

**REPORT OF THE AUDITOR-GENERAL TO COUNCIL  
ON THE FINANCIAL STATEMENTS OF THE NQUTHU MUNICIPALITY  
FOR THE YEAR ENDED 30 JUNE 2005**

**1. AUDIT ASSIGNMENT**

The financial statements as set out on pages 8 to 22, for the year ended 30 June 2005, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 126 of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations are the responsibility of the Municipal Manager. My responsibility is to express an opinion on these financial statements, based on the audit.

**2. SCOPE**

The audit was conducted in accordance with Statements of South African Auditing Standards. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement. An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- assessing the accounting principles used and significant estimates made by management, and
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations which came to my attention and are applicable to financial matters.

The audit was completed in accordance with Auditor-General Directive No. 1 of 2005.

I believe that the audit provides a reasonable basis for my opinion.

**3. QUALIFICATION**

**3.1 Limitation of scope**

The failure to furnish various supporting documents, satisfactory explanations, working papers and accounting records to substantiate the following balance sheet and income statement amounts in the financial statements limited the scope of the audit.

Alternative audit procedures were not feasible and consequently, the following amounts could not be substantiated, during the course of the audit.

### **3.1.1 Financial system**

In terms of section 62(1) of the MFMA, "the accounting officer of a municipality, is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards." Nquthu Municipality did not keep a full and proper set of accounting records. There was no general ledger, no journals, no creditors' ledger, no debtor's ledgers, etc. The only accounting record that was in place was an incomplete cashbook. This inadequate record keeping has impacted on the audit trail resulting in a limitation of audit scope in a number of areas.

### **3.1.2 Service income**

Electricity income of R2 234 238 and refuse removal income of R1 869 294 could not be verified for completeness, accuracy and occurrence for the following reasons:

- The total revenue recorded for services could not be verified to a detailed cash receipts book nor to a detailed general ledger as these financial records were not maintained for the 2004/05 financial year.
- The monthly billings reports from uMsekeli for January 2005 to June 2005 could not be located.
- Although tariffs were approved by Council, no copy of the actual approved tariffs could be found.
- No evidence could be found that the legislative requirements of the KwaZulu-Natal Local Authorities Ordinance, 1974 (No. 25 of 1974) as well as section 75A of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000), in respect of advertising the tariffs for the 2004-2005 financial year were complied with.
- No service level agreement, for the 2004/05 financial period, between Nquthu Municipality and uMsekeli could be located.

### **3.1.3 Inadequate salaries, wages and allowances records**

Salaries, wages and allowances of R9 750 092 could not be verified for completeness and accuracy as a result of the following deficiencies in the records and controls:

- Salary payments could not be agreed to the cash payments book or the general ledger as these records were not maintained for the 2004/05 financial year.
- The total cost to company of salaries, wages and allowances was obtained from the monthly payroll reports, which do not agree to the actual cost reflected in the financial statements. No explanation could be obtained for the difference nor for the large increase in salary costs for November 2004.
- The monthly payroll reports were not approved by the chief financial officer or the municipal manager.
- The monthly payroll report for February 2005 forwarded to the municipality by the service provider could not be located.
- Personnel files did not contain information on salary notches, authorisation of salary allowances, approval of deductions, leave records, attendance records and approval of overtime.

- I was unable to verify the appointment or termination procedures of the municipality as no list could be provided of new appointments and terminations of employees.
- A number of staff members occupy municipal houses, however no list of these staff could be presented for audit and no indication could be given of the tariff being charged for rental or whether rentals were being recovered from staff.
- The IRP5 forms could not be located for the 2005 year, as a result we were unable to verify that the IRP5's were prepared and reconciled to PAYE and SITE payments.
- No updated service level agreement, for the 2004/05 financial period, between Umzinyathi district municipality and Nquthu municipality could be located.

#### **3.1.4 Debtors**

- (i) The amount of R4 659 781 disclosed as debtors in the financial statements could not be verified as no supporting documentation was made available for audit. The age analyses received from uMsekeli could not be located for the January 2005 to June 2005 period, as a result we were unable to verify the validity, completeness and accuracy of the amount disclosed. The large decrease of 45% in debtors, prior to provision, from the prior year (2004: R9 433 764 and 2005: R5 177 534), could not be explained.
- (ii) I was unable to verify the appropriateness of the provision for bad debts at year end as the age analysis was not available to determine the actual aging in days. The provision was made up of 10% of the total debtor balance as per the accounting policies.
- (iii) No evidence could be provided to indicate whether efforts were being made to review and collect long outstanding debts and whether any interest was being charged on these outstanding balances.

#### **3.1.5 Cash and Bank**

- (i) The amount disclosed in the financial statements for bank increased from an overdraft of R1 209 606 in the 2004 financial year to a positive balance of R3 318 620 in the 2005 financial year. A detailed explanation for the significant increase in the bank balance could not be provided as no detailed cash receipts book and detailed general ledger was maintained for the 2004/05 financial year.
- (ii) A review of the bank statement indicated an overdraft balance of R512 333. No explanation could be provided for the difference in the bank statement amount and the financial statement amount. No bank reconciliations for all accounts held in the name of the municipality were prepared.
- (iii) No petty cash register is maintained and no reconciliation of petty cash is performed, thus we were unable to assess the accuracy, completeness and validity of payments made through petty cash.

#### **3.1.6 Appropriation account**

- (i) Appropriations totalling R5 524 971 could not be verified as no supporting documentation could be provided to support the entries.
- (ii) Prior year adjustments of R4 713 922 could not be explained.

### **3.1.7 Investments**

- (i) The balance of R1 794 317 disclosed in the notes to the financial statements excludes a call account balance of R99 761.
- (ii) No investment register is maintained and the amounts recorded for investments and interest earned could not be traced to the cash receipts book, general ledger or journals as these records were not maintained for the 2004/05 financial year.

### **3.1.8 Long term liabilities**

The amount of R329 617 for long-term liabilities could not be verified for completeness, existence and valuation as no supporting documentation was presented for audit. No lease/loan register is maintained and no lease schedules/statements from the bank could be provided to verify the accuracy of the amounts. No signed lease agreements could be provided to assess the terms of the agreements. No detailed cash receipts book, detailed general ledger or journals were maintained for the 2004/05 financial year.

### **3.1.9 Consumer Deposits**

The amount of R491 886 for consumer deposits could not be verified for existence, completeness and valuation as no supporting documentation was made available for audit. No consumer deposits register is maintained detailing the properties and consumers for which deposits are held. There was a significant increase in the deposits held of R394 833 from the prior year (2004: R97 053), however no explanation was provided for this large increase. The total received for consumer deposits could not be verified to a detailed cash receipts book nor to a detailed general ledger as these financial records were not maintained for the 2004/05 financial year.

### **3.1.10 Inventory**

The existence and the valuation of the inventory figure of R147 800 could not be verified as no supporting documentation related to a stock count at year end, stock reconciliations or a detailed general ledger account could be provided for audit. The value of inventory decreased by R604 777 (2004: R752 577, 2005: R147 800) during the period, however no explanation could be provided for this large decrease.

### **3.1.11 Leave provision**

The balance of R854 593 disclosed in the financial statements as leave provision could not be verified as no supporting documentation could be provided for audit. No general ledger or journals are available to verify figures as these financial records were not maintained for the 2004/05 financial period.

### **3.1.12 Rates Income**

The revenue reflected in the financial statements as assessment rates in the amount of R68 199 could not be audited to ensure the completeness or accuracy as no supporting documentation was available.

The total revenue recorded for rates could not be verified to a detailed cash receipts book nor to a detailed general ledger as these financial records were not maintained for the 2004/05 financial year.

### **3.1.13 Receipting records**

For the 2004/05 financial period no cash receipts book or detailed general ledger (income and expenditure statement) was maintained, thus it was not possible to determine the completeness, accuracy, cut-off and classification of all receipts issued during the year ended 30 June 2005. This situation facilitates misappropriation of funds.

### **3.1.14 Expenditure**

The accuracy, classification and completeness of expenditure payments could not be verified as no cash payments book or detailed general ledger accounts were maintained for the period. Cheques totalling R2 008 331 could not be located for audit. Furthermore original invoices were not available for payments totalling R727 000. This situation facilitates unauthorised expenditure, misappropriation of funds and duplicate payments.

### **3.1.15 Creditors**

The existence, completeness and valuation of the creditors figure of R2 226 515 disclosed in the financial statements could not be verified as:

- No supporting documentation related to the Umzinyathi creditors (R1 266 643) was made available.
- Accrued creditors (R959 872) could not be traced to supporting documentation due to inadequate audit trails.

### **3.1.16 Grants /reserves**

The occurrence, accuracy, completeness, classification, rights and obligations and valuation of grants and subsidies received as well as expenditure thereon could not be verified as a consequence of the following:

- Debit balances totalling R3 004 705 recorded in the financial statements for 30 June 2004 were restated to credit balances. No explanation or documentation could be provided to support the restatement.
- Monies in respect of grants received and the correct allocation and recording thereof could not be verified as there were no records kept of grants received. No reconciliation or detailed cash receipts book and detailed general ledger were maintained for the period under review.
- A review performed of deposits in the bank statements indicated that a total of R32 553 428 was received from government resulting in a possible understatement of R17 634 428 in the income statement as only R14 919 000 was recorded as income received from grants and subsidies in Appendix D of the financial statements.
- The amount of R500 000 and R9 859 864 shown as other income and contributions respectively, could not be traced to any supporting documentation.
- Expenditure of R12 791 147 incurred against grants received could not be verified as no supporting documentation was available to indicate what payments had been made and whether it was in line with the intended purpose of the grants.
- No grants reconciliation was prepared.

### **3.1.17 Long term loan**

- (i) A review of the bank statements indicate that R1 839 594 was received from the Development Bank of South Africa (DBSA). Only R314 846 was brought to account resulting in an understatement of R1 524 748.
- (ii) The amount of R314 846 referred to in paragraph 3.1.16 (i) has been disclosed as part of reserves net of prior year expenditure R22 730 resulting in a further understatement of long term loans by R314 846.

### **3.1.18 Statutory funds**

- (i) In terms of section 103(b)(i) of the Local Authorities Ordinance, 1974 (No. 25 of 1974), the council shall pay into each Capital Development Fund (CDF) not less than three percent of the annual revenue accruing to the borough fund (rate and general service) and to the relevant trading fund. A letter was sent to Province to request an exemption from the contribution, however, no response has been received to indicate that the exemption was approved. No contribution was made by council, resulting in an understatement of R524 894 to the Capital Development Fund.
- (ii) No documentation could be provided to support interest totalling R117 377 allocated to the Public Improvement Fund and Capital Development Fund.
- (iii) No documentation could be provided to support expenditure of R23 700 charged to the Public Improvement Fund.

### **3.1.19 Inadequate fixed assets records**

A fixed asset register was not maintained during the year nor were details of additions and disposals. In the absence of a detailed asset register and other documentation the accuracy and completeness of fixed assets totalling R26 901 830 could not be verified.

### **3.1.20 Annual financial statements**

The annual financial statements contain numerous errors and inconsistencies within disclosures and do not conform to the requirements of the Institute of Municipal Finance Officers (IMFO) framework for the preparation of financial statements by local government.

In addition to the IMFO disclosure requirements the following disclosure requirements of sections 124(1)(c) and 125(1)(c) of the MFMA were not complied with:

- Salaries, allowances and benefits for the Municipal Manager, Chief Financial officer and Senior Managers.
- Total payments in taxes, levies, duties, pension and medical aid contributions and whether any amounts are outstanding at year end.

#### **4. DISCLAIMER OF OPINION**

Because of the significance of the matters referred to in paragraph 3, I do not express an opinion on the financial statements.

#### **5. EMPHASIS OF MATTER**

Furthermore, attention is drawn to the following matters:

##### **5.1 Late submission of AFS**

In terms of section 126(2)(b) of the MFMA, the accounting officer must prepare the annual financial statements within two months after the end of the financial year to which those statements relate and submit the statements to the Auditor-General for auditing. This office received the first set of financial statements by 31 August 2005. These financial statements were withdrawn and a final set received on 22 December 2005, almost four months after the deadline for submission.

Furthermore, as noted in paragraph 3.1.20, the financial statements submitted for audit were in fact not suitable for audit and are indicative of the municipality's severe lack of financial skills. This resulted in a delay in issue of the audit report.

##### **5.2 Policies and procedures**

The following policies were not in place for the year under review:

- Cash management and investment
- Tariffs
- Credit control and debt collection

The absence of these policies is a contravention of section 13(2) of the MFMA and sections 74(1), 75, 96, 97 and 98 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).

##### **5.3 Banking and finance**

- (i) In terms of section 45(3)(b) of the MFMA, a municipal council may approve an agreement with a lender for a short-term credit facility, including a bank overdraft facility, provided that the credit limit must be specified in the resolution of the council and that it is limited to emergency use. A bank overdraft was noted on account number 40-6181-7353 of R738 214, no council resolution was noted for the approval of this bank overdraft.
- (ii) In terms of section 11(4) of the MFMA, the accounting officer must within 30 days after the end of each quarter, table in the municipal council a consolidated report of all withdrawals made from any of the municipality's bank accounts and submit a copy of the report to the relevant provincial treasury and Auditor-General. A review of the council minutes revealed that no such report is submitted quarterly and forwarded to the relevant authorities.

- (iii) Payments totalling R6 798 886 were not made within 30 days as required by section 65(2)(e) of the MFMA.
- (iv) The payment for the skills development levy for the month of December 2004 was not made by the 7th day of the following month as required by the Skills Development Act, 1998 (No. 97 of 1998). Payment was made on 13/01/05 which could result in penalties being incurred.

#### **5.4 Value Added Tax (VAT)**

Vat 201 returns have been submitted as required however it was not possible to determine whether the amounts returned were accurately computed as no cash receipts book or detailed general ledger was maintained for the period under review.

#### **5.5 Direct income records**

Revenue related to other direct income could not be verified as no supporting documentation could be provided for audit. No application forms for direct income could be located (i.e. burials fees and hiring facilities) and no registers are maintained. No evidence could be found that the legislative requirements of the KwaZulu-Natal Local Authorities Ordinance, 1974 (No. 25 of 1974) in respect of advertising the additional service tariffs for the 2004-2005 financial year were complied with.

#### **5.6 Performance measurement audit**

An evaluation has been performed on the controls implemented by the municipal manager during the financial year to develop and manage the City's performance management system as required by section 45(b) of the Local Government: Municipal Systems Act, 2000. At the date of compiling this report, the audit was being finalised and a separate report in this regard has been issued.

### **6. APPRECIATION**

The assistance rendered by the staff of the Nquthu Municipality during the audit is sincerely appreciated.

V. Maharaj *for* Auditor-General  
Pietermaritzburg  
28 September 2006



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