# REPORT OF THE AUDITOR-GENERAL ON THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS TO THE COUNCIL OF THE CACADU DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

## 1. AUDIT ASSIGNMENT

The financial statements as set out on pages ...to ..., 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, 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 (MFMA), 2003 (Act No. 56 of 2003). These financial statements are the responsibility of the accounting officer. My responsibility is to express an opinion on these 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 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 is required to prepare financial statements on the basis of accounting determined by the National Treasury, as described in the addendum to this report.

## 4. QUALIFICATION

### 4.1 Non-adherence with the financial statement preparation framework

a) The municipality must prepare financial statements in accordance with the basis of accounting determined by the National Treasury, as described in paragraph 3 above. The basis of preparation disclosed in the accounting policies of the annual financial statements indicates that the municipality opted not to comply with accounting standards which are outside the ambit of the Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP).

This is in contravention of GRAP 3, Accounting Policies, Changes in Accounting Estimates and Errors, which requires that the South African Statements of Generally Accepted Accounting Practice (GAAP), including any interpretations of such Statements issued by the Accounting Practices Board, be applied for the recognition and measurement of all transactions that do not fall within the scope of GAMAP and GRAP.

b) The accounting policy for the revaluation of land and buildings as per the financial statements complies with paragraph 41 of GAMAP 17, Property, Plant and Equipment. Based on this accounting policy, the land and buildings are carried at a revalued amount, being its fair value at the date of revaluation less any subsequent impairment losses. As per note 10 to the financial statements, this policy is not consistently applied as only four out of forty-one buildings are stated at fair value. The remainder of the buildings are stated at a nominal value of R1. As the remainder of the buildings have not been revalued and the available financial records were inadequate to allow the performance of alternative procedures, it was not possible to determine the extent of the misstatement on the total land and buildings. The disclosure of the revalued properties is inadequate in terms of paragraph 79 of GAMAP 17.

c) The accounting policy for property, plant and equipment does not comply with the requirements of GAMAP 17, Property, Plant and Equipment. In terms of paragraph 59 the useful life of an item of property, plant and equipment should be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods should be adjusted. In terms of paragraph 66 the carrying amount of an item or a group of identical items of property, plant and equipment should be reviewed periodically in order to assess whether or not the recoverable amount has declined below the carrying amount. No such periodic reviews have taken place for the financial year under review. The total misstatement is not known.

d) The accounting policy for provisions does not comply with the requirements of GAMAP 19, Provisions, Contingent Liabilities and Contingent Assets. In terms of paragraph 53 where the effect of time value of money is material, the amount of a provision should be the present value of the expenditure expected to be required to settle the obligation. As the municipality did not discount creditors, the effect of the time value of money on the valuation of the creditors' balance of R21 155 460 could not be determined.

e) The accounting policy for revenue does not comply with the requirements of GAMAP 9, Revenue. In terms of paragraph 37, revenue for service charges should be recognised when it is probable that the economic benefits will flow to the entity and the revenue can be measured reliably. Based on this requirement, the revenue for June 2006 service charges should be recognised irrespective of whether such charges have been invoiced at 30 June 2006. Accounts receivable is therefore understated by the June 2006 service charges. Accordingly, revenue is understated by the June 2006 service charges and overstated by the June 2005 service charges. The total misstatement is not known; consequently the completeness of service charges of R137 654 as disclosed in note 17 of the financial statements could not be verified.

f) The disclosure of prior year errors in Note 32 to the financials is inadequate in terms of paragraph 42 of GRAP 3, Accounting Policies, Changes in Accounting

Estimates and Errors. The balances prior to adjustment, movements and balances after error adjustment are not disclosed.

g) The full value of leave accrued by staff at year end had been determined and recorded as a provision amounting to R1 193 291 (2005: R256 910) in the financial statements, which is consistent with accounting policy number 8.1.3 as disclosed in the financial statements. According to paragraph 15(b) of GAMAP 19, Provisions, Contingent Liabilities and Contingent Assets, this should be accounted for as an accrual and not a provision.

h) Financial Instruments: The category of the financial assets held by the council is not disclosed in the financial statements, as required in terms of paragraph 9 of IAS 39. Loans and receivables are not measured at amortised cost, as required in paragraph 46 of International Accounting Standard (IAS) 39, Financial Instruments: Recognition and Measurement.

The above exceptions relate to management's inability to create a control environment that would enable the municipality to report financial information in the required manner. This inability is the result of capacity constraints.

### 4.2 Levy income

Due to the inherent uncertainties that exist regarding the completeness of registered levy payers and the integrity of the financial information submitted by the levy payers on a self-assessment basis, adequate and relevant audit evidence to support the completeness and accuracy of the base for levy income of R31 417 964 could not be obtained.

### 4.3 Fruitless and wasteful expenditure

Due to inadequate monitoring by the building contractors, expenditure amounting to R6 196 628 in respect of the Paterson housing project is considered to be fruitless and wasteful expenditure in terms of section 1 of the Municipal Finance Management Act, No.56 of 2003 (MFMA). The Minister of Housing, Local Government and Traditional Affairs instructed council on 9 June 2006 to address the problem of inferior quality houses built under the project. Twenty-three (23) houses are to be demolished and the remaining hundred and seventy-seven (177) houses must be rehabilitated to an acceptable standard.

## 5. DISCLAIMER OF AUDIT OPINION

In my opinion, because of the significance of the matters described in the preceding paragraphs and the uncertainty on the effect thereof on the financial statements, I do not express an opinion on the consolidated financial statements.

## 6. EMPHASIS OF MATTER

Without further qualifying the above opinion, attention is drawn to the following matters:

## 6.1 Consolidation of the Kouga Development Agency (KDA)

a) In terms of an agreement between the Industrial Corporation of South Africa Limited and Cacadu District Municipality (CDM) on 29 April 2004, an amount of R796 000 was made available to CDM in respect of pre-establishment costs for the establishment of the Kouga Development Agency (KDA).

The unutilised portion of the grant amounting to R10 200 (2005: R747 277) was correctly accounted for as a liability in the Consolidated Statement of Financial Position at year end and the net movement of R737 077 was disclosed in Appendix F to the consolidated financial statements. The underlying transactions of the net movement were not consolidated in the Consolidated Statement of Financial Performance resulting in the misstatement of revenue and expenditure of R737 077. The net effect of the misstatement is nil.

b) The financial statements submitted on 24 October 2006 by the KDA did not comply with the all the requirements of the basis of accounting determined by the National Treasury, as described in paragraph 3 above. The municipal entity did not accrue for the leave liability of R15 120 as at 30 June 2006. Subsequently the financial statements of the KDA were adjusted to reflect the accrual for the leave liability and were submitted on 4 December 2006.

The consolidated financial statements had not been adjusted accordingly as management did not regard the amount to be material for consolidation purposes.

## 6.2 Non - adherence with the financial statement preparation framework

a) In addition to the non-adherence of the financial statements to the requirements of GAMAP, GRAP and GAAP as reported in paragraph 4.1 above, others instances were noted and reported to management in the management letter.

b) Note 25 to the consolidated financial statements relating to grants and subsidies paid do not agree to the Statement of Financial Performance. The difference of R308 629 arose as an adjustment was made to the Statement of Financial Performance, but the note was not updated accordingly.

c) Note 11 to the financial statements incorrectly indicates that the council has a 50% share in unlisted investments. This shareholding relates to the council's role in the establishment of the Kouga Development Agency (KDA).

The KDA is a municipal entity as contemplated by section 87 of Local Government: Municipal Systems Amendment Act, 2003 (Act No. 44 of 2003). It was subsequently established as a multi –jurisdictional service utility in terms of section 84 of the MFMA. The Cacadu District Municipality (CDM) has no financial obligation towards the KDA and did not invest any monies in KDA. Furthermore, the CDM has no share or right to the equity of KDA, and KDA should thus not be disclosed as an unlisted investment. As parent municipality, the CDM has certain responsibilities in terms of administration and financial reporting of the municipal entity.

## 6.3 Fruitless and wasteful expenditure

Paragraph 62(1)(d) of the MFMA requires the accounting officer to take all reasonable steps to ensure that fruitless and wasteful expenditure is prevented. Due to a lack of independent checks, the Value Added Taxation payable to the South African Revenue Services (SARS) was incorrectly calculated and interest amounting to R23 632 was incurred.

## 6.4 Internal Control Weaknesses

In terms of section 62(1)(c)(i) of the MFMA, the municipality's accounting officer must ensure that the municipality has and continues to maintain effective, efficient and transparent systems of financial and risk management and internal control. The following are areas of significant non-compliance and/or internal control weaknesses that were identified during the course of the audit:

- Employee costs
- Expenditure
- Budget monitoring
- Payables
- Property, plant and equipment
- Value Added Taxation
- Computerised Information System environment

These internal control weaknesses could contribute to an environment which is conducive to fraud and error.

## 6.5 Material Financial Statement Adjustments

Due to the lack of monitoring and independent checks by management, the financial statements did not comply with the basis of accounting determined by the National Treasury, as described in paragraph 3 above and, as a result, material changes were made to the financial statements which were submitted on 5 December 2006.

## 7. APPRECIATION

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

SM Ngqwala
for Auditor-General

East London

15 December 2006

## ADDENDUM TO THE REPORT OF THE AUDITOR-GENERAL ON THE CONSOLIDATED FINANCIAL STATEMENTS TO THE COUNCIL OF THE CACADU DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

**Basis of preparation**

The financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP) prescribed by the Minister of Finance in terms of:

- *General Notice* 991 of 2005, issued in *Government Gazette* no. 28095 of 7 December 2005; and
- *General Notice* 992 of 2005, issued in *Government Gazette* no. 28095 of 15 December 2005.

The standards comprise of the following:

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| GRAP 1 | Presentation of Financial Statements |
| GRAP 2 | Cash Flow Statements |
| GRAP 3 | Accounting Policies, Changes in Accounting Estimates and Errors |
| GAMAP 4 | The Effects of Changes in Foreign Exchange Rates |
| GAMAP 6 | Consolidated Financial Statements and Accounting for Controlled Entities |
| GAMAP 7 | Accounting for Investments in Associates |
| GAMAP 8 | Financial Reporting of Interests in Joint Ventures |
| GAMAP 9 | Revenue |
| GAMAP 12 | Inventories |
| GAMAP 17 | Property, Plant and Equipment |
| GAMAP 19 | Provisions, Contingent Liabilities and Contingent Asset |

Accounting policies for material transactions, events or conditions not covered by the above GRAP and GAMAP Standards have been developed in accordance with paragraphs 7, 11 and 12 of GRAP 3. These accounting policies and the applicable disclosures have been based on the South African Statements of Generally Accepted Accounting Practices (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board.