

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

1. AUDIT ASSIGNMENT

The financial statements as set out on pages 6 to 17, for the year ended 30 June 2006, 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(3) of the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 200) (MFMA). These financial statements are the responsibility of the municipal manager. My responsibility is to express an opinion on these financial statements, based on the audit.

2. NATURE AND 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 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
- 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 entity specific basis of accounting as described in accounting policy note 1.1 to the financial statements.

4. QUALIFICATION

4.1 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. For the year under review the scope has been limited significantly as discussed below:

4.1.1 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 journals, creditors' and debtor's ledgers, and an incomplete general ledger. The only accounting record that was in place was an incomplete cashbook and an unbalanced general ledger. This inadequate record keeping has impacted on the audit trail resulting in a limitation of audit scope in a number of areas.

4.1.2 Service income

Electricity income of R2,6 million and refuse removal income of R256 000 could not be verified for completeness, accuracy and occurrence as a result of the following:

- The amount reflected as budgeted in the financial statements (R2,2 million) did not agree to the approved budget (R3,8 million). Explanations for this difference could not be provided.
- Transactions in the general ledger for debtors as well as sale of electricity do not occur in a logical sequence. It is noted that October 2006 and November 2006 transactions are posted in the previous financial period, and that transactions do not appear in sequential date order with certain months been excluded.
- The municipality does not have any policy or procedure in place to monitor distribution losses.
- Explanations for variances between the revenue for the current period, prior period and budget could not be provided.
- The following documents could not be obtained upon request and therefore certain audit procedures were not performed:
 - Service listings, meter readings, service contracts.
 - Listing of new connections, reconnections and disconnections.
 - Prepaid electricity agreements and prepaid listings.
- A difference of R940 000 exists between the approved budget and the budget figure disclosed in the financial statements.

4.1.3 Inadequate salaries, wages and allowances records

Salaries, wages and allowances of R11,2 million could not be verified for completeness and accuracy as a result of the following deficiencies in the records and controls:

- Salaries and wages could not be accurately traced to the general ledger, due to the ledger being inadequate and incomplete.
- The monthly payroll reports were not approved by the chief financial officer or the municipal manager.
- Personnel files did not contain information on salary notches, authorisation of salary allowances, approval of deductions, leave records, attendance records and approval of overtime.
- A number of staff members occupy municipal houses. A list of these staff could not be presented for audit and no indication could be given of the tariff being charged for rental or whether rentals were being recovered from the staff concerned.
- Employees tax is being incorrectly calculated on employees salaries.
- Explanations for variances between salaries and wages in the current period, prior period and budget could not be provided.
- The amount reflected in the general ledger (R32 000) did not agree to the trial balance (R54 000) for travel allowances. No explanation was provided for this difference.
- Reconciliations of PAYE and SITE were not being performed.

4.1.4 Debtors

The validity, completeness and accuracy of debtors amounting to R6,7 million could not be verified as a result of the following:

- The debtors age analysis reflected a balance of R6,4 million whereas the general ledger reflects an amount of R6,7 million resulting in an unexplained difference of R365 000.
- Transactions in the general ledger for debtors do not occur in a logical sequence. It is noted that November 2006 transactions occur in the current financial period under review as well as transactions do not appear in sequential date order.
- A 10% provision reflected as R678 000 is not a true reflection of the debt collection of the municipality as 93% of consumer debtors shown in the age analysis are reflected as greater than 120 days. No evidence could be provided to indicate whether efforts were being made to review and collect long outstanding debtors and whether any interest was being charged on these outstanding balances.
- Explanations for variances between debtors in the current period, prior period and budget could not be produced.
- An amount of R12 000 reflected as sundry debtors could not be traced to the trial balance. Reasonable explanations could not be furnished for this amount.

4.1.5 Cash and bank

The accuracy of the bank account of R3,9 million could not be verified as a result of the following:

- Bank reconciliations were not performed monthly.
- The closing balance per the general ledger (R3 million) did not agree to the trial balance (R374 000), bank statement (R382 000) and financial statements (R3,9 million). Explanations for the differences could not be obtained.
- The general ledger contained transactions relating to November 2006.
- Journals affecting cash and bank of R1,6 million were processed. No supporting documents were produced to substantiate these journals.
- Bank statements for the month of July 2006 could not be produced for audit purposes.
- A list of outstanding cheques could not be provided.
- No cheque return register was being maintained.
- Information relating to bank accounts as required by section 9 of the MFMA, was not submitted to the relevant provincial treasury and the Auditor-General.

4.1.6 Appropriation account

Appropriations totalling R60 000 could not be verified as no supporting documentation could be provided to support the entries.

4.1.7 Investments

No investment register is maintained and the financial statements do not agree to bank confirmations.

4.1.8 Long term liabilities

The amount of R341 000 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.

4.1.9 Consumer deposits

The amount of R492 000 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 and no reconciliations are performed.

4.1.10 Inventory

The existence and the valuation of the inventory figure of R148 000 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. There was no movement between the current and prior year's inventory balances. This is inaccurate and unlikely as it was evident during the audit that inventory items had been received and issued during the year.

4.1.11 Leave provision

The balance of R478 000 disclosed in the financial statements as leave provision could not be verified as no supporting documentation could be provided for audit.

4.1.12 Rates income

The revenue reflected in the financial statements as assessment rates in the amount of R403 000 could not be audited to ensure the completeness or accuracy as no supporting documentation was available. There is no valuation roll and no rates policy in place.

The amount reflected as budgeted in the financial statements (R1,8 million) did not agree to the budget (R228 000) and Munsoft budget (R22,4 million).

Explanations for variances between the rates for the current period, prior period and budget could not be produced.

4.1.13 Receipting records

The general ledger does not balance, thus it was not possible to determine the completeness, accuracy, cut-off and classification of all receipts issued during the year ended 30 June 2006. This situation facilitates misappropriation of funds.

4.1.14 Expenditure

The accuracy, classification and completeness of expenditure payments could not be verified as a result of the following:

- Explanations for variances between the expenditure for the current period, prior period and budget could not be produced.
- Amounts reflected in the trial balance (R4,1 million) did not agree to the general ledger (R4,4 million). No explanations were provided for the difference of R265 000.
- Supporting documentation for expenditure vouchers and all lease agreements amounting to R4,6 million could not be produced.
- Supporting documentation for repairs and maintenance amounting to R1,4 million could not be produced.
- Invoices amounting to R55 000 were omitted from the general ledger.
- A difference of R1,7 million exists between the approved budget and the budget figure disclosed in the financial statements.

4.1.15 Creditors

The existence, completeness and valuation of the creditor's figure of R2,2 million disclosed in the financial statements could not be verified as:

- No supporting documentation related to creditors was made available.
- There has been no movement between the current and prior year's balance. This is inaccurate as it shows that no purchases were made or paid during this period under review.

Included in creditors is an amount of R7,4 million, which is a suspense account for salaries to be reallocated.

4.1.16 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:

- The amounts reflected in the general ledger for three projects (R7,4 million) did not agree to the amount in the trial balance (R7,1 million). This resulted in an unexplained difference of R285 000.

4.1.17 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. From a review of the financial statements, it is evident that no contribution was made, and there is also no evidence that exemption was obtained from local government. This has resulted in an understatement of R600 000 to the CDF.
- (ii) No documentation could be provided to support interest totalling R99 000 allocated to the Public Improvement Fund and Capital Development Fund.

4.1.18 Inadequate fixed assets records

The existence, completeness and accuracy of fixed assets could not be verified as a result of the following:

- Additions amounting to R540 000 were not included in the asset register.
- Additions amounting to R573 000 could not be physically verified.
- Plant and equipment disclosed in the financial statements is understated by R880 000, as a result of a new grader purchased.
- Certain assets could not be physically verified.
- Documentation supporting reconciliations, insurance policy, disposals and redundant assets could not be produced for audit purposes.

4.1.19 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 123, 124(1)(a) and (b), 125(1)(c), 125(2)(a), (b), (c) and (d) of the MFMA were not complied with:

- The financial statements do not disclose information on any allocations received by the municipality from an organ of state in the national or provincial sphere of government or from elsewhere, or any allocations made by the municipality to a municipal entity or another municipality or any other organ of state.
- With regard to political office bearers and councillors remuneration (note 13), no statement has been made by the accounting officer whether or not salaries, wages and benefits are within the upper limits of the framework envisaged in section 219 of the Constitution.
- No particulars of any arrears owed by individual councillors to the municipality, for rates or services outstanding for 90 days or more, including the names of those councillors.
- Total amounts paid in audit fees, taxes, levies, duties, pension and medical aid, and whether any amounts were outstanding as at the end of the financial year, were not disclosed as a note.
- The notes do not disclose in respect of each bank account held by the municipality, the name of the bank where the account is or was held, the account type, and year opening and year end closing balances.
- The notes do not disclose a summary of all investments of the municipality as at the end of the financial year.
- The notes do not disclose particulars of any contingent liabilities of the municipality as at the end of the financial year.
- The notes do not disclose particulars of any material losses and any material fruitless and wasteful expenditures, including any material unauthorised expenditure and whether these were recoverable, or whether any criminal or disciplinary steps were taken as a result of such losses or such unauthorised, irregular or fruitless and wasteful expenditures, or any material losses recovered or written off.
- Leases were not disclosed in the accounting policies and in the notes to the financial statements.

- Certain amounts disclosed in the annual financial statements did not agree to the approved budget.

4.1.20 Value added tax (VAT)

Reconciliation between the VAT accounts in the general ledger and the VAT 201 returns could not be produced. Consequently, the accuracy of the VAT amounting to R694 000 could not be verified.

There is an unexplained difference of R44 000 between the general ledger and trial balance.

VAT returns for April, May and June 2006 were not submitted. This will also attract interest and penalties, the amount of which cannot be quantified.

Invoices totalling R181 000 were recorded inclusive of VAT.

4.1.21 Journals

Supporting documentation corroborating journals amounting to R1,8 million was requested, but was not furnished for audit purposes.

4.1.22 Interest received not disclosed in financial statements

The municipality has not recognised any interest regarding investments, interest on current account as well as interest on outstanding debtors in the current year's financial statements. In terms of section 64 of the MFMA, the accounting officer must ensure that the municipality has effective revenue collection systems, that revenue due is calculated monthly and that it has and maintains a management information system which recognises revenue when it is earned, and accounts for receipts of revenue.

4.1.23 Capital Commitments

The validity and accuracy of capital commitments could not be verified as a result of several requests being made for this information; however nothing could be produced for audit purposes.

4.1.24 Other Service Charges

The accuracy and completeness of other service charges could not be verified as a result of the following:

- Fines were only received in the month of April 2006 and December 2005.
- Traffic fines are not reconciled when received.
- It was further noted through inspection of the remittance register that receipt number 8326 for R13 000 received on 14/11/2005 in respect of traffic fines, had not been recorded in the general ledger or financial statements.
- The municipality does receive rentals in respect of property owned by the municipality. These rentals are deducted from employee salaries, but have not been recorded as revenue, thereby understating revenue in the financial statements.
- Explanations for variances between the other service income for the current period, prior period and budget could not be produced.

- There were no supporting documentation produced for a sample amounting to R81 000 for service charges.
- Certain audit procedures could not be performed as a direct income register and register of deposits and rentals could not be produced.
- Receipts were also being allocated incorrectly.

4.1.25 Fruitless, wasteful and irregular expenditure

Interest and penalties incurred on the late submission of VAT 201 and Employee 201 returns to South African Revenue Services have not been disclosed in the financial statements.

4.1.26 Comparative Amounts

Certain issues included in this report were also reported in the previous year. As a consequence, the affected comparative amounts and opening balances are also either misstated or could not be verified.

5. DISCLAIMER OF OPINION

Because of the significance of the matters referred to in paragraph 4, I do not express an opinion on the financial statements.

6. EMPHASIS OF MATTER

Furthermore, attention is drawn to the following matters:

6.1 Other irregularities, losses and internal control weaknesses

In terms of section 62 of the MFMA, it is the responsibility of the municipal manager to ensure that:

- Full and proper accounting records to be kept as are necessary to reflect the transactions and financial state of affairs of the municipality;
- A system of internal control be established and maintained.

During the audit, it was evident that some key and other controls were either poor or non-existent and that management supervision and control was inadequate. As a result, laid down routine procedures and controls were not always adequately monitored to ensure that they operated as designed and that delegated responsibilities had been properly discharged. Timely and effective remedial action was not taken on weaknesses detected, as well as failure to maintain proper records and safeguarding the entity's assets.

The following is a summary of the more significant audit observations raised during the course of the audit which indicates a lack of control in these areas:-

- There was no evidence to suggest that core reconciliations (i.e Bank, Debtors, Creditors, VAT, Payroll, and Revenue etc) were prepared, reviewed and approved at monthly finance meetings.
- No formal risk assessments were undertaken.
- There is no approved fraud prevention plan.

- Employees are booking excessive overtime, which in some instances exceed 30% of their basic income.
- Physical verification of fixed assets has not been carried out in the past year due to the fixed asset register not being properly maintained and fixed assets not being tagged.
- Lack of segregation of duties as the following functions/activities are not performed by different individuals:
 - Initiation,
 - Approving,
 - Processing/ Recording,
 - Reconciliation, and
 - Custody of related assets.
- There are no performance contracts in place for senior management and a performance review policy was not in place for the 2005-06 financial years.
- No mechanisms were in place to respond to unusual or exceptional circumstances eg. Business continuity plans and back up policies.
- There is no person ultimately responsible for performance information, nor has a proper framework been established or developed to manage performance information.
- There are no formally documented policies and procedures in place at the municipality.
- Some councilors have not declared their financial interests.

6.2 Late submission of financial statements

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. In this regard, the financial statements for the year ending 30 June 2006 were only submitted for audit on 1 December 2006.

6.3 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.

6.4 Fraud and error

Due to the content of this audit report and the various weaknesses highlighted above, it is important to note that the risk of fraud and error is high.

7. APPRECIATION

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

V. Maharaj *for* Auditor-General
Pietermaritzburg
1 March 2007



AUDITOR - GENERAL