

REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NDLAMBE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ndlambe Municipality which comprise the balance sheet as at 30 June 2007, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the standard determined by the Institute of Municipal Treasurers and Accountants in its Code of Accounting Practice (1997) and Report on Published Annual Financial Statements (second edition – January 1996) which constitutes an entity specific basis of accounting and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)]. This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by [section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004)], my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

The municipality's policy is to prepare financial statements on the basis of the standards laid down by the Institute of Municipal Finance Officers as determined by the National Treasury and as set out in note 1 to the financial statements.

Basis for adverse opinion

Fixed assets

9. The completeness, existence and valuation of the fixed assets balance of R46,375 million as reported in note 4 and on appendix C to the annual financial statements could not be determined as the Municipality has no properly updated fixed asset register supporting this balance. A comparison performed between the fixed asset register and the annual financial statements revealed an unreconciled difference of R10,682 million.
10. Furthermore additions acquired during the year from trust funds and reserves were not reflected in the annual financial statements additions totaling R8,496 million and were not included in the asset register.
11. Proceeds received from the disposal of assets for the year of R5,308 million are not reflected in note 4 or on appendix C to the annual financial statements.

Trust funds and reserves

12. The trust fund Building Fund Erven as reported in note 2 and annexure A to the annual statements reflects contributions for the year amounting to R5,308 million in respect of erven sales. This amount represents only the net amount receipted by the municipality in respect of the erven sales after deducting amounts payable to the property developer in terms of a joint venture agreement. The result of reflecting only the net receipt is the understatement of both fund income by an amount of R33,208 million and expenditure by an amount of R29,13 million respectively. I was not able to determine the full extent of this error.
13. Upon comparison between the Division of Revenue Act (DORA) allocations and appendix A contributions to the trust funds Municipal Infrastructure Grant and National Electricity Regulator Grant revealed unexplained discrepancies of R1.4 million and R1.08 million respectively for the year.
14. Trust funds and reserves as reported on annexure A and note 2 for the year amounting to R33,174 million could not be agreed to the trial balance. Comparison with the total trust funds and reserves balances according to the trial balance revealed an unknown difference of R389 912. No explanation could be obtained for this difference.

Statutory funds

15. A comparison between the amounts paid by the Eastern Cape Department of Housing and Local Government revealed unexplained discrepancies of R3,096 million in Housing Fund contributions for the year as reflected in appendix A.

16. Adequate supporting documentation for payments made from the Housing Fund totalling R15,048 million could not be provided for audit purposes. The significance thereof represented a limitation of scope on the extent of audit work that could be performed.
17. Housing Fund income and expenditure for the year as reflected in annexure A to the annual financial statements is understated by R26,711 million and R24,610 million respectively as a result of not including transactions for the year processed from the housing bank account. The fund balance is therefore understated by an amount of R2,101 million.
18. The total statutory funds as reported on annexure A and note 2 for the year amounting to R25,352 million could not be agreed to the trial balance. Comparison with the total statutory fund balances according to the trial balance revealed an unknown difference of R90 000, however further consideration of the above omission indicates the amount of this difference to be R2,191 million.

Appropriation account

19. The unappropriated surplus balance as reported in note 15 for the year amounting to R587 508 could not be agreed to the trial balance. Comparison with the total unappropriated surplus balances according to the trial balance revealed an unknown difference of R4,053 million. No explanation could be obtained for this difference.
20. Adequate supporting documentation for journals totaling R1,99 million could not be provided for audit purposes. The significance thereof represented a limitation of scope on the extent of audit work that could be performed.

Cash and bank

21. The general ledger opening balance of the housing fund bank account of R7,016 million was found to be understated by an amount of R1,84 million when compared to the closing balance of R8,856 million reported in the prior year annual financial statements. No explanation for the difference could be obtained.

Value Added Tax (VAT)

22. A portion of the creditors balances as reported in note 10 to the financial statements comprises VAT owing to the South African Revenue Service (SARS) amounting to R2, 273 million. Due to the lack of a proper management framework for reconciliations, this amount remains unreconciled, as was reported in the prior year, as a result no documentation is available to support the valuation and existence of the balances.
23. Furthermore the municipality contracted a VAT investigator during the year to identify any unclaimed VAT input. The results of the investigation were received in April 2007 and showed claimable input VAT of R1,01 million. No adjustments have been made to the books of account for the amount which was claimed in the June 2007 Vat return. As a result the VAT balance as reported above is overstated by the amount whilst the full financial effect of the adjustments required to current and capital expenditure are unknown.
24. As reported under trust funds and reserves above the municipality has not properly account for transactions relating the sale of erven for the year. As a result the VAT balance as reported above is overstated by an amount of at least R1,237 million being

VAT claimed in September 2007 on the transactions which were not recorded during the year. The full extent of this error could not be determined as stated above.

Accounts receivable

25. An analysis of service debtors balances as at 30 June 2007 revealed that debtors totalling to R47,862 million have been outstanding for a period of longer than 90 days. In view of the aforementioned a provision amounting to R35,325 million has been made to cover the possible level of irrecoverable debts. The provision is therefore considered to be understated by an amount of R12,618 million which could result in unbudgeted charges against the rates and general account in future financial periods. Furthermore trade debtor's balances have increased by R5,488 million since the prior year, whilst the provision has decreased by an amount of R1,654 million.

Accounts payable

26. Creditors balances as reported in note 10 for the year amounting to R5,993 million could not be agreed to the trial balance. Comparison with the total creditor's balances according to the trial balance revealed an unknown difference of R1,018 million. No explanation could be obtained for this difference.
27. The trade creditors balance was found to be understated by an amount of at least R3,132 million in respect of unpaid obligations at the yearend having not been accounted for as creditors. As a result current expenditure for the year is also understated by the same amount.
28. The municipality has unidentified deposits amounting to R1,2 million as at the year end. The full financial effect of not having cleared the unidentified deposits account is not known, however it is considered that this will have a material effect on the municipalities debtors, creditors and revenue balance's.
29. A portion of the accounts payable balances accounts reported in note 10 to the annual financial statements amounting to R4,105 million could not be substantiated and are considered unlikely that these balances represent an outstanding obligation of the municipality. Due to the lack of a proper management framework for reconciliations and the processing of journals, these accounts have not been investigated and cleared on a regular basis. It was therefore not possible to confirm the existence, accuracy and completeness of these payables.
30. Included in creditors is an account balance of R1,760 million which is in debit and should therefore not have been disclosed as a liability. Furthermore this balance is unsubstantiated and it is therefore not known what the full financial effect of reallocating the balance from payables will be.

Expenditure

31. Procedures performed on expenditure and contracts awarded, revealed significant unsatisfactory results regarding the procurement and payment processes. Audit findings included:
- Service level agreements and or tax clearance certificates could not be provided in numerous instances.
 - The competitive bidding process was not followed in numerous instances. All such instances identified amounted to R2,544 million.

- Payments totaling R784 000 were found to have been made without obtaining the minimum number of required quotations.
32. The above instances were considered to meet the definition of irregular expenditure in terms of the MFMA. No disclosure of the amounts was made in the annual financial statements and, furthermore, no written notification was submitted to the relevant treasury in this respect. As a result it was not possible to determine the full extent of irregular expenditure that should be disclosed in note 33 to the annual financial statements.

Commitments and contingent liabilities

33. Contingent liabilities amounting to R5,704 million are reported in note 25 whilst no commitments were disclosed in note 35. However additional contingent liabilities totalling R411 622 and commitments amounting to R6,843 million were identified that should have been disclosed respectively. We were however not able to determine the full extent of commitments and contingent liabilities that were not disclosed.

Unauthorised expenditure

34. Actual expenditure for the main division of trading services for the year exceeded the budgeted expenditure by R4,250 million. The resultant unauthorised expenditure as a result of this over expenditure had not been disclosed in the financial statements.

Adverse opinion

35. In my In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of Ndlambe Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended, in accordance with the standards as laid down by the Institute of Municipal Finance Officers and in the manner required by the MFMA.

EMPHASIS OF MATTER

I draw attention to the following matters:

Highlight of a matter affecting the financial statements which is included in a note to the financial statements

36. Approximately R34,650 million of the funds and reserves balances reported in note 2 and appendix A has been loaned to fund the operations of the municipality. It is considered unlikely that these amounts will be repaid timeously and this could affect the completion of capital projects as delays may be experienced due to a shortage of available funds.
37. Attention is drawn to note 5 to the annual financial statements, reflecting a long term investment with New Republic Bank – who have been placed under curatorship. Interest is accrued by the bank, but no withdrawals can be made. It is therefore doubtful when and at what value this amount will be recovered.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Internal control

38. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The paragraphs below depict the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies existed in more than one internal control component.

| Reporting item | Control environment | Assessment of risks | Control activities | Monitoring |
|---|---------------------|---------------------|--------------------|------------|
| Fixed assets | | | ✓ | ✓ |
| Trust funds and reserves | | | ✓ | ✓ |
| Statutory funds | | | ✓ | |
| Appropriation account | | | ✓ | |
| Cash and bank | | | | ✓ |
| Value Added Tax | | | ✓ | |
| Accounts receivable | | | | ✓ |
| Accounts payable | | | ✓ | |
| Expenditure | | | ✓ | |
| Commitments and contingent liabilities | | | | ✓ |
| Unauthorised expenditure | | | | ✓ |
| Cash flow statement | | | | ✓ |
| Non-compliance with applicable laws and regulations | | | | ✓ |
| Material corrections to the financial statements | | | ✓ | ✓ |

Material non-compliance with applicable legislation

Value Added Tax Act No.89 of 1991

39. The audit of VAT revealed that output VAT was not declared on revenue transactions that have become taxable at the standard rate as of 1 July 2006 due to the amendments to the act. These amendments now include the activities of municipalities within the

scope of the ordinary test for an 'enterprise' in terms of paragraph (a) of the 'enterprise' definition and section 7(1)(a) of the VAT Act.

Municipal Finance Management Act, 2003 (Act No. 56 of 2003)

40. Two joint venture agreements were identified and these are considered to meet the definition of a public private partnership. The municipality did not comply with the prescripts of section 120 of the MFMA prior to entering into these agreements.

Material corrections made to the financial statements submitted for audit

41. The financial statements that were approved by the accounting officer and submitted for auditing on 30 August 2007 have been significantly revised in respect of the following material misstatements identified during the audit:

- Interest expense was increased by R696,859 and the fixed assets were decreased by R468,872 and appropriation credited by R226,987.
- Grants and subsidies was increased by R1,133 million and operating revenue was decreased by R578,397 and the appropriation account debited by R554,278 Transfer payments were decreased and current expenditure was increased by R2,6 million.
- Security disclosure of R5 million on the Development Bank of South Africa loans was moved as being disclosed in note 25 to be disclosed in note 3, and a contingent liability of R130,275 was removed from note 25.
- Additional disclosure in note 31 of R3,652 million in PAYE.
- Lottery fund revenue increase by R553,000 and expenditure increase by R352,269.
- Creditors increased by R735,765 while long term liabilities decreased by the same amount.
- Capital asset additions were decreased by R771,236 and creditors was reduced by the same amount.
- Disclosure note 14 interest earned increased by R1,694 million.
- Debtors were reduced by R506,723 while current expenditure was increased by R138,942 and the appropriation account was debited by R367,304.
- ...Bad debts provision was decreased by R1,564 million and the appropriation account was credited by the same amount. And the bad debt write off disclosed in note 8 was increased by R1,564 million.
- Debtors were increased by R1,324 million while creditors were increased by the same amount.

OTHER REPORTING RESPONSIBILITIES

Responsibility of the accounting officer

42. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

43. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 646 of 2007*, issued in *Government Gazette No. 646 of 25 May 2007* and section 45 of the MSA.

44. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and

related systems, processes and procedures. The audit procedures selected depend on the auditor's judgment.

45. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

46. I was not able to complete an evaluation of the quality of the reported performance information as set out on pages xx to xx of the annual report, since the information was not received in time.

APPRECIATION

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

Auditor-General

East London

05 December 2007



AUDITOR-GENERAL