

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Sundays River Valley Municipality which comprise the statement of financial position as at 30 June 2007, statement of financial performance, statement of changes in net assets and separate 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 basis of accounting determined by National Treasury, as set out in accounting policy note 1.1.2 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) *Auditor-General audit circular 1 of 2007*. 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) (PAA), 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 judgement, 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. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is still in the process of being developed, I have determined that my audit of any disclosures made by the Sundays River Valley Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by National Treasury, as set out in accounting policy note 1.1.2.

Basis for adverse opinion

10. Basis of accounting (departures and deviations)

National Treasury approved a deviation from the basis of accounting in terms of *Government Notice 552 of 2007* issued in *Government Gazette 30013 of 29 June 2007*. Paragraph 3(2)(b) of the Gazette states that no medium capacity municipality may deviate from paragraph (a) or from an exemption in terms of sub clause 1(a) or (b) unless the municipality has consulted the relevant Treasury. A letter was sent to National Treasury on 4 July 2007 to enquire as to whether the exemptions applicable to high capacity municipalities in the annexure to the Gazette would be available to the Sundays River Valley Municipality based on the fact that the municipality is a medium capacity municipality which has elected to early adopt the Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP) and South African Statements of Generally Accepted Accounting Practices (SA GAAP) where not covered by GRAP and GAMAP Standards.

The response received by National Treasury on 8 August 2007 stated that the municipality may apply the exemptions available to high capacity municipalities as per the annexure to the Gazette. However, note 1.1.2 *Basis of preparation* to the financial statements incorrectly states that the municipality has elected to early adopt certain standards that were exempted in terms of *Government Notice 552 of 2007* issued in *Government Gazette 30013 of 29 June 2007* as the standards listed in the note have not been early adopted in the current financial year. Furthermore, note 1.24 *Exemptions* to the financial statements lists the exemptions applied in terms of the abovementioned Gazette, but this list is not complete.

11. Receivables

11.1 Provision for bad debts not adequate

The municipality provides for all trade debtors that have been outstanding for longer than 150 days. The provision for bad debts amounted to R19 845 224 at year-end. A recalculation of the provision for bad debts based on the same assumptions and criteria used by management amounted to R19 029 668. The provision for bad debts and the bad debts expense is thus overstated by R815 556.

12. Property, Plant and Equipment

12.1. Construction assets not correctly accounted for

The traffic building that is currently under construction has been classified as an item of inventory in note 6 to the financial statements as opposed to property, plant and equipment as required by *GAMAP 17: Property, Plant and Equipment*, paragraph 6. This resulted in an understatement of Property, Plant and Equipment and an overstatement of inventory by R1 162 799.

12.2. Difference between the general ledger and the financial statements

The balance relating to the cost of property, plant and equipment per note 6 to the financial statements is R79 995 255, but the general ledger reflects a balance of R80 268 067. Property, plant and equipment at cost is thus understated by R272 812. The accumulated depreciation per the financial statements also differs to the general ledger by the same amount resulting in an understatement of accumulated depreciation. The net effect on the carrying value of the property, plant and equipment is nil.

13. Payables

13.1. Limitation of scope

The balance relating to sundry creditors included in the trade creditors balance per note 5 of the financial statements is R2 077 098. The balance per the general ledger is R2 246 139. No reason could be provided for the difference of R169 041. Furthermore, supporting documentation for creditors amounting to R330 806 could not be provided for audit purposes.

There were no satisfactory audit procedures that I could perform to obtain reasonable assurance to satisfy myself as to the occurrence, valuation and completeness of the creditors balance per the financial statements.

13.2. Reconciliation not performed

Creditors are not raised on receipt of goods/services i.e. on transfer of the risks and rewards resulting in an obligation as required by *IAS 37 (AC 130): Provisions, contingent liabilities and contingent assets*. Furthermore, creditors at year-end are determined based on payments made in the subsequent two months and reconciliations are not performed between the supplier statements and the balances in the general ledger. There were no satisfactory audit procedures that I could

perform to obtain reasonable assurance to satisfy myself as to the completeness, occurrence and valuation of trade creditors amounting to R6 363 750 per note 5 to the financial statements.

13.3. Cash and cash equivalents

Subsequent to year end cheques to the value of R276 043 on the outstanding cheque list have either been cancelled or become stale. Although the obligation still existed at year end, these cheques were not written back to creditors resulting in the understatement of payables and cash and cash equivalents by R276 043.

Cheques to the value of R274 074 were cancelled, however these cheques were not written back to creditors and are still reflected on the outstanding cheque list. Furthermore, the expenditure relating to the replacement cheques was incorrectly duplicated. Thus, expenditure and payables are understated by R274 074.

It was identified that cheques are printed, processed and not sent to suppliers within a reasonable time as to prevent non compliance with section 65(e) of the MFMA which states that that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement. The remaining overdraft facility at year end was not sufficient to allow for the payment of the outstanding cheque list of R4 898 671. Thus, payables and cash and cash equivalents is understated by a further R4 348 553.

13.4. Leave pay accrual

The leave pay accrual of R1 358 479 as per note 5 to the financial statements has been calculated based on gross salaries whereas *IAS 19 (AC 116): Employee benefits*, requires that the basis of the calculation should be the total cost to company.

Supporting documentation to allow of the recalculation of the leave pay accrual could not be provided for audit purposes. In addition, a number of variances were identified between the attendance registers, leave applications and leave records. There were no satisfactory audit procedures that I could perform to satisfy myself as to the valuation, occurrence and completeness of the leave pay accrual amounting to R1 358 479.

14. Government grants

14.1. Limitation of scope

Supporting documentation for the expenses incurred during April 2007 could not be provided for audit purposes. There were no satisfactory audit procedures that I could perform to obtain reasonable assurance to satisfy myself as to the occurrence and accuracy of grant expenditure amounting to R304 777.

14.2. Incorrect treatment of conditional grants relating to property, plant and equipment

The municipality has received conditional grants for the construction of assets in the current and prior financial years. A work in progress asset, as required by paragraph 6 and 9 of *GAMAP 17: Property, plant and equipment* is not recognised as

expenditure is incurred. In addition, revenue has not been recognised in the statement of financial performance in respect of grants used to construct assets as required by paragraphs 42 – 46 of *GAMAP 9: Revenue*.

Management was unable to provide grant agreements and a detailed breakdown of completed assets and construction assets in progress funded by conditional grants. There were no satisfactory audit procedures that I could perform to determine impact of the incorrect accounting treatment on the value of the property, plant and equipment, revenue, depreciation, the government grant reserve and the accumulated surplus account as a result of conditional grants received and utilised.

15. Provisions

15.1. Provision for rehabilitation of landfill sites

The valuation, occurrence and completeness of the provision for rehabilitation of landfill sites of R1 200 000 per note 4 to the financial statements could not be determined as the calculation provided by management did not contain sufficient information to enable a recalculation/evaluation of the provision.

16. Leases

16.1. Finance lease incorrectly classified

A lease agreement has incorrectly been classified as an operating lease as opposed to a finance lease as per the criteria set by *IAS 17 (AC 105): Leases*, resulting in the understatement of property, plant and equipment by R373 657 and understatement of expenditure and long term liabilities by R103 716 and R477 373 respectively.

17. Reserves

17.1. Reserves not cash backed

GRAP 1: Presentation of financial statements, paragraph 144 states that all balances in reserves and trust fund accounts that are not represented by cash on the date of transition should be transferred to the opening balance of the accumulated surplus/deficit account in the statement of changes in net assets. There is no legislative requirement to maintain separate fund accounts. The municipality has a capital replacement reserve of R224 384 as per note 2 to the financial statements, however this amount has not been cash backed by a separate investment account and thus the amount in the reserve should be transferred to the accumulated surplus account as required by *GRAP 1*. Accordingly, the capital replacement reserve is overstated and the accumulated surplus understated by R224 384. Furthermore, the municipality does not have sufficient cash to back the purchase of the assets as the main bank balance is in overdraft by R5 538 174 and the capital replacement reserve balance amounts to R224 385.

17.2. Capitalisation reserve (CR)

The valuation, accuracy and completeness of the CR of R5 574 592 per note 2 to the financial statements could not be verified as supporting documentation for the

schedule of workings used to calculate the reserve balance could not be provided for audit purposes.

A transfer of an amount equal to additions, as reflected in the fixed asset register, from the accumulated surplus to the CR did not take place during the current year resulting in the overstatement of the accumulated surplus and the understatement of the CR by R1 027 468.

A transfer of an amount equal to the value of depreciation on property, plant and equipment financed from formerly legislated funds from the CR to the accumulated surplus account did not take place during the current year resulting in the overstatement of the CR and an understatement of the accumulated surplus of the R475 608.

The accounting policy for the capitalisation reserve has not been disclosed in the financial statements.

17.3. Government grant reserve (GGR)

An annual transfer of an amount equal to additions financed from government grants as reflected in the fixed asset register, from the accumulated surplus account to the GGR did not take place during the current year resulting in the understatement of the GGR and overstatement of the accumulated surplus account by R5 548 797.

In addition, an annual transfer of an amount equal to the value of depreciation on property, plant and equipment financed from government grants from the GGR to the accumulated surplus account did not take place during the current year resulting in the overstatement of the GGR and an understatement of the accumulated surplus account by R2 329 027.

17.4. Unspent grants with debit balances

The recoverability of unspent grants with debit balances of R1 576 751 could not be determined as no supporting documentation could be provided for audit purposes.

18. Statutory funds

18.1. Funds not used for intended purposes

Statutory funds are not always used for their intended purposes. It was identified that funds allocated to specific projects are transferred to other funds on a temporary basis to fulfil cash flow needs. The Moses Madiba Waterborne Sewerage fund has a credit balance of R1 914 781 after deducting the investments available to this project as the related investments have been transferred to fund shortfalls in other grant accounts.

18.2. Incorrect allocation

A VAT refund received in the amount of R637 409 had been incorrectly posted to statutory funds resulting in an overstatement of statutory funds and an overstatement of the VAT debtor.

19. Accumulated surplus

19.1. Limitation of Scope

Supporting documentation could not be provided for the GAMAP/GRAP adjustment amount of R4 739 461 included in the Statement of Changes in Net Assets in the financial statements. There were no satisfactory audit procedures that I could perform to obtain reasonable assurance to satisfy myself as to the occurrence and accuracy of the adjustment made.

The prior year financial statements reflected a closing balance of R75 904 738 for the accumulated surplus. The current year restated opening balance is R31 332 138. Adequate supporting documentation in support of amounts totalling R17 438 271 included in the movement of R44 572 600 could not be provided for audit purposes.

20. Revenue

20.1. Assessment of rates

A rateable valuation reconciliation between the valuation roles and rates charged in support of assessment rates income of R4 591 924 per the statement of financial performance was not performed. Thus, sufficient and appropriate audit evidence was not available to perform audit procedures to determine the accuracy and completeness of assessment rates income recognised.

20.2. Understatement of government grants and subsidies

The finance management grant of R500 000 received has been incorrectly disclosed in the financial statements in the statement of financial position under short-term portion of unspent grants and subsidies instead of in the statement of financial performance under government grants and subsidies received resulting in an overstatement of current liabilities and an understatement of revenue by R500 000.

20.3. Agency fees not shown on net value

The municipality collects monies on behalf of the Department of Roads and Transport and is entitled to a 15% agency fee. Fees received by the municipality for assisting the department are not shown on a net basis as required by *GAMAP 9: Revenue* paragraph 08. This resulted in the overstatement of revenue and expenditure relating to amounts owed/paid to the department by R2 552 819.

21. Expenditure

21.1. Limitation of scope

Supporting documentation for bulk-, general expenditure and repairs and maintenance expenditure of R1 552 748 could not be provided for audit purposes. The occurrence, accuracy, completeness and correct classification of these expenses could thus not be determined.

21.2. Value Added Taxation (VAT)

Capturing errors and the incorrect accounting treatment of VAT invoices from suppliers resulted in the following:

- Understatement of expenditure by R104 837.
- Understatement of trade payables by R400 416.
- Understatement of cash and cash equivalents by R249 451.

21.3. Expenditure does not agree to supporting documentation

Capturing errors, non-reversal of cancelled cheques and the misallocation of invoices from suppliers resulted in the following:

- Overstatement of expenditure and understatement property, plant and equipment by R415 218.
- Understatement of administrative expenditure and unspent conditional grants by R701 754.
- Understatement of audit fees and trade payables by R446 051.

Based on the high error rate within the samples selected for auditing and the significance of the errors identified, the occurrence, accuracy, completeness and classification of total expenditure on bulk purchases, repairs and maintenance and general expenses amounting to R26 275 568 as per the financial statements could not be determined.

22. Journals

22.1. Journal download does not balance

The download of journal entries passed during the year obtained from management did not cast by R4 173 381 although the trail balance at year end balanced. Management could not provide any reason for the discrepancies and there were no satisfactory audit procedures that I could perform identify the reason for the discrepancies which arose as the result of weak internal controls over the preparation and approval of journal entries. This increases the risk of fraud and error.

22.2. Inadequate documentation

Supporting documentation for journals processed directly to the accumulated surplus account amounting to R4 739 461 could not be provided for audit purposes. There were no satisfactory audit procedures that I could perform to satisfy myself as to the occurrence, valuation and completeness of these journal entries.

23. Unauthorised, irregular and fruitless and wasteful expenditure

23.1. Unauthorised expenditure

The expenditure incurred on employee costs, depreciation, bulk purchases and general expenditure during the year has exceeded the budget by R17 474 688 per Appendix E(1) to the financial statements. This constitutes unauthorised expenditure as defined in section 1 of the MFMA. The unauthorised expenditure has not been

disclosed in the financial statements as required in terms of section 125 (2)(d)(i) of the MFMA.

Asset additions to the value of R1 674 819 was not budgeted for during the financial year under review. This constitutes unauthorised expenditure as defined in section 1 of the MFMA and has not been disclosed in the financial statements as required in terms of section 125 (2)(d)(i) of the MFMA.

23.2. Irregular expenditure

The procedures prescribed by the supply chain management policy (section 111 of the MFMA), relating to quotes and the tender processes have not been complied with. There is no evidence that tender processes were followed for expenditure above R100 000 and quotes have not been obtained in terms of the policy for the entire sample relating to repairs and maintenance, bulk purchases and other general expenses selected for audit purposes. The expenditure amounts to R26 404 537 and constitutes irregular expenditure as defined in section 1 of the MFMA. The irregular expenditure has not been disclosed in the financial statements as required in terms of section 125 (2)(d)(i) of the MFMA

23.3. Fruitless and wasteful expenditure

Expenditure amounting to R757 000 has been incurred as a result of interest and penalties charged, inefficiencies in administration and unsuccessful law suits. This constitutes fruitless and wasteful expenditure as defined in section 1 of the MFMA. The fruitless and wasteful expenditure has not been disclosed in the financial statements as required in terms of section 125 (2)(d)(i) of the MFMA.

24. Cash flow statement

- 24.1. In terms of *GRAP 2: Cash flow statements*, paragraph 2, an entity that prepares and presents financial statements under the accrual basis of accounting shall prepare a cash flow statement in accordance with the requirements of the standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented. The cash flow statement included in the financial statements does not cast. The cash and cash equivalents balance at the end of the year per the cash flow statement reflects an overdraft of R3 638 484, however it actually casts to an overdraft of R8 377 945. The statement of financial position reflects a net overdraft balance of R3 638 484 at year-end. Management could not provide any reasons for the difference of R4 739 461.

25. Presentation and disclosure

25.1. Changes in accounting policy not adequately disclosed

The following exemptions were applied in terms of the *Government Gazette no. 30013 dated 29 June 2007*, after early adoption of GRAP, GAMAP and GAAP in the prior year, however the disclosure required in terms of the change in accounting policy was not in line with the guidance provided by National Treasury on the updated application of accounting standards and implications of the *Government Gazette no. 30013 dated 29 June 2007* issued on 17 August 2007:

- *GAMAP 9: Revenue*: the entire standard to the extent that it relates to measurement at fair value.
- *IAS 20 (AC 134): Accounting for Government Grants and disclosure of government assistance*; the entire standard excluding paragraphs 24 and 26, replaced by paragraph 08 of GAMAP 12, paragraph 25 of GAMAP 17 and paragraphs 42 – 46 of GAMAP 09.
- *GAMAP 12: Inventories*; to the extent that it relates to water stock that was not purchased by the municipality.
- *IAS 40 (AC 135): Investment property*; the entire standard to the extent that the property is accounted for in terms of GAMAP 17.
- *IAS 19 (AC 116): Employee benefits*; regarding defined benefit accounting as far as it relates to defined benefit plans accounted for as defined contribution plans and the defined benefit obligation disclosed by narrative information.
- *IAS 36 (AC 128): Impairment of assets and GAMAP 17: Property, Plant and Equipment*; paragraphs 61, 62 – 69 and 77 regarding the review of useful life and depreciation of assets.

25.2. Revenue

Accounting policy 1.13 as per the financial statements did not include other income and fines as required by paragraph 61 of *GAMAP 9: Revenue*.

25.3. Receivables

Receivables have not been disclosed in the notes to the financial statements by sub-classifications such as receivable from user charges, taxes and other non-exchange revenues, other members of the economic entity, receivables from related parties, prepayments and other amounts as required by paragraph 84 of *GRAP 1: Presentation of financial statements*. Such presentation is relevant to an understanding of the entity's financial position.

25.4. Unspent conditional grant liability

In terms of the conditions of the loan agreement, an amount of R600 000 was to be transferred from the municipality's own funds into a separate investment account as security for the Development Bank of South Africa (DBSA) loan. The separate investment account was opened by the municipality; however an unspent conditional grant liability was raised in the prior year for the same amount. The creditor raised was not valid as the transaction does not meet the definition of a liability as per *IAS 37 (AC 130): Provisions, contingent liabilities and contingent assets*. A prior year error adjustment has been made in this respect in the current year as reflected in the statement of changes in net assets, however the disclosure as required by *GRAP 3: Accounting policies, changes in accounting estimates and errors* in respect of prior period errors have not been included in the financial statements. As at 30 June 2007, this investment account had a closing balance of R396 827 resulting in a breach of the conditions of the agreement.

25.5. Leases

Accounting policy 1.4 per the financial statements indicates that the municipality has finance leased assets; however no finance leased assets were disclosed in the financial statements as required by *IAS 17 (AC 105): Leases*. In addition, the

disclosures in the financial statements for operating leases as required by *IAS 17 (AC 105): Leases* is inadequate.

25.6. Inventories

The disclosure requirements of *GAMAP 12: Inventories*, paragraph 41(a) have not been complied with as the accounting policy adopted in measuring inventories does not include the cost formula used.

25.7. Employee Benefits

The municipality raised a provision for post retirement benefits amounting to R112 525 regardless of the application for an exemption in respect of *IAS 19 (AC 116) Employee benefits* regarding defined benefit accounting as far as it relates to defined benefit plans accounted for as defined contribution plans and the defined benefit obligation disclosed by narrative information. The supporting documentation and assumptions used in calculating the provision could not be produced for audit purposes.

25.8. Provisions, contingent liabilities and contingent assets

The disclosures as required by *GAMAP 19: Provisions, contingent liabilities and contingent assets*, paragraphs 95 and 96 have not been complied with as a reconciliation of the movement in the carrying value of provisions has not been included in the financial statements.

25.9. Property, plant and equipment

25.9.1 The accounting policy note 1.4 for property, plant and equipment in the financial statements states that property, plant and equipment is stated at cost, less accumulated depreciation and accumulated impairment losses, except for land and buildings, which are revalued. An exemption for impairments was obtained from National Treasury in terms of *Government Notice 552 of 2007 issued in Government Gazette 30013 of 29 June 2007*.

25.9.2 Disclosure requirements in respect of revaluation which includes the frequency at which revaluations occur as required by *GAMAP: 17 Property, Plant and Equipment*, paragraph 79 has not been met in the financial statements. Furthermore, there is no revaluation reserve reflected in the financial statements and the last valuation was performed in the 2002/2003 financial year. The land and buildings value of R27 206 970 included in property, plant and equipment as per note 6 and Appendix B to the financial statements may be understated.

25.9.3 In terms of *GAMAP 17: Property, Plant and Equipment* paragraph 55, land normally has an unlimited life and, therefore, is not depreciated. Depreciation amounting to R1 280 880 has been accounted for in the current year resulting in an overstatement of depreciation and an understatement of property, plant and equipment by the said amount.

25.9.4 Opening balances for property, plant and equipment have been restated, however the disclosure as required by *Generally Recognised Accounting Practices (GRAP) 3: Accounting policies, changes in accounting estimates and errors*, have not been made in the financial statements.

25.10. Disclosure requirements per the MFMA

The following items have not been disclosed separately in the financial statements as required by section 125(1)(c) of the MFMA:

- Audit fees
- Taxes paid
- Levies paid
- Duties paid
- Pension and medical aid contributions paid as well as the amounts outstanding as at the last day of the financial year in respect of medical aid contributions.

25.11. Related parties

Related party disclosures as required by *IAS 24 (AC 126): Related party disclosures* have not been included in the financial statements. Management was unable to provide information relating to any related party transactions or balances. There were no satisfactory audit procedures that I could perform to satisfy myself as to the occurrence, valuation and completeness of these related party transactions.

25.12. Subsequent events

The disclosures made in notes 38 and 40 to the financial statements which relate to events after the reporting date are insufficient for interpretation purposes. In addition, the disclosure as required by *IAS 10 (AC 107): Events after the balance sheet date* with regards to the nature of the event and the estimate of its financial effect has not been included.

25.13. Comparatives

Comparative amounts have been restated and reclassifications have occurred, however the disclosure as required by *GRAP 1: Presentation of financial statements*, has not been correctly included in the annual financial statements.

Prior year errors occurred relating to accumulated surplus, non-current provisions, trade and other payables, property, plant and equipment, unspent conditional grants, trade and other receivables, service charges, contributions to and from provisions and depreciation. The disclosure as required by *GRAP 3: Accounting policies, changes in accounting estimates and errors* in respect of prior period errors have not been included in the financial statements.

25.14. Change in accounting policies

The disclosure requirements of *GRAP 3: Accounting policies, changes in accounting estimates and errors* has not been fully complied with for the changes in a number of accounting policies from the prior year. The changed accounting policies include all the areas affected by the exemptions applied as well as the accounting policies relating to the leave pay provision, reserves, inventory and trade and other payables.

25.15. Government Gazette no. 30013 dated 29 June 2007

An implementation plan, detailing progress towards full compliance with section 22(3), was not submitted to the National and Provincial Treasury before 30 October 2007. A discussion on the progress made toward full compliance with GRAP, GAMAP & GAAP as well as a narrative explanation of the extent to which the information in the financial statements would need to be adjusted to fully comply with GRAP, GAMAP & GAAP were not included in an annexure to the financial statements or in the Municipal Manager's report as required by *Government Gazette no. 30013 dated 29 June 2007*.

Adverse opinion

26. 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 the Sundays River Valley Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting determined by National Treasury, as set out in accounting policy note 1.1.2 and in the manner required by the MFMA.

Emphasis of matter

I draw attention to the following matters:

27. Going Concern

The going concern concept assumes that the municipality will continue in operational existence for the foreseeable future. It further implies that the municipality has neither the intention nor the need to discontinue or curtail materially the scale of its operations or the services rendered in terms of its mandate. The financial statements have been prepared on the going concern basis which assumes that it will be able to meet its future obligations and commitments as they occur in the ordinary course of business. However, certain matters came to our attention that placed uncertainty on the municipality's ability to continue as a going concern. The aforementioned factors include a loss of R10 869 582 incurred in the financial year under review, a bank overdraft balance of R5 538 174 and letters of demand received from major suppliers.

OTHER MATTERS

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

28. Non-compliance with applicable legislation

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

- 28.1.1 The financial statements were not submitted to the Auditor-General within two months after the end of the financial year as required by section 126(1) of the MFMA.
- 28.1.2 The adjustments budget was not accompanied by a motivation of material changes to the annual budget; an explanation of the increased spending on the annual budget and the annual budget for the next two years as required by section 28(5) of the MFMA.
- 28.1.3 There is no evidence to verify that the mayor, within 30 days of the end of each quarter, submits a report to the council on the implementation of the budget and the financial state of affairs of the municipality as required by section 52(d) of the MFMA.
- 28.1.4 There was no council resolution in respect of the bank overdraft as required by section 45(3) of the MFMA.
- 28.1.5 The mayor of the municipality did not table the municipality's annual report in the municipal council within 7 months after the end of the previous financial year as required by section 127(2) of the MFMA; and a written explanation, setting out the reasons for the delay in terms of section 127(2), was not submitted to the council as required by section 127(3).
- 28.1.6 Salaries, travel allowances and cell phone allowances amounting to R701 358 were overpaid to councillors and the mayor in the prior financial year. No evidence could be provided to confirm that an attempt was made to recover the expenditure as required by section 167 2(a) and (b) of the MFMA.
- 28.1.7 The process required section 33(1) of the MFMA relating to contracts having future budgetary implications was not complied with in respect of significant finance leases entered into during the financial year.

28.2 Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

- 28.2.1 The municipality has not adopted and implemented a tariff policy on the levying of fees for municipal services as required in terms of section 74 (1) and (2) of the said act.
- 28.2.2 With regards to the DBSA loan incurred, the accounting officer of the municipality has not made public an information statement setting out particulars of the proposed debt, including the amount of the proposed debt, the purposes for which the debt was to be incurred, and particulars of any security to be provided; and invited the public, National Treasury and the Provincial Treasury to submit written comments or representations to the council in respect of such proposed debt prior to the meeting of the council at which approval for the debt was to be considered, as required by section 21A of the MSA.

28.3 Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000)

The municipality has not established a preference point system as required in terms of section 2(1)(a) of the said act.

28.4 National Environmental Management Act, 1996 (Act No. 108 of 1996)

The municipality did not have an environmental policy, detailed plans or clear strategies relating to environment management and/or achieving a sustainable environment as required by section 16(1)(1).

28.5 Environment Conservation Act, 1989 (Act No. 73 of 1989)

Permit conditions and the minimum requirements for waste disposal were not complied with at the Kirkwood and Addo (Langbos) landfill sites as required by section 20(1) of the Environment Conservation Act, 1989 (Act No. 73 of 1989).

29 Matters of governance

The municipality did not have a risk management policy and fraud prevention plan in place for the current financial year.

30 Internal control

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. A significant deficiency in the internal controls over blank, signed cheques were identified which increases the risk of fraud. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for adverse opinion					
Basis of accounting (departures and deviations)		X			
Receivables		X	X	X	
Property, plant and equipment	X		X	X	
Payables			X		
Government Grants			X		
Provisions	X		X		
Leases			X		
Reserves			X		
Statutory Funds			X		

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Accumulated surplus			X		
Revenue			X		
Expenditure			X		X
Journals			X		
Unauthorised, irregular and fruitless and wasteful expenditure	X	X			
Cash flow statement			X		
Presentation and disclosure			X		
Emphasis of matter					
Going concern		X			
Other matters					
Non-compliance with applicable laws and regulations	X	X	X	X	X
Matters of governance		X		X	

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

31 I have audited the performance information as set out on pages xx to xx.

Responsibility of the accounting officer for the performance information

32 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

33 I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 646 of 25 May 2007*.

- 34 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 procedures selected depend on the auditor's judgement.
- 35 I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

36 Non-compliance with regulatory requirements

36.1 Municipal Systems Act No. 32 of 2000 (MSA) and Local Government: Municipal Planning and Performance Management Regulations of 2001:

- 36.1.1 Performance based bonuses of R193 065 were paid to section 57 employees during the current year relating for the 2005/2006 financial year, although there were no pre-determined key performance indicators against which their performances were evaluated on their personnel files as required by section 57(4)(a) - (c) of the MSA.
- 36.1.2 The performance objectives and targets per the performance management system has not been cascaded down to all employees as required by section 9(2)(b)(i) of the Local Government: Municipal Planning and Performance Management Regulations of 2001.
- 36.1.3 The municipality has not included the key performance indicators and performance targets in the integrated development plan (IDP) as required by section 26(i) of the MSA. Priorities and objectives as approved in the IDP have not been linked to the Performance Management System (PMS), the Service Delivery and Budget Implementation Plan (SDBIP) outcome and results, as well as the performance assessment documentation.
- 36.1.4 The municipality has not prepared a performance report for each financial year reflecting the performance of the municipality, a comparison of the performance with targets set and comparisons with the results of the previous year and measures taken to improve performance as required by section 46(1) of the MSA.
- 36.1.5 No evidence could be provided for audit purposes to confirm that a performance audit committee has been established in terms of section 14(2)(a) of the Local Government: Municipal Planning and Performance Management Regulations of 2001.

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

The revenue and expenditure projections for each month and the service delivery targets and performance indicators for each quarter, as set out in the service delivery and budget implementation plan (SDBIP), were not made public within 14 days after the approval of the service delivery and budget implementation plan. In addition, the performance agreements of the municipal manager, senior managers and other categories of officials were not made public within 14 days after the approval of the

municipality's service delivery and budget implementation plan as required by section 53(3) of the MFMA.

APPRECIATION

37 The assistance rendered by the staff of the Sundays River Valley Municipality during the audit is sincerely appreciated.

Auditor - General

Port Elizabeth

16 May 2008



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