

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Intsika Yethu 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, and the chief finance officer's report, as set out on pages to

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 entity specific basis of accounting 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) (PAA)] and section 126(3) of the MFMA, 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 Intsika Yethu 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 entity-specific basis of accounting, as set out in accounting policy note 1.

Basis of adverse opinion

Trust Funds

10. Included in the investment balance of R13,6 million is an amount of R9,9 million in respect of trust funds. These trust funds together with other project funds have not been disclosed in the annual financial statements as required by the IMFO guidelines. Consequently Appendix A has been understated by the said amount.

Appropriation account

11. Included in the appropriation account, as detailed in note 13 to the annual financial statements is an amount of R1,8 million. This amount could not be supported by documentation or explanations. There were also no alternative procedures that could be performed thereon. As a result I was unable to obtain sufficient acceptable evidence to verify the said amount.

Fixed Assets

12. Repairs and maintenance were shown as additions in the fixed asset register thus overstating fixed assets by an amount of R209 433 and understating expenditure by the same amount.

Furthermore the fixed asset balance of R57, 1 million as disclosed in Appendix C did not agree to the asset register and is understated by R16, 9 million. The asset additions per register also do not agree with asset additions disclosed in Appendix C and as a result an unreconciled difference of R18.5 million exists. This difference is also not disclosed or adequately explained in the financial statements.

Debtors

13. There was no credit control policy in place to monitor outstanding debts and management did not implement any procedures to discontinue service delivery to outstanding debtors which is a contravention of section 95 of the Municipal Systems Act, Act No. 32 of 2000.

Comparison of the amount of debtors outstanding for longer than 90 days as at 30 June 2006 could not be done due to differences between the age analysis report and the debtor's schedule. In addition the debtors balance has

increased by R4,3 million when compared to previous year. The amount of increase could not be explained or substantiated by management.

Evidence that billing journal transactions amounting to R3, 9 million were approved by management could not be submitted for audit purposes.

Provisions

14. Journal documentation in respect of leave provision amounting to R701 208 as disclosed in note 7 to the annual financial statements was not signed as proof of approval. In addition the pay rates used in calculation of the leave provision were not the rates prescribed by chapter 7, paragraph 7.3 of the South African Local Government Association (SALGA). In some instances negative leave credits were included in the calculation of leave provision. Leave credits per leave accrual report could not be reconciled with the leave register. Furthermore, in some instances employees took leave without prior approval. Consequently accuracy, completeness and validity of leave provision could not be verified.
15. Provision for audit fees amounting to R507 255 as disclosed in note 7 to the annual financial statements has been understated by R376 456 when considering the auditors' remuneration of R883 711 as disclosed in note 11 to the annual financial statements.

Investment income

16. Investment income of R2,5 million as disclosed in note 14 to the annual financial statements could not be agreed to the investment register figure of R2,1 million by R362 890. The investment income also does not agree to the trial balance and as a result an unreconciled difference of R212 427 exists.

Water income

17. The validity, accuracy and completeness of water income amounting to R439 271 as disclosed in Appendix D could not be verified as actual meter readings were not always used in the calculation of monthly billings and the water statistic information was also incomplete.

General ledger

18. The recorded transactions in the general ledger could not be linked to the original entry records like purchases, receipts and general journal records due to lack of audit trail and the use of manual records. Consequently some audit tests could not be performed and thereby limiting the scope of the audit.

Payments journals

19. The occurrence, completeness and accuracy of payments journal transactions amounting to R7, 2 million could not be verified as the supporting documentation and evidence of approval could not be provided. The municipality's records did not permit the application of alternative procedures.

Irregular expenditure

20. The service level agreement and contract signed with the service provider in respect of the preparation of annual financial statements and fixed asset register could not be provided for audit purposes. Consequently it was uncertain whether the expenditure transactions were procured in accordance with the supply chain management policy as prescribed by section 111 of the MFMA or not .

21. Contract agreements in respect of access road projects, community halls (Maqwatini, Maduma and Tsakana) and landfill site with the value of R22, 9 million were not signed by both parties. In addition the progress in the building of community halls has been reported as very slowly due to shortage of machinery and skilled labour.

21-22. The matters reported in this paragraph could be the result of corruption and collusion and requires further investigation.

Salaries and wages

22-23. The salaries and wages expenditure of R29, 2 million as disclosed in Appendix D to the annual financial statements does not agree with the trial balance and is overstated by R2, 2 million.

Material non-disclosure

23-24. An amount of R2,3 million in respect of taxes, levies, duties, pension and medical aid contributions was not disclosed in annual financial statements as required by section 125(1)(c) of the Municipal Finance Management Act, 2003 (Act No.56 f 2003). In addition it could not be determined whether there were any outstanding balance in respect of the said salary deductions at year because the sundry creditors' balance of R2,3 million was not broken down into the said salary deductions.

24-25. Unauthorised expenditure

Due to inadequate monitoring of the budget, the following expenditure exceeded the budget resulting in unauthorised expenditure of R5, 1 million. In addition the budget figures disclosed in the annual financial statements do not agree with the budget document and as a result an unreconciled difference of R4, 1 million exists.

Components	Budgeted	Actual	Variance
Salaries and wages	R27 139 884	R29 246 052	R2 106 168
Electricity purchases	R9 015 694	R12 036 798	R3 021 104
Total amount	R36 155 578	R41 282 850	R5 127 272

Going concern

25-26. The financial statements have been prepared on the going concern basis which assumes that the municipality will be able to meet its existing and future service obligations and commitments during the ordinary course of business.

However, certain matters have come to our attention which places uncertainty over the municipality's ability to continue as a going concern. The aforementioned factors include, inter alia, the following:

- The municipality has a reported net deficit for the year of R24 million.
- The correction of the errors reported in paragraphs 5 to 32 will result in the annual financial statements reflecting that the municipality has a net liability position and a net current liability position.

It is unlikely, that the municipality will be able to continue as a going concern without a significant increase in the subsidies provided by the national and provincial governments.

The annual financial statements do not disclose any of the going concern risks identified above.

Adverse opinion

In my opinion, because of the significance of the matter(s) described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of Intsika Yethu local municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended, in accordance with the applicable basis of accounting and in the manner required by the MFMA.

OTHER MATTERS

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

Non-compliance with applicable legislation

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

~~26-27~~ The following sections of the MFMA were not complied with: Sections 64(2)(a), 125(1)(b), 65(2)(e), 64(3), 16(2), 64(2)(g), 23, 11(4), 143, 74, 28(5),

Municipal Systems Act, 2000 (Act no. (MSA)

~~27-28~~ The following sections of the MSA were not complied with : Sections

Value Added Tax 1991 (Act No.89 of 1991) Ex.88,

~~28-29~~ The following sections of the VAT Act were not complied with: Sections 28(1),

Matters of governance

Fraud prevention plan and fraud risk assessment

~~29-30~~ Management have not performed a formal fraud risk assessment and have also not prepared or implemented a fraud prevention plan. The absence of such a plan may result in fraud being committed without prevention or detection.

~~30-31~~ Policies and procedures dealing with key financial cycles (purchases and payables, revenue and receivables, asset management, finance delegation), leases, performance information, employee costs and the back up and recovery of data have not been formally documented and approved by council.

Internal audit and audit committee

31-32..... The internal audit and audit committee were not yet established during the period under review which situation is contrary to the requirements of sections 165 166 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

Internal Control

32-33..... 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 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 components.

<i>Reporting item</i>	<i>Control environment</i>	<i>Assessment of risks</i>	<i>Control activities</i>	<i>Information and communication</i>	<i>Monitoring</i>
Basis for adverse opinion					
Trust funds	✓		✓		✓
Appropriation account	✓		✓		✓
Fixed assets	✓		✓		✓
Debtors	✓		✓		✓
Provisions	✓		✓		✓
Grants and subsidies	✓		✓		✓
Investment income	✓		✓		✓
Water income	✓		✓		✓
Payments journals	✓		✓		✓
Irregular expenditure	✓		✓		✓
Salaries and wages	✓		✓		✓
Material non-disclosure	✓		✓		✓
Unauthorised expenditure	✓		✓		✓
Going concern	✓		✓		✓
Other matters					
Non-compliance with laws	✓		✓		✓
Matters of governance	✓	✓	✓	✓	✓
Other reporting responsibilities					
Performance information	✓		✓		✓

Control environment

33-34..... The municipality did not establish the key elements of a control environment to achieve sound financial management. This resulted in a general lack of segregation of duties, lack of an approved supply chain policy, prior authorisation of overtime and limitations of scope that affected revenue and receivables, and other components of the audit.

Control activities

34-35. The effectiveness of control activities over business and accounting processes was not adequate and contributed to the matters reported relating to funds and reserves, fixed assets, debtors, creditors, disclosure, irregular and fruitless and wasteful expenditure, arrear councillor service charges and non compliance with legislation.

Monitoring

35-36. The monitoring of controls such as the review of the cash and data captured, review of bank reconciliations, employees' tax reconciliations were lacking . This contributed to the matters reported relating to VAT accounts, fixed assets, debtors, creditors, disclosure, irregular and fruitless and wasteful expenditure, arrear councillor service charges and non compliance with legislation.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

36-37. I was not able to complete an evaluation of the quality of the performance information, since the report on performance information was not submitted together with the annual financial statements.

APPRECIATION

37-38. The assistance rendered by the staff of the Intsika Yethu Local Municipality during the audit is sincerely appreciated.

MTHATHA

30 May 2008



AUDITOR - GENERAL