REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE LUKHANJI MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

1. AUDIT ASSIGNMENT

The annual financial statements as set out on pages 14 to 35 for the year ended 30 June 2006, have been audited in terms of section 188(1) (b) 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(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003). (MFMA) These annual financial statements are the responsibility of the accounting officer. My responsibility is to express an opinion on these annual financial statements, based on the audit.

2. SCOPE

The audit was conducted in accordance with the International Standards on Auditing, read with General Notice 1512 of 2006, issued in Government Gazette no 29326 of 27 October 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the annual financial statements are free of material misstatement.

An audit includes:

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

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

3 BASIS OF ACCOUNTING

The Municipality's policy is to prepare the financial statements on the basis of accounting as described in accounting policy note 1 to the financial statements

4. QUALIFICATION

4.1 Revenue and receivables – Provision for bad debts

Due to inadequate accounting frameworks and policies to structure and govern its financial management responsibilities as required by the MFMA, the following was identified:

The debtor's balance of R151 414 716 as disclosed on page 25 of the annual financial statements, is stated before provisions. Of this amount 86% (R 129 527 145) pertains to amounts outstanding exceeding 90 days. The municipality has no formal Bad Debt Policy and outstanding debts due to non-payment are no longer written off. Furthermore debts are no longer handed over to attorneys and the debt collection agency had been dispensed of. Accordingly the provision for bad debts of R 90 274 415 is considered to be inadequate to cover the possible level of irrecoverable debts.

4.2 Fixed Assets

The Balance Sheet for the year ended 30 June 2006, reflects an amount of R21 041 207 for Fixed Assets. However, land owned by the municipality is not included in the fixed asset register. The land is currently valued at nil by the municipality and is not disclosed in the financial statements.

The fixed asset register is not complete as it does not contain all of the required information pertaining to the assets. In addition, no physical verification of fixed assets has been performed by the municipality during the period under review due to the fact that fixed assets are not allocated unique identification numbers. Accordingly no assurance could be obtained pertaining to the completeness, accuracy and validity of the fixed assets.

4.3 Inventory

Note 9 of the Annual Financial Statements pertaining to inventory, reflects the balance as nil (R1 611 524: 2004/2005). Journal entries relating to inventory amounting to R1 178 019 could not be validated by supporting documentation. The municipality has indicated that inventory was disbursed to the various departments, however no indication of the completeness of stock on hand could be ascertained.

The above indicates management's inability to put in place controls to help identify and implement the appropriate accounting frameworks and policies to structure and govern its financial management responsibilities.

4.4 Long term debtors – Interest and repayments of debt

In order to ensure good financial management, the municipality management is required to properly analyse financial risk at account balance level and implement appropriate controls to minimise these risks. The following material instances were noted, where the absence of good internal controls led to management's inability to manage revenue and debtors, leading to material misstatements of the financial position of the municipality.

Long term debtors as disclosed in note 8 of the Annual Financial Statements totalling an amount of R672 490 transferred to current assets, included debtors to the value of R 644 892 for which there has been no movement from the prior year. However, as no provision was made for any irrecoverable amount it would appear that the balance is overstated by the said amount.

Furthermore, it was noted that the agreements entered into between the municipality and the debtors stipulated that repayments must be made and interest would be levied on outstanding amounts. However interest has not been levied on such accounts and accordingly interest receivable is understated.

4.5 Financial – Consumer deposits

Consumer Deposits of R6 256 021 as disclosed on page 23, note 5, of the Annual Financial Statements did not agree to the Consumer Deposit Ledger as at 30 June 2006. No reconciliations between the deposit register (sub-ledger) and the deposit control account are performed to ensure that the balance of these two ledgers agree at all times.

Consequently, the balance per the deposit register exceeded the balance per the general ledger by R230 032.

4.6 Financial – Bank reconciliation

During the performance of the audit work, it was noted that several deposits listed as "Outstanding" to the value of R2 022 853 in the June 2006 bank reconciliation could not be traced to subsequent bank statements. The validity of these deposits could therefore not be confirmed hence the cash balances on page 20 of the annual financial statements could be understated.

Outstanding deposits amounting to R586 182 from the 2004/ 2005 financial year are still reflected on the 2005/ 2006 bank reconciliation. This implies that the cash balance per the financial statements at 30 June 2006 on page 20 may not be fairly stated.

Outstanding deposits amounting to R509 484 from the 2004/2005 financial year could not be traced to Bank statements during the 2005/2006 financial year, nor did it reflect as an "Outstanding deposit" at 30 June 2006.
This implies that the cash balance per the financial statements at 30 June 2006 on page 20 may not be fairly stated.

Outstanding cheques amounting to R3 851 093 (R5 248 926: 2004/2005), older than six months, are not written off and this indicates that the cash balance per the financial statements at 30 June 2006 on page 20 may not be fairly stated.

All of the above indicate management's inability to put in place good financial management disciplines which require management to prepare reconciliations on key accounts, follow-up and clear reconciling items on a monthly basis.

4.7 Information systems – System change-over

During the financial year under review, in November 2005, the Lukhanji Municipality changed their Computer Information Systems from SAMRAS DB4 to E Venus.

In the performance of the audit, a review was performed of the reconciliation prepared to reconcile the balances on the SAMRAS DB4 system to the E Venus system at the 30th November 2005. The reconciliation did note discrepancies which were made up of the differences between the two systems balances at the 30th November 2005 and also listed the journal entry passed on the E Venus system to align the two system balances in response to those differences. These differences comprised of transactions and journal entries passed on one system but not the other and expense commitments erroneously transferred to the E Venus system as actual expenditure.

Scrutiny of the reconciliation's balances and differences against various forms of supporting documentation revealed exceptions which cast doubt as to the accuracy of the reconciliation worksheet. These exceptions fell into three broad categories:
In the audit of the reconciliation the following discrepancies were noted:

a) Journals were processed to votes different from that which had been reflected per the reconciliation worksheet. Although debits and credits match, a classification error of expense type arises. The financial impact of these errors amounts to R4,608,464.86 as determined by the adding of both debits and credits.
b) Journals were consolidated and processed instead of being processed individually to the respective votes. Although debits and credits match, a classification error of votes

arises. The financial impact of these errors amounts to R83,057.38 as determined by the adding of both debits and credits.

c) Additionally billing integration journals identified from the ‘Transven” download obtained from the client were not reflected in the reconciliation worksheet prepared by the client. Although the debits and credits match, the effect is that the debit value and credit value is understated in the reconciliation. The financial impact of these errors amounts to R664,500.64 as determined by the adding of both debits and credits.

Furthermore, as all supporting documentation provided was system generated, originating from either the E Venus or SAMRAS system, except for the salary journal, the differences could not be vouched to accounting or source documents; therefore the validity of the differences in the reconciliation is doubtful.

Due to the lack of appropriate reconciliation procedures, documentation and specific items identified above, no assurance can be ascertained as to the completeness, validity or accuracy of the opening balances as a result of the system change.

4.8 Lack of supporting documentation

Further to the qualifications and limitations identified above, during the performance of the audit normal procedures performed included a process of formally requesting information for audit purposes. On numerous occasions such requests were repeated and information was often not submitted timeously resulting in significant delays and scope limitations. Accordingly, some information could not be extracted or made available timeously in order to validate for audit purposes, including;

4.8.1 Revenue and receivables

- Transaction listing for each category of revenue
- Supporting documentation to validate the existence debtors amounting to R6 057 319.18

4.8.2 Purchases and payables

- The transaction listing from the SAMRAS system for each category of expenses.

4.8.3 Employee costs

- Numerous personnel files
- A complete list of all new appointments for the year
- Monthly payroll reconciliations for the financial year under review
- A list of any penalties and interest incurred with regard to the late payment of PAYE, for the period 1 July 2005 to 30 June 2006
- Copy of the annual tax reconciliations performed for the year ended 30 June 2006
- An exception report from the time sheets, identifying all employees who worked on a Sunday for the period 1 July 2005 to 30 June 2006
- An exception report from the salary system showing all employees who have worked overtime for the period 1 July 2005 to 30 June 2006
- Monthly schedules of all overtime worked for the period 1 July 2005 to 30 June 2006
- Requested attendance registers

4.8.4 Inventory and asset management

- Lease agreements or supporting documentation relating to leases
- A listing of written down / obsolete stock at year end
- The last 5 goods received vouchers issued in the 2005/2006 financial year.

4.9 Purchase and Payables – Incorrect allocation of expenses

The following differences were noted between the General ledger and the Annual financial statements for the year ending 30 June 2006.

- Other General expenses amounting to R33 980 758 in the annual financial statement, page 33, as compared to R33 372 993 per the general ledger thus resulting in a difference of R607 765.

- Entertainment expenses amounting to R128 054 in the annual financial statement, page 33, as compared to R0 per the general ledger thus resulting in a difference of R128 054.

- Repairs and maintenance amounting to R4 982 530 in the annual financial statement, page 33, as compared to R4 389 290 per the general ledger thus resulting in a difference of R593 240.

Although it was indicated that these differences relate to mis-allocation, no assurance could be obtained to confirm the validity or accuracy of these amounts.

The above indicate management's inability to put in place good financial management disciplines which require management to prepare reconciliations on key accounts and follow-up clear reconciling items on a monthly basis.

No alternative procedures could be effected due to a scope limitation.

5 DISCLAIMER

Due to the significance of the matters discussed in paragraph 4, I do not express an opinion on the annual financial statements of the Lukhanji Municipality for the financial year ended 30 June 2006

6. EMPHASIS OF MATTER

Attention is drawn to the following matters.

6.1 Disclosure and other matters - Reticulation

Good financial management discipline requires of management to prepare reconciliations on key accounts and follow-up items on a monthly basis. The reticulation calculation as disclosed in the Financial Statements per Appendix D on page 22 (Electricity purchases R28 533 048) and per the General Ledger exceeded the amount per the reticulation calculation schedule (R27 766 394) by R766 654.

Furthermore, the amount of units bought as per the annual financial statements exceeded the amount of units per the reticulation schedule by 12 854 units as per page 24 Appendix F (172 628 455 units).

6.2 Property Valuation

In terms of sections 8(1) and (2) of the Property Valuation Ordinance 148 of 1993, a local authority shall from time to time cause a general valuation to be performed on all property. The general valuation must be performed at least every four years. The MEC may extend the period on request for one year.

The last general valuation was performed in 1997; therefore the Council is in contravention with the above mentioned legislation.

It was noted that a general valuation was performed by an external service provider. However, a report on an investigation of the valuation, issued by the Department of Housing, Local Government and Traditional Affairs, indicates that no reliance can be placed on the accuracy of the valuation and as such was rendered not applicable for rates purposes.

Furthermore, no interim valuations were performed during the year under review thus property valuations were not updated for divisions, additions and damage to properties.

6.3 Audit Committee and Internal Audit

The municipality did not have a functioning audit committee in place during the 2005/06 financial year due to the fact that amongst other things there was no audit committee charter in place. The audit committee charter sets out the responsibilities of the audit committee members as well as their functions and duties.

The audit committee only met twice during the year, the last of which was in November 2005.

Per inspection of the minutes of audit committee meetings, it appears as though significant developments in financial reporting were not monitored and discussed, i.e. the system change which took place during the year.

The majority of the audit committee members were in the employ of the municipality.

It was also noted that internal audit has not been afforded sufficient independence and authority to enable it to meet its required obligations in terms of the internal audit charter and approved internal audit plan. This is evidenced by the fact that the internal audit personnel are performing certain supervisory functions which should be done by line-management.

6.4 Risk Management

Management has not performed any formal risk assessment at the Lukhanji municipality. Consequently, no risk management policy has been devised and implemented.

6.5 Disclosure

Inventory is not split by major category in the notes to the financial statements in accordance with the accounting framework. The write-down of obsolete/damaged inventory has not been disclosed in the annual financial statements.

6.6 Value for money

Documentation relating to various projects, such as tenders, contracts, plans and other related documents were not available for review during the performance of the audit for review in terms of value for money.

6.7 Revenue and receivables – Incorrect transfer of balances

Good financial management discipline requires of management to prepare reconciliations on key accounts and follow-up and clear reconciling items on a monthly basis. The closing balance of the property valuations per the rateable properties reconciliation for the 2004/2005 financial year exceeded the total opening balance per the 2005/2006 reconciliation by R5 981 111.

7. LATE FINALISATION OF THE AUDIT REPORT

In terms of section 126(3)(b) of the MFMA I am required to submit my report to the accounting officer within three months of the receipt of the financial statements. In the interest of improving accountability and due the process implemented by me to ensure consistency in the manner in which material audit findings are reported, I have delayed the finalisation of my report to the date reflected on the audit report

8. APPRECIATION

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

S M Ngqwala
***for* Auditor-General**

EAST LONDON

19 December 2006

AUDITOR-GENERAL

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON PERFORMANCE MEASUREMENT AT LUKHANJI MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

1. ASSIGNMENT

The compilation, presentation and publishing of performance measurements and the implementation, management and internal control of supporting systems, are the responsibility of the accounting officer.

My responsibility is to provide an assessment of the controls implemented by the accounting officer to develop and manage the municipality's performance management system as required by section 45(b) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).

My role is not to assess or comment on the municipality's actual performance, but rather to assess the processes followed during the implementation of the performance management system.

2. NATURE AND SCOPE

A high-level overview was performed which indicated that performance measurement and supporting systems have not progressed to the point where they can be audited. Therefore no audit was performed and the procedures performed were limited to high-level overview interviews.

3. FINDINGS

I report my findings and matters which came to my attention during the high-level interviews below:

Although management has reviewed their Integrated Development Plan during the financial year under review management have implemented no controls to manage the municipality's performance management system. Consequently, we are unable to evaluate the municipality's performance management system as none of the following key activities to promote the implementation of a performance management system, have taken place:

- Development and implementation of Key Performance Indicators
- Settings targets for the developed Key Performance Indicators
- Internal monitoring and control
- Performance measurement and reporting

4. CONCLUSION

Because the above procedures do not constitute either an audit or a review made in accordance with Statements of South African Auditing Standards, I do not express any assurance on any performance measurement as at 30 June 2006.

An audit of the financial statements in accordance with statements of South African Auditing Standards was concluded and a report to this effect was included in the annual report.

5. APPRECIATION

The assistance rendered by the staff of Lukhanji Municipality during the assignment is sincerely appreciated.

SM NGQWALA
***for* Auditor-General**

PO Box 13252

Vincent

EAST LONDON

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19 December 2007

AUDITOR-GENERAL