

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Emalahleni 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 and the accounting 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 an entity specific basis of accounting, as set out in accounting policy 1 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), 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.

**Basis of accounting**

4. The municipality's policy is to prepare financial statements on the entity specific basis of accounting as set out in accounting policy note 1.

**Basis for disclaimer of opinion**

**Receivables**

5. An amount of R27.2 million was disclosed in note 9 to the financial statements at 30 June 2007 as the provision for doubtful debts. In view of the fact that 94% of debtors disclosed were older than 90 days, this amount was understated. As a result thereof, the provision of R27.2 million was inadequate to cover the level of irrecoverable debts at year end.
6. Furthermore, a vehicle loan to the former municipal manager amounting to R114 752 was still outstanding at year-end. The recoverability of this loan appeared to be doubtful.

7. In addition, due to the findings in paragraph 5 above, it was not possible to confirm the existence, completeness and valuation of consumer debtor balances of R43.8 million included in accounts receivable as disclosed in note 9 to the financial statements.
8. Other debtor balances totalling R5.7 million disclosed in note 9 of the financial statements includes "Capital Projects" amounting to R854 380. Due to the absence of supporting documents the validity, accuracy and completeness of the amount could not be verified.
9. The salary control account amounting to R363 348 disclosed in note 9 of the financial statements could not be substantiated with supporting documentation. As a result, the validity, accuracy and completeness of the amount could not be verified. In addition, the amount is overstated due to the underpayment of the PAYE payment to South African Revenue Services (SARS) for the month of February 2007 amounting to R260 313.

#### **Fixed assets and capital projects**

10. Assets to the value of R36.3 million were recognised as additions in the current year per the asset register and per the general ledger. However, the assets in question were measured at estimated values. Therefore it was not possible to determine the reasonability and completeness thereof and it was not possible to confirm that these additions to fixed assets were correctly measured and whether the municipality had adequate right and title to each asset. Furthermore, no mention of this process and the related adjustments to the municipal financial records was made in the report of the chief financial officer.
11. A Deeds search revealed that no land was registered in the name of the municipality or of its former constituent transitional local councils. Due to the lack of supporting documentation it was not possible to verify the validity, accuracy and completeness of land and buildings amounting to R4.6 million included in fixed assets in Appendix C of the financial statements.
12. In addition, fixed assets amounting to R276 460 were incorrectly expensed as repairs and maintenance instead of being capitalised resulting in an understatement of fixed assets and the corresponding understatement of accumulated surplus by the said amount.

#### **Statutory, Reserves and Trust Funds**

13. Unspent trust funds amounting to R14.2 million disclosed in Appendix A in the financial statements could not be verified for validity, accuracy and completeness due to a register of conditional grants not being maintained for the financial year under review. No alternate procedures were possible to confirm whether expenditure transactions were in accordance with the conditions of each grant and transactions and balances relating to conditional grants had been correctly recognised and measured in the annual financial statements.
14. No interest was credited to statutory funds and trust funds for the year. All interest income was credited directly to the income statement. No appropriation was made to transfer interest received attributable to statutory funds and trust funds from the accumulated surplus to these funds at year-end. The balances for statutory funds, reserves and trust funds were therefore understated and the net surplus for the year was overstated by the same amount. It was not possible to quantify the effect of the misstatement.

15. Included in reserves is an amount of R712 560 disclosed as leave pay reserve in note 2 of the financial statements. The leave reserve was overstated due to the calculation that included leave accruals and leave taken transactions for the month of July 2007. The validity, accuracy and completeness of the reserve could not be verified.

#### **Finance leases**

16. Contrary to accounting policy 10, the municipality directly expensed monthly payments relating to a finance lease to the income statement instead of capitalising the underlying asset, recognising the underlying liability and expensing the applicable interest over the lease period. In the absence of a schedule of leased assets of the municipality, the effect on the financial statements could not be determined.

#### **Inventory**

17. The municipality did not maintain an inventory system for recording inventory transactions and balances. My attempt to observe the inventory count was fruitless due to there being no municipal officials available at the municipality on the day of the count, 29 June 2007. Alternative procedures proved unsuccessful in that an inventory listing of the inventory on hand at year end was not provided for audit purposes to verify the physical quantity of inventory on hand. I was therefore unable to confirm existence, completeness, valuation and rights relating to inventory of R82 180 disclosed in the balance sheet at 30 June 2007.

#### **Appropriation account**

18. Included in prior year adjustments totalling R17.1 million as disclosed in note 17 of the financial statements is a net adjustment of R7.1 million that was debited against the appropriation account in the current year. The majority of the components of this adjustment relate to the correction of prior period balances that could not be supported, that is, assets and liabilities for which existence, rights, obligations, completeness and correct valuation could not be established. Council approval for all the adjustments processed against the appropriation account, which also included an amount of R9.9 million representing an increase in the provision for doubtful debts, has not however been granted at the time of issuing this report.

#### **Restoration of landfill sites**

19. The municipality does not have a restoration plan for its landfill sites and as such is in breach of section 28 of the National Environment Management Act, No. 107 of 1998. No liability in respect of the obligation for restoring/ rehabilitating these landfill sites has been raised. The understatement of the liability could not be determined in the absence of management's assessment in this regard. Furthermore, no permits existed for landfill sites.

#### **Accounts Payable**

20. Included in accounts payable, is an amount of R267 719 in respect of employee back pay disclosed in note 11 to the financial statements. Supporting documentation could not be presented for audit purposes. As a result, the accuracy and completeness of this amount could not be verified.

## **Revenue**

21. No rateable valuation reconciliation was prepared to support the amount of R1.7 million disclosed as assessment rates in appendix D to the financial statements. Furthermore, a detailed property register was not maintained for the financial year under review resulting in the inability to verify the validity, accuracy and completeness of this amount.
22. Included in R38.6 million income as disclosed in the income statement for the year ended 30 June 2007, is income of R4.3 million and R4.5 million for economic and trading services respectively. It was not possible to confirm the completeness, accuracy and correct classification of income from the abovementioned services due to the following factors:
  - No record of registered meters was maintained;
  - Differences were noted in my testing of consumption recorded per meter-reading records and the corresponding consumption billed to consumers;
  - The completeness of the database of erven for which services were provided could not be relied upon as the valuation rolls were incomplete;
  - Detailed schedules of units of water and electricity purchased and sold could not be presented for audit purposes. It was therefore not possible to assess distribution and reticulation losses, the reasons for such losses and the possible effect thereof on the completeness of income recognised from sale of water and electricity;
  - No approved tariff policy was in operation; and
  - Consumer debtor balances per the debtors control account in the general ledger were not reconciled to the balances per the subsidiary ledger on a monthly basis.
23. Controls over initiating and recording transactions for the various sources of sundry income were inadequate for the purpose of ensuring the validity, accuracy and completeness thereof. No registers were maintained to record and control transactions in respect of each source of direct income. Rental contracts related to rental income selected for testing could not be presented for audit purposes. Consequently I was unable to perform an audit beyond those amounts that were actually recorded and receipted.

## **Expenditure**

24. Documentation in support of amounts totalling R188 789 could not be presented for audit purposes. As a result, the validity, correct classification and accuracy of all expenditure items could not be verified.
25. In addition, documentation in support of payments totalling R137 486 in respect of the Mackay's Neck Access Road infrastructure project could not be presented for audit purposes. The validity of these payments could therefore not be verified.

## **Financial statements**

26. The annual financial statements did not comply in all respects with the requirements of the standards laid down by the Institute of Municipal Finance Officers (IMFO) in its Code of Accounting Practice (1997) and Report on Published Annual Financial Statements (January 1996, 2<sup>nd</sup> edition). In addition, there were a number of errors and discrepancies in the compilation of the annual financial statements.
27. The additional disclosures required in terms of sections 123, 124 and 125 of the MFMA were not made in the annual financial statements.

28. Capital commitments disclosed per the annual financial statements were not split between commitment as required:

- approved and not yet contracted for; and
- approved and contracted for.

29. No contingent liability details were disclosed in note 24 to the annual financial statements in respect of the ongoing legal matter between the municipality and the former municipal manager. Disclosure of contingent liabilities is a specific requirement of section 125(2)(c) of the MFMA.

**Disclaimer of opinion**

30. 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 Emalahleni Municipality. Accordingly, I do not express an opinion on the financial statements.

**OTHER MATTERS**

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

**Material non-compliance with applicable legislation**

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

- Municipal Finance Management Act, 2003: Sections 11(4), 124(1), 125(1)(c), 125(2)(a),(d),(e), 52(d), 54(1), 56(1), 64(3), 66, 71(1), 74(1), 79, 82, 121, 122(1), 127(1) (2) (3), 129(1), 131, 133(1)
- Municipal Systems Act, 2000: Sections 5(1)(d), 5(1)(b), 55(1)(b), 55(1)(n), 57(2), 75(1) (2), 95, 96, 97, 98, 99, 16, 17, 96, 29, 55(1)(d), 68, 70(2)(b)
- Division of Revenue Act, 2005: Sections 22(1)(b), 22(4) and 27.
- Preferential Procurement Policy Framework Act, 2000: Section 21
- Housing Act, 1997: Section 10(4) (d) and (f)
- Property Rates Act,2004: Section 3(1)

**Internal control**

32. 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 existed in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for disclaimer</b>					
Receivables			■		
Fixed Assets			■		

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Statutory, Reserves and Trust Funds			■		
Finance leases			■		
Inventory			■		
Appropriation account			■		
Restoration of landfill sites			■		
Accounts Payable			■		
Revenue			■		
Expenditure			■		
Financial statements			■		
<b>Other matters</b>					
Material non-compliance with applicable legislation			■		■

## OTHER REPORTING RESPONSIBILITIES

### Reporting on performance information

33. I was engaged to audit the performance information.

### Responsibility of the accounting officer for the performance information

34. 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

35. 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* and section 45 of the MSA.

36. 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.

37. 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)**

**Non-compliance with regulatory requirements**

**No reporting of performance information**

38. The municipality did not have performance review policies and procedures in place and did not monitor performance through performance agreements.

39. No performance management system was in place as required in terms of the MSA and GNR. 796 of 24 August 2001: Local Government: Municipal Planning and Performance Management Regulations, 2001.

**Performance information not received**

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

**APPRECIATION**

41. The assistance rendered by the staff of the Emalahleni Municipality during the audit is sincerely appreciated.

East London

30 November 2007

