to determine whether any adjustments relating to employee related costs of R48.9 million (2011: R27 million) as disclosed in the financial statements is necessary.
54. The municipality did not comply with the upper limits of salaries for councillors as determined by Government Gazette 34869. Councillors were overpaid during the financial year. As a result, remuneration of councillors of R8.3 million as disclosed in the statement of financial performance and note 22 to the financial statements is overstated by R255 755. In addition, staff debtors are understated by the same amount.

Employee benefits

55. Employee benefits of R3.5 million is included in the statement of financial position and note 2 to the financial statements. I am unable to assess the work of the expert who performed the actuarial valuation as sufficient appropriate audit evidence was not submitted. I am unable to confirm this benefit by alternative means.
56. As a result of the above finding, I am unable to determine whether any adjustment relating to employee benefits of R3.5 million (2011: R2.6 million) as disclosed in the statement of financial position and note 2 to the financial statements is necessary.
57. Provision for performance bonuses of R1.9 million and the staff bonuses accrual of R674 343 is disclosed in current employee benefits in the statement of financial position and note 5 to the financial statements. The municipality incorrectly calculated bonuses to the value of R462 561. Consequently, current employee benefits is understated by R462 561 and employee related costs in the statement of financial performance is understated by the same amount.
58. Provision for staff leave amounting to R3.1 million is disclosed in current employee benefits in the statement of financial position and note 5 to the financial statements. GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets* defines a provision as a liability of uncertain timing or amount. It further defines an accrual as liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees. The municipality has incorrectly classified amounts accrued for vacation leave as a provision instead of an accrual in the financial statements. In addition, the municipality used the incorrect salary scales and leave days when calculating the leave provision for some

employees. Incorrect leave days were used as leave days taken by staff were not updated on the system. The provision for staff leave listing did not agree to the amount per the financial statements. I am unable to confirm the provision by alternative means. Consequently, I am unable to determine whether any adjustment relating to provision for staff leave in the financial statements is necessary.

Provisions

59. The provision for rehabilitation of landfill sites of R2.7 million (2011: R2.6 million) is disclosed in the statement of financial position and note 3 to the financial statements. The municipality did not provide for their best estimate of the expenditure required to settle the present obligation of the expected future costs to rehabilitate the landfill site in accordance with GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets*. The municipality has only provided for costs incurred for the volume of landfill sites used to date and have not considered the time value of money. It was not possible to confirm the provision by alternative means. Consequently, I am unable to determine whether any adjustment relating to this provision in the financial statements is necessary.
60. The municipality did not pay Workmen's Compensation to the Compensation Commissioner since 2005 as required by the Compensation for Occupational Injuries and Diseases Act as amended by Compensation for Occupational Injuries and Diseases Amendment Act, No 61 of 1997. The estimated amount owing including interest was not raised as a provision in accordance with GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets*. As a result, provisions as disclosed in the statement of financial position and note 3 to the financial statements and expenditure as disclosed in the statement of financial performance is understated by an amount of R17.6 million.

Commitments

61. Capital commitments of R516 455 (2011: nil) is disclosed in note 37 to the financial statements. Sufficient appropriate audit evidence was not submitted to support the information disclosed in the financial statements. I am unable to confirm the committed expenditure by alternative means. As a result, I am unable to determine the full extent of the misstatement of commitments.

Material losses

62. Distribution losses relating to the supply of electricity and water were not monitored during the year and were not disclosed in the financial statements as required by section 125(2)(d) of the MFMA. As a result, even after performing alternative procedures, sufficient appropriate audit evidence was not submitted to ascertain the full extent of any distribution losses to be reported.

Cash flow statement

63. Cash and cash equivalents as disclosed in the statement of financial position, cash flow statement and note 16 to the financial statements is R42.4 million (2011: R42.8 million). Presentation of a cash flow statement, summarising the entity's operating, investing and financing activities, is required by GRAP 2, *Cash Flow Statements*. Reconciliations of cashbook balances to the bank statements received for bank accounts held by the municipality for the year were not adequately prepared for all cashbook accounts. I cannot reconcile a difference of R15.4 million between the general ledger and amounts confirmed by the banks. The municipality has included a cash suspense account amounting to R12 million (2011: R15.4 million) in the total cash and cash equivalents