

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

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Tsolwana Municipality which comprise the balance sheet as at 30 June 2007, income statement, 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 standards laid down by the institute of Municipal Treasurers and Accountants and in the manner required by the 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) and section 126(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003), my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis of accounting**

8. The municipality's policy is to prepare financial statements on the basis of the standards laid down by the Institute of Municipal Treasurers and Accountants as set out in accounting policy note 1.1.

#### **Basis for disclaimer of opinion**

##### *Expenditure*

- 9.1 Payments totaling an amount of R2.3 million did not have any returned cheques attached to payment authorization slips. This represents a material scope limitation as it is not possible to verify that the payment had been made to the correct payee, nor if the payment was authorised by the correct staff members.
- 9.2 It was evident during the audit that deficiencies exist in the procurement process at the municipality. Audit testing of a sample of expenditure items revealed that goods to the value of R335 050 were not procured according to the requirements of the supply chain managements policies and principles.
- 9.3 Furthermore goods purchased to the value of R803 097 did not have adequate orders to support the purchase.
- 9.4 There is inadequate supporting documentation maintained by the municipality to support its expenditure transactions. It was found that payments were made to the amount of R1.08 million without the necessary supporting documentation present.
- 9.5 The expenditure budget for the year was exceeded by an amount of R2.1 million, this represents unauthorised expenditure.
- 9.6 No supporting documentation was submitted for journals that had been passed to capture expenditure into the accounting records of the municipality. As a result it was not possible to verify expenditure to the amount of R335 688.

##### *Employee Costs*

- 9.7 Personnel and leave records were found to be unsatisfactory and mostly not authorised.
- 9.8 Employees lacked employment contracts and in some instances employee files did not exist.
- 9.9 Employees had taken leave that had not been authorized and had accumulated more than the maximum leave allowed considered resulting in fruitless and wasteful expenditure.

- 9.10 In addition some employees had not taken the minimum amount of leave.
- 9.11 It was also found that incorrect leave payouts had occurred and overtime and deductions were not adequately authorised.
- 9.12 A provision for leave pay had been calculated but this was overprovided for at an amount of R3 441.
- 9.13 It was also not possible to confirm existence of certain casual employees.
- 9.14 There was also a lack of documentation relating to salary scales so it was not possible to determine if employees were paid according to salary scales as set by the SALBC.
- 9.15 In March 2006 an employee's contract had expired. He was however continued to be paid up until June 2007. Amounts totaling R465 347 were paid to him and this is considered to be fruitless and wasteful expenditure.
- 9.16 The municipality received conditional grants during the year. Contracts relating to the spending of these conditional grants were requested for audit purposes but these were not provided. As a result it was not possible to determine if R815 487 had been spent in accordance with the conditions of the grant.

#### *Revenue*

- 10.1 No supporting documentation was submitted for journals that had been passed to capture the debtors and revenue for various months throughout the year. As a result it was not possible to verify revenue to the amount of R3.8 million.
- 10.2 It was not possible to confirm interest of R533 723 included under other income as referred to on page 20 as there was no supporting documentation supporting the calculations used in determining the interest figure nor could the staff of the municipality indicate how these calculations were performed.
- 10.3 It was also not possible to determine the balance of the other income figure as referred to on page 20 as lists of water meters, income registers and rental contracts were not provided for audit purposes.
- 10.4 Certain properties in the municipal region are classified as non-rateable. These details are disclosed in part b of the property register. This was not supplied for audit purposes and as a result it is not possible to determine if all the non-rateable properties are in fact non-rateable and thus the completeness of revenue cannot be determined.

#### *Fixed Assets*

- 11.1 There is inadequate supporting documentation maintained by the municipality for its additions to fixed assets and thus additions to fixed assets to the value of R3.3 million could not be verified.
- 11.2 During the performance of our audit, we were unable to determine the individual values of assets relating to the former Hofmeyr TLC as their values had been consolidated into a single amount. Inspection of the fixed asset register revealed that balances have merely been brought forward from Hofmeyr and Luxolweni as no Fixed Asset register was maintained by Hofmeyr prior to the amalgamation. Accordingly no opinion can be expressed on the opening balances brought forward for these

amounts. All additions were however included in the consolidated fixed asset register. The aggregated amounts represent R3.1 million.

- 11.3 The fixed asset budget for the year was exceeded by an amount of R1.4 million, this represents unauthorised expenditure.

#### *Creditors*

- 12.1 Audit procedures revealed that an amount of R313 529 had not been accrued at year end.
- 12.2 Furthermore an amount of R50 905 had been excluded from the creditors listing, this represented Vat on individual creditors that had not been included when calculating the total. This is partly due to the fact that creditors are not accrued as they are incurred but only once at year end.

#### *Debtors*

- 13.1 During the year a journal had been passed for an internal advance. The journal had been incorrectly processed and as a result debtors are overstated by an amount of R39 501.
- 13.2 Audit procedures revealed that long outstanding debtors that cannot be collected are not being written off, despite the provision for doubtful debts having increased.
- 13.3 Problems have been identified in verifying the completeness of income, due to lack of monthly debtors' printouts confirming the accrual of amounts relating to rates and services. Consequently amounts raised not be agreed to supporting documentation, this no opinion can be presented on the existence of debtors.

#### *Value Added Tax*

- 14.1 Journals to the value of R516 067 were passed to capture vat into the accounting records but were not authorised.
- 14.2 During the audit of vat inputs it was found that there was no tax invoices present to support inputs claimed to the value of R66 143.

#### *Long Term Liabilities*

- 15 No supporting documentation could be provided to confirm the balance outstanding on external loans amounting to R295 721, thus the balance owing could not be confirmed.

#### *Trust Funds*

- 16.1 Audit procedures revealed that expenditure to the value of R4 276 604 during the year had no supporting documentation attached. This represent a material scope limitation as it is not possible to verify whether payment has been made to valid contractors for work actually performed.
- 16.2 Contracts relating to capital commitments were also not made available for inspection.

### **Disclaimer of opinion**

- 17 Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Tsolwana Municipality. Accordingly, I do not express an opinion on the financial statements.

### **Emphasis of matter(s)**

I draw attention to the following matter(s):

Note 14 on page 16 regarding the suspension of two municipal officials due to irregularities with regards to housing projects.

### **OTHER MATTERS**

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

#### 18 Internal control

##### 18.1 Control environment

Management and employees should establish and maintain an environment throughout the organisation that sets a positive and supportive attitude toward internal control and conscientious management

- The municipality does not have a commitment ensuring that staff are adequately trained in the functions that they perform. This was evident from the fact that staff did not know how all of the functions of the Sebata and TurboMunex system work.
- The Municipality does not ensure that positions are filled and that staff are monitored. This was evident from the fact that evidence could not be obtained that staff are monitored to ensure that they perform their duties properly and that there are currently vacancies in key positions at the municipality.
- The municipality has various weaknesses in its control environment, which has lead to overall weakness in the internal control. This was evident from the following:
  - Weak access controls over documentation
  - Lack of isolation of responsibility
  - The incorrect banking details appearing on their debtors invoices
  - Insufficient records and registers being kept
  - Oversubsidisation of indigent debtors
  - Lack of supporting documentation to support the transactions that took place
  - Ineffective procedures in the disconnection process.
  - Lack of a risk assessment process

##### 18.2 Control activities

Internal control activities are the policies, procedures, techniques and mechanisms that help ensure that management's directives to mitigate risks identified during the risk assessment process are carried out. Control activities should form an integral part of management's planning, implementing and reviewing.

- The municipality does not have adequate policies, procedures, techniques and mechanisms in place over all of its functional areas. As a result the municipality is

unable to ensure that transactions and events are carried out free of error. This was evident from the lack of policies, procedures, techniques and mechanisms over revenue, receivables, expenditure, inventory, compliance, and internal control.

- The municipality does not have adequate review processes in place to ensure that transactions and events occurred free of error. This was evident as during the audit it was found that various transactions and processes had taken place, but they had not been reviewed by a second independent person and the existence of various employee files and contracts could not be determined. In addition various transactions that took place were found not to have the necessary supporting documentation present nor were any bad debts identified.
- The municipality also has a lack of senior staff and management involvement in the various transactions and events that take place during the year. This was evident from the lack of authorisation that took place over and errors found in leave, employee costs, expenditure, revenue and journals as well as disclosure and presentation of the financial statements. This was also evident from the fact that delegations were not adequate nor were there adequate reviews over senior management.
- The municipality has also not adequately implemented controls over its functional areas. This has resulted in staff not following the correct processes. This was evident from the fact that there was a lack of adherence to SCM policies, a lack of reconciliations performed, inadequate authorisations, ineffective budget process, incorrect calculations and disclosures and incorrect valuations used for revenue calculation.
- The municipality does not employ safeguards to ensure that documentation is securely maintained. This was evident from the following:
  - Documentation relating to expenditure, fixed assets, value added tax, revenue and receivables could not be provided for audit purposes.
  - Documents used for the recording of expenditure and revenue were found easily accessible by most staff members.
  - Lack of access control to the computer system

#### *Material non-compliance with applicable legislation*

#### Municipal Finance Management Act

- 19 There was no performance evaluation performed for a S57 Manager
- 20 Audit work performed on the Integrated Development Plan revealed the document to be so incomplete that it could not be as a result of an properly designed and developed system for the development of an IDP in direct contravention with the Municipal Finance Management Act and Municipal Systems Act.
- 21 Section 125(2) (d) requires the disclosure of fruitless and wasteful as well as unauthorised expenditure per the Notes to the Annual Financial Statements, as such compliance has not been met as matters reported under paragraphs 29.1, 29.2, 29.3 has not been disclosed.

#### Municipal Systems Act

- 22 The municipality has not complied with section 6 of the Municipal Systems Act in that they have not put adequate control and monitoring mechanisms in place.
- 23 Section 95 of the Municipal Systems Act has not been complied with in that no formal policy of customer care has been implemented.
- 24 Section 73 of the Municipal Systems Act requires the Municipality to exercise their functions having regard to the provision of basic services and the constitutional rights and needs of the community, in manner that would promote economic sustainability. In view of the general lack of internal controls this duty cannot be seen to be discharged.
- 25 Section 55 of the Municipal Systems Act has not been complied with evidenced by the inadequate system of internal control
- 26 Section 15 of the Municipal Systems Act has not been complied with in that no copy of the municipal code, containing the Municipal Bylaws could be produced and was not available for public inspection.

#### Division of Revenue Act

- 27 Section 26(2) b of the Division of Revenue Act has not been complied with as monthly reports were not submitted to National Treasury.

#### *Value for money matters*

- 28 Audit procedures revealed that work on Tarka 671, Tarka 1004, Thornhill 1400 and Hofmeyr 1000 housing projects have been ceased due to alleged irregularities resulting in the contractors not being able to complete the projects within the required timeframes.

#### *Cashflow Statements*

- 29 Cash generated by operations has been overstated by R10 395 915. Furthermore the cash contributions by State has been understated by R12 876 134, this is in direct contravention with Section 123(a)(i) of the Municipal Finance Management Act, which requires all allocations to be disclosed.

#### *Unauthorised, Fruitless and Wasteful Expenditure*

- 29.1 Deficit incurred in the current year of R438 097 is considered unauthorised.
- 29.2 Increase in the provision for doubtful debts of R3 553 017 have been accounted for under appropriations. This allocation is considered incorrect as amount actually reflects overspending by the municipality and as such is considered to be unauthorised expenditure.
- 29.3 Referring to matters as listed under paragraphs 9.8, 9.9, 9.10 and 9.15. These matters are all considered to result in fruitless and wasteful expenditure.

#### *Disclosure Matters*

- 30 Capital charges of R117 710 per Note 12 of the Annual Financial Statements does not reconcile with capital charges of R72 817 per Appendix D.
- 31 Contributions from income per Appendix C are reflected as R486 274, whereas Appendix D does not indicate any contributions to fixed assets.

- 32 The balance of fixed assets of R2 007 374 does not reconcile to the total of internal and external loans of R2 098 737.

*Trust Funds*

- 33.1 Revolving fund has not been fully cash backed. The Revolving fund is reflected at R2 454 355 whereas the invested amount is only R429 456.

- 33.2 No contribution has been made to revolving fund during the year as required.

*Matters from prior year audit report that could affect current year*

- 34.1 Misallocation of an amount of R249 552 relating to fixed assets that should be disclosed under Street and Stormwater and not Land and Buildings.

- 34.2 Unreconciled amounts per the cashbook to the amount of R73 160 that could result in overstatement of bank balance amount.

**OTHER REPORTING RESPONSIBILITIES**

**Reporting on performance information**

- 34 We were not able to review the performance information as no annual performance report has been prepared by the municipality. This is a direct contravention of section 121(3) (c) of the MFMA. As a result no opinion can be expressed on performance information.

**Responsibility of the accounting officer**

- 35 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**

- 36 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.
- 37 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.



## **APPRECIATION**

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

East London

24 November 2007



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