

# REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE EDEN 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(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 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 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 District Municipality has elected to early adopt the preparation of its financial statements on the basis of accounting determined by the National Treasury, as described in the addendum to this report.

## 4. QUALIFICATION

### 4.1 Post retirement benefits

The District Municipality has not recognised its obligation in respect of ex gratia pension benefits and medical aid benefits payable to former employees as required in terms of IAS19 (AC116): *Employee Benefits*. The effect on liabilities, net surplus and accumulated surplus of the District Municipality recognised in the annual financial statements could not be quantified as the District Municipality has never obtained an actuarial valuation in respect of these obligations. The annual payments by the District Municipality in respect of ex gratia pensions and post retirement medical aid contributions for the year to 30 June 2006 amounted to R157 088 and R985 508 respectively.

## **4.2 Leave pay obligation**

It was not possible to rely on the integrity of the underlying data used in the compilation of the accrued leave pay obligation due to pervasive control and procedural weaknesses with regard to filing in general, completeness of personnel files, completion and processing of leave applications and completion of attendance registers.

Under these circumstances it was not possible to carry out all the auditing procedures, or to obtain all the information and explanations considered necessary, to satisfy myself as to the completeness, valuation and obligations in respect of the accrued leave pay obligation amounting to R 1 190 491 (2005: R2 035 190).

## **4.3 Property, plant and equipment**

### **4.3.1 Capitalisation of land and buildings at Municipal valuations**

Certain fixed property with a carrying value of R 29 443 120 was capitalised for the first time during the current financial year. These properties had not been recognised as assets of the District Municipality in prior periods and there was no applicable cost price. The carrying values of the fixed property have been measured with reference to the municipal valuation of each property. In terms of GAMAP 17 fixed property recognised under these circumstances should be measured at fair value. Fair values of land and buildings are usually their market value, determined by appraisal normally undertaken by a member of the valuation profession who holds a recognised and relevant professional qualification. In the absence of sworn appraisals for each property in question it was not possible to determine whether or not the municipal valuations used were a reasonable approximation for fair values and therefore whether or not land and buildings are correctly measured in the financial statements. It is acknowledged in this regard that the District Municipality is in the process of obtaining sworn valuations for each property.

### **4.3.2 No depreciation provided on buildings**

No depreciation has been provided on buildings in the current year as required in terms of paragraph 55 of GAMAP 17. Furthermore, the entire accumulated depreciation balance amounting to R7 900 196 which had erroneously been provided in respect of both land and buildings, for the period to 30 June 2005 was reversed with retrospective effect.

### **4.3.3 Impairment of assets**

In terms of IAS36 (AC128) *Impairment of assets*: the District Municipality must at each reporting date assess whether there is any indication that an asset may be impaired. If so, the asset must be tested for impairment.

The above was not done by the District Municipality during the year under review due to the recent conversion to the new accounting framework. In addition, no accounting policy was included in the annual financial statements for the impairment of assets. It is acknowledged that an explicit statement has been made in note 10 to the financial statements that no assessments of impairment has been done as yet.

#### **4.3.4 Assessment of useful life**

In terms of GAMAP 17, the useful life 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.

Due to the District Municipality's recent conversion to the new accounting framework the useful life of items of property, plant and equipment was not reviewed in the year under review.

#### **4.3.5 Residual values**

In terms of GAMAP 17, the depreciable amount of an asset is determined after deducting the residual value of the asset.

Due to the District Municipality's recent conversion to the new accounting framework it did not determine or assess the residual values of property, plant and equipment for the year under review.

The effect of the departures from GAMAP 17 listed above on the carrying values of property, plant and equipment recognised in the annual financial statements could not be quantified.

#### **4.4 Investment property**

Income from rental of facilities and equipment amounting to R258 371 (2005: R530 973) has been recognised per the Statement of Financial Performance. No fixed property has however been classified and recognized as investment property and the separate disclosures required in relation to investment properties have not been made as required in terms the provisions of IAS40 (AC135): *Investment Property*.

It is acknowledged that the District Municipality is in the process of assessing each newly capitalised property with a view to appropriate classification, recognition, measurement, presentation and disclosure before 30 June 2008.

#### **4.5 Long term receivables**

No formal loan agreements could be presented in support of balances owing to the District Municipality by various local Municipalities totalling R1 820 301. One of the balances amounting to R347 006 described as "Vicbay Sewerage and Paving" has been outstanding for a considerable period of time and no payments were received against this loan during the current year. It was not therefore possible to confirm inception dates, principal debt, interest rates and terms of repayment relating to these balances. Under these circumstances it was not possible to confirm the recoverability, rights, valuation and completeness of these balances, or the short term portions thereof.

#### **4.6 Financial instruments**

The District Municipality has not applied the provisions of IAS 39 (AC133) *Financial Instruments: Recognition and Measurement* or IAS32 (AC125) *Financial Instruments: Presentation and Disclosure* in their accounting processes and in the

compilation of the annual financial statements at 30 June 2006. This is due to their recent conversion to the new accounting framework. It was not possible to quantify differences, if any, between the fair values of financial instruments and their carrying amounts. Details of the carrying amounts of financial instruments at 30 June 2006 are set out below.

- Held to maturity investments: R94 604 (2005: R94 604)
- Long term receivables: R3 406 159 (2005: R13 710 290)
- Consumer debtors: R931 274 (2005: R5 244 688)
- Other debtors: R14 676 807 (2005: R 15 415 877)
- Call investment deposits: R17 780 367 (2005: R49 010 077)
- Bank balances and cash R46 288 261 (2005: R8 070 235)
- Long term liabilities: R8 591 670 (2005: R9 458 018)
- Creditor balances: R10 079 699 (2005: R33 871 387)

#### **4.7 Statement of changes in net assets**

GRAP 3: *Accounting Policies, Changes in Accounting Estimates and Errors* requires that material prior period errors are corrected retrospectively in the first set of financial statements authorised for issue after their discovery by:

- restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets for the earliest prior period presented.

Note 29 to the financial statements provides a breakdown of the items representing prior period errors totalling R11 234 317. This amount has been credited directly to the accumulated surplus via the statement of changes in net assets. Comparative amounts, and opening balances at 1 July 2004 have not however been restated as required in terms of GRAP3.

Property, plant and equipment totalling R29 443 119 recognised for the first time has also been credited directly to the accumulated surplus via the statement of changes in net assets. Comparative amounts, and opening balances at 1 July 2004 have not however been restated as required in terms of GRAP3.

Total net assets per the sub total line item "Restated balance" does not agree to net assets per the balance sheet at 30 June 2005. Furthermore, the column "Capital Replacement Reserve" has not been split to separately present Pre-GAMAP Reserves and Funds" and movements thereon on conversion to GAMAP.

#### **4.8 Compilation of annual financial statements**

A number of other deficiencies and discrepancies with regard to compilation of the annual financial statements were noted. The more significant deficiencies and discrepancies were as follows:

##### **4.8.1 Statement of Financial Performance**

Depreciation: The prior year charge does not transfer correctly from the property, plant and equipment note and related annexure.

#### **4.8.2 Cash Flow Statement**

- Cash utilised in operations in the current year amounts to R7 525 921 whereas note 30 reflects cash generated from operations amounting to R30 007 036.
- Cash inflows have been presented as outflows and vice versa in the prior year.
- Note 30 to the annual financial statements contains a line item "Surplus for the year" which should read "Deficit for the year" for both the current and prior financial years. In addition, the surplus of R9 972 510 presented for the prior year does not agree to the prior year deficit of R542 395 per the statement of financial performance.
- Note 30 to the Annual Financial Statements also contains a line item "GAMAP conversion" amounting to R7 737 626 in the current period. This amount could not be supported. The conversion to GAMAP took place in the previous financial year.
- Note 31 to the annual financial statements discloses that total cash and cash equivalents included in the cash flow statement comprise bank balances and cash per the statement of financial position. Cash and cash equivalents per the cash flow statement do in fact also include the call investment deposit balances per the statement of financial position.

#### **4.8.3 Notes**

- Note 14: Summary of debtors by customer classification: The totals do not reconcile correctly to total consumer debtor balances. The difference is represented by insurance and rental agreement debtor balances which have been excluded from the summary of debtors by customer classification. It is acknowledged in this regard that insurance and rental agreement transactions are not processed via the accounts receivable module of the management information system and have not therefore been aged.
- Note 20 the annual financial statements does not correctly transfer to the statement of financial performance for the prior financial year. The reason for this is that the total has not been reduced by the portion of grants and subsidies unspent at the year end date.
- Note 20.5 to the annual financial statements reflects anticipated growth in the RSC Levy grant from the 2008 to 2009 financial year of 17.8%. This amount has been incorrectly calculated and should read 12.5%.
- The comparative amount in the note 22 does not agree with the signed prior year financial statements and no reconciliation has been provided for any restatements or reclassifications.

#### **4.8.4 Annexures**

Annexure F should present details of grants and subsidies as required in terms of Section 123 of the MFMA. This annexure however presents statistical information.

### **5. QUALIFIED AUDIT OPINION**

In my opinion, except for the effect on the financial statements of the matters referred to in the preceding paragraph, the financial statements present fairly, in all

material respects, the financial position of the District Municipality at 30 June 2006 and the results of its operations and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury of South Africa, as described in paragraph 3, and in the manner required by the MFMA.

## **6. EMPHASIS OF MATTER**

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

### **6.1. Inadequate disclosure in the financial statements**

The following disclosures have not been made in the financial statements as required by the relevant GAMAP, GRAP and International Accounting Standards (IAS):

- (a) Risk management policies and the risk exposure to interest rate risk and credit risk as required in terms of IAS 32 (AC125) *Financial Instruments: Presentation and disclosure* paragraphs 67 and 76.
- (b) The accounting policies regarding post retirement employment benefits in terms of IAS 19 (AC116) *Employee benefits*.
- (c) Details of operating leases in terms of IAS 17 (AC105): *Leases*.
- (d) Details of related party relationships, transactions with related parties, balances owed or owing to or by related parties and key management personnel compensation as required in terms of IAS24 (AC126) *Related party disclosures*. It is acknowledged that partial compliance with regard the requirements of this statement relating to key management personnel remuneration has been achieved through disclosures made in notes 23 and 24 which disclose the remuneration of the Municipal Manager, Chief Financial Officer, Executive Directors and Councillors.

### **6.2. District Council Levies**

It was not possible to verify the completeness and accuracy of recorded income from levies as it could not be confirmed that a structured basis for collection of such levies exists.

It is however acknowledged that levy inspectors are assigned to cover the entire area of jurisdiction of the District Municipality and are incentivised to maximize collection of levies.

Taking into account the relative percentages of turnover and payroll applied in calculation of the establishment and services levies, the extent of levy income that is not collected from unregistered enterprises may not be material.

It should also be noted in this regard that District Council levies have been abolished with effect from the end of June 2006.

### **6.3. Non Compliance with laws and regulations:**

A number of instances of non compliance with applicable laws and regulations were surfaced during the course of my audit. Instances noted include the following:

- MFMA: Sections 121, 127 and 164(1)(c).
- Housing Act, 1997: Section 10(4) (f)

### **6.4. Internal controls**

In terms of Section 62 of the MFMA it is the responsibility of the Municipal Manager to ensure that an effective system of internal control is implemented and maintained. In the light of matters raised in my management letter, it appears that internal checking and control mechanisms require improvement.

### **6.5. Performance management**

The assessment of the controls implemented by municipal management to implement and manage the Eden District Municipality's performance management system as required by section 45(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) has been reported on in separate report on performance measurement.

### **6.6. Annual Financial Statements**

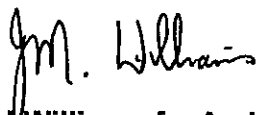
Material changes and corrections were made to the statements submitted for audit. The statements were subsequently re-signed and dated on 15 December 2006.

### **6.6. Un-audited additional information**

The supplementary schedule set out on page 37 does not form part of the annual financial statements and is presented as additional information. This schedule has not been audited and accordingly no opinion is expressed thereon.

## **7. APPRECIATION**

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



**J. Williams for Auditor-General**

**Cape Town**

**15 March 2007**



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

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

*GRAP & GAMAP:*

**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:

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.