

FIN 12

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

Fin 13



AUDITOR-GENERAL

Accounting Officer
Sakhisizwe Municipality
P O Box 26
CALA
5320

Reference: 03564REG06/07
Enquiries: C Boettger
Date: 29 April 2008

Dear Sir

**REPORT OF THE AUDITOR-GENERAL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF SAKHISIZWE MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2007**

1. The above-mentioned report of the Auditor-General are submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004 read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA)
2. In terms of section 121(3) and 127(2) of the MFMA municipalities have to include the audit report in the municipality's annual report for tabling within seven months after the end of the financial year.
3. Until tabled as required by section 127(2) the report is **not a public document** and should therefore be treated as **confidential**.
4. As your municipality will be responsible for publishing the attached audit report as part of the annual report, you are required to do the following please:
 - Submit the final printer's proof of the annual report (which includes the audit report) to the relevant audit manager of the Auditor-General for verification of the audit-related references before it is printed or copied. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature at the end of the hard copy of the audit report should be scanned in when preparing to print the report. The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report, as well as the place and date of signing and the logo should also appear at the end of the report, as in the hard copy that is provided to you. The official logo and the authorised signature will be made available to you in electronic format.

FIN 14

5. Please notify the Provincial Auditor-General (Business Executive) well in advance of the date on which the audit report, or the annual report containing this audit report, will be tabled at the municipality.
6. Your cooperation to ensure that all these requirements are met would be much appreciated.
7. Kindly acknowledge receipt of this letter.

Yours Sincerely



.....
Caryn Boettger
Senior Manager

Enquiries: Caryn Boettger
Telephone: (043) 709 7200
Fax: (043) 709 7300
Email: carynb@agsa.co.za

FIN 15

REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND THE
EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS
AND PERFORMANCE INFORMATION OF SAKHISIZWE LOCAL 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 Sakhisizwe Municipality which comprise the statement of financial position as at 30 June 2007, statement of financial performance and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 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 Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP) prescribed by the Minister in terms of *General Notices 991 and 992 of 2005 and 552 of 2007*, issued in *Government Gazette No. 30013 of 29 June 2007*, and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), and the enabling legislation. 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 in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, I was, however, not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP) prescribed by the Minister in terms of *General Notices 991 and 992 of 2005*. Exemptions granted by the National Treasury and departures from the applicable basis of accounting in terms of *General Notice 552 of 2007* as disclosed in paragraph 1.1 of the accounting policies.

Fin 16

Basis for disclaimer of opinion

Accounting Records

5. The municipality did not keep adequate financial records and financial systems that could be relied upon to obtain all information and explanations considered necessary for audit purposes. The failure to furnish various supporting documents, satisfactory explanations and working papers to substantiate balances and classes of transaction assertions as detailed below has resulted in a limitation of scope of the audit. Alternative audit procedures were not possible and, consequently, sufficient appropriate audit evidence on the following material items, for example, could not be obtained during the course of the audit.

Prior year comparative information

6. The statement of financial position discloses the following prior year items, whereas there were no amounts recorded per the trial balance and general ledger provided to the auditors:
- accumulated surplus to the value of R63,8 million
 - other debtors to the value of R6,0 million
 - creditors to the value of R6,9 million
 - VAT payable to the value of R888 833
 - current portion of long-term liabilities to the value of R62 500
 - government grant reserve to the value of R82 898

Management was unable to provide comprehensive explanations or reconciliations of the above variances.

7. The statement of financial performance discloses the following prior year items, whereas there were no amounts recorded per the trial balance and general ledger provided to the auditors:
- grants and subsidies to the value of R18,5 million
 - rental of facilities and equipment income to the value of R67 755
 - other income to the value of R3,8 million
 - general expenditure to the value of R4,4 million
 - employee-related costs to the value of R12,7 million
 - remuneration of councillors expenditure to the value of R871 731
 - repairs and maintenance expenditure to the value of R673 586
 - interest paid to the value of R149 434

Fin 17

Management was unable to provide comprehensive explanations or reconciliations of the above variances.

8. The statement of financial position discloses prior year unspent conditional grants and receipts to the value of R2,2 million, whereas per the trial balance and general ledger an amount of R2,5 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R380 977.
9. The statement of financial position discloses prior year property, plant and equipment to the value of R37,6 million, whereas per the trial balance and general ledger an amount of R37,3 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R248 328.
10. The statement of financial position discloses prior year bank overdraft balance of R1,38 million, whereas per the trial balance and general ledger an amount of R33 264 was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R1,35 million.
11. The statement of financial position discloses prior year long-term receivables to the value of R145 148, whereas per the trial balance and general ledger an amount of R269 148 was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R124 000.

Revenue and Income

12. The statement of financial performance discloses income from grants and subsidies to the value of R15,8 million, whereas per the trial balance and general ledger an amount of R14 million was recorded. According to appendix E: *Disclosure of Grants and Subsidies* to the annual financial statements, in terms of section 123 of the MFMA, 2003 (Act No. 56 of 2003), the total grant income received by the municipality is disclosed as R16,7 million. Management was unable to provide a comprehensive explanation or reconciliation of the above variances.
13. The financial statements disclosed other income to the value of R8,4 million, whereas per the trial balance and general ledger an amount of R4,5 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R3,9 million.
14. The supporting and source documentation for grants and subsidy journal transactions amounting to R3,7 million was not made available for auditing purposes. The documentation and records available at the municipality did not allow for alternative audit procedures to verify the journal transactions.
15. The documentation supporting direct and other income transactions to the value of R6,7 million was not available for auditing purposes.
16. The documentation supporting assessment rate transactions to the value of R2,1 million was not available for auditing purposes.

Fin 18

17. The last general valuation of properties within the municipal boundaries was undertaken in the 1991 financial year. No interim valuations have been performed since the general valuation was completed. Accordingly, the annual assessment rates are calculated on old and outdated property values. The disclosed assessment rates were understated, as the improvements in property values were not considered in the billing process. Although the impact of using the old property values could not be calculated, it was determined that the disclosed assessment rates income of R1,4 million was not accurate or complete.
18. Sufficient appropriate audit evidence on the occurrence, completeness, accuracy, cut-off and classification of total revenue amounting to R34,5 million could therefore not be obtained.

Consumer debtors

19. The supporting and source documentation for consumer debtors' journal transactions amounting to R7,0 million could not be obtained. The documentation and records available did not allow for alternative audit procedures to verify the journal transactions.
20. The financial statements disclose the current year consumer debtors balance as R2,6 million whereas per the trial balance and general ledger a balance of R22,9 million is recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R20,3 million. Although it was noted that the amount of R20,3 million relates to the allowance account for credit losses (provision for bad debts) created at year-end, it had not been processed through the financial system and statement of financial performance.
21. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocations and rights and obligations of consumer debtors amounting to R2,6 million could therefore not be obtained.

Expenditure

22. The statement of financial performance discloses current year general expenditure to the value of R8,8 million, whereas per the trial balance and general ledger an amount of R5,7 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R3,1 million.
23. The statement of financial performance financial statements discloses current year depreciation expenditure to the value of R1,7 million, whereas per the trial balance and general ledger an amount of R1,8 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R60 872.
24. The municipality did not have a Supply Chain Management Policy in place for the year under review as required by section 111 of the MFMA. In addition, no documentation was provided in support of expenditure transactions amounting to

FIN 19

R360 937. Due to the non-submission of documentation in support of the above transactions, it was not possible to determine whether the municipality implemented alternative processes to ensure that the expenditure was procured in a transparent, fair and equitable manner. Consequently, as a result of the material non-compliance, it is not possible to determine the extent of irregular expenditure incurred by the municipality for the year ended 30 June 2007.

25. Expenditure amounting to R197 981 was incurred during the 2005-06 financial year, but was only paid and recorded during the 2006-07 financial year. Accordingly, the 2006-07 year expenditure is overstated by R197 981 and the opening accumulated surplus balance is understated by the same amount.
26. Expenditure amounting to R229 768 was incurred during the 2006-07 financial year, but only paid and recorded during the 2007-08 financial year. Accordingly, the 2006-07 year expenditure and accruals (current liabilities) are understated by R229 768.
27. The occurrence and accuracy of employee cost could not be verified due to the failure to keep proper records, resulting in inaccurate calculation and unauthorised payments to employees.
28. Failure to stop salary payments to a terminated employee resulted in an overpayment of R296 860. Such payments can be deemed as fruitless and wasteful expenditure and were not recorded as such in the statement of financial performance.
29. Interest and penalty payments amounting to R129 882 were incurred during the year. Such expenditure was deemed to be fruitless and wasteful, but was not recorded as such in the statement of financial performance.
30. Sufficient appropriate audit evidence on the occurrence, completeness, accuracy, cut-off and classification of total expenditure amounting to R24,7 million could therefore not be obtained.

Current liabilities

31. The supporting documentation to payables transactions and journals amounting to R1,8 million was not provided for auditing purposes.
32. The municipality was a defendant in a claim lawsuit instituted by its service providers for unpaid services rendered. Although the municipality opposed the claim, correspondence received in September 2007 from its attorneys and the high court revealed that the municipality was indebted to the amount of R1,2 million and the interest thereon, from 24 February 2006 until date of final payment. I was unable to determine whether this liability was recorded appropriately in the financial records of the municipality.
33. No supporting documentation was provided for the leave provision of R477 354.
34. The current liabilities balance at year-end included a VAT creditor balance of R1,4 million. The South African Revenue Services could not confirm the balance of

FIN 20

R1,4 million. The variance of R1,4 million was not confirmed and accordingly may not represent a valid payable at year-end. Accordingly, the disclosed accounts payable balance at year-end could be overstated.

35. The statement of financial position discloses current year unspent conditional grants and receipts to the value of R3,8 million, whereas per the trial balance and general ledger an amount of R3,6 million was recorded. Management was unable to provide a comprehensive explanation or reconciliation of the above variance of R191 288.
36. The disclosed creditors balance included debit balances to the value of R483 146. The balances should have been reclassified as debtors. Accordingly, the disclosed creditors balance at year-end could be overstated by R483 146 and the other debtors balance could be understated by R483 146.
37. The disclosed creditors balance included a credit balance of R509 473 that had not shown any movement since the previous financial year. The municipality failed to accrue for all expenditure incurred during the year under review, including capital expenditure, but only paid after year-end. Accordingly, the existence, valuation and completeness of the liabilities could not be verified.
38. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of current liabilities amounting to R7,3 million could therefore not be obtained.

Property, plant and equipment

39. The municipality did not maintain an adequate fixed asset register that contains the required information to verify the existence, completeness and valuation and allocation of the amounts recorded in the general ledger and disclosed in the financial statement for property, plant and equipment.
40. The supporting and source documentation of asset journal transactions amounting to R7,0 million was not made available for audit purposes.
41. The statement of financial position discloses current year property, plant and equipment to the value of R38,2 million, whereas per the trial balance and general ledger an amount of R38,3 million was recorded.
42. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of property, plant and equipment amounting to R38,3 million could therefore not be obtained.

Cash and bank

43. The supporting and source documentation for cash and bank journal transactions amounting to R6,0 million was not made available to the auditors.
44. The valuation of the municipality's disclosed call accounts is not correct. There were variances identified between the disclosed bank balances and the

Fin 21

confirmation letters received from the banks amounting to R96 682. This indicated that the call account could be overstated by R96 682 in the statement of financial position.

45. The municipality did not implement an investment policy or maintain an investment register as required by the section 13(2) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003). Consequently I could not verify the valuation and completeness of cash and bank.
46. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of cash and bank amounting to R2,2 million could therefore not be obtained.

Long-term receivables

47. The statement of financial position discloses the long-term receivables balance as R524 263, whereas per the trial balance and general ledger an amount of R269 148 was recorded. Management was unable to supply the auditor with a comprehensive explanation or reconciliation of the above variance of R255 114.
48. The current portion of long-term debtors to the value of R100 270 has been incorrectly disclosed under long-term receivables. Accordingly, the long-term debtors could be overstated and the current portion of long term-debtors could be understated by the same amount.
49. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of long-term receivables amounting to R524 263 could therefore not be obtained.

Accumulated surplus

50. The statement of financial position discloses current year accumulated surplus to the value of R34,1 million, whereas per the trial balance and general ledger an amount of 62,6 million was recorded. Management was unable to provide the auditor with a comprehensive explanation or reconciliation of the above variance of R28,4 million.
51. Documentation to the value of R2,0 million and supporting debit transactions recorded in the accumulated surplus general ledger accounts could not be provided for auditing purposes. Further, documentation to the value of R711 053 and supporting credit transactions recorded in the accumulated surplus general ledger accounts could not be provided for auditing purposes.
52. Sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of accumulated surplus amounting to R34,2 million could therefore not be obtained.

FIN 22

Funds and reserves

53. Documentation to the value of R2,3 million and supporting transactions recorded in the funds and reserves general ledger accounts could not be provided for auditing purposes. Consequently, sufficient appropriate audit evidence on the existence, completeness, valuation and allocation and rights and obligations of Government grant reserves amounting to R2,3 million could not be obtained.

Financial statements

54. The municipality was unable to comply with the minimum disclosure requirements, as determined by Generally Accepted Municipal Accounting Practice (GAMAP), and sections 123, 124 and 125 of the Municipal Finance Management Act, in their annual financial statements for the year ended 30 June 2007.

Disclaimer of opinion

55. 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 Sakhisizwe Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matters:

Budget not aligned to system

56. The municipality's final budget for the 2006-07 financial year was not aligned correctly to the financial system in use at the municipality. Accordingly, it was not possible to trace all the budgeted figures per the final budget to the individual vote accounts per the financial system.

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 and regulations

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

57. The municipality did not comply fully with the following legislation in various material instances during the period under review, as highlighted below:
- Municipal Finance Management Act, 2003 (Act No. 56 of 2003): Sections 11(4), 13(2), 15, 16, 21, 22, 23, 24, 28, 29,32, 54(3), 52(d), 54, 53(d), 59(1), 64, 65(1) and (2), 66, 70(1), 71, 73, 74, 75, 79, 111, 114, 116, 121, 124, 125, 127, 131, 132, and 165.

FIN 23

- Division of Revenue Act, 2005 (Act No. 1 of 2005): Section 27.
- Local Government: Municipal Property Rates Act, 2004 (Act No. 6 of 2004): Sections 32(b), 77, and 8(1).
- Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000): Sections 5, 6, 7, 11, 21, 45, 59, 60, 63, 74, 75, 81, 83, 97, 98, 99 and 100.
- Municipal Supply Chain Management Regulations: Sections, 2, 3, 6, 7, 13, 17, 18, 30 and 31.
- Value-Added Tax Act, 1991 (Act No. 89 of 1991): Sections 20 and 28.
- South African Local Government Bargaining Council (SALGBC): Section 7(1), 7(2), 7(3) and 7(6).
- Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997): Sections 16 (1).
- Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA): Section 57.

Matters of governance

Internal audit

58. The function of the audit committee and internal audit was not performed at the municipality during the year under review, as required by sections 165 and 166 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003). This contributed to poor financial record keeping and maintenance of a proper system of internal control.

Fraud prevention plan and fraud risk assessment

59. A fraud prevention and detection plan and a fraud hotline did not exist at the municipality. Furthermore, fraud and other risk assessments were not performed at the municipality.
60. The municipality's computer information technology (IT) control environment had limited controls and poses a high fraud risk. There were no documented and formalised IT policies and procedures. There was no Disaster Recovery Plan and backups were not made regularly. There was inadequate physical security over IT hardware and software, the anti-virus programs were not sufficiently monitored or updated on regular basis, and there were no procedures and controls in place over the use of illegal software by municipal officials.

There were also vacant critical posts at the municipality which affected the municipality's objectives on service delivery.

FIN 24

Personal gain from public business

61. The municipality has not followed up extensively on the possible conflicts of interest that may exist. The declaration of interest forms were not completed by all. The auditors cannot exclude the possibility that either the municipal council and officials or their associates are involved in awarding municipal business, which as such had not been disclosed appropriately.

Value-for-money matters

62. The municipality did not always obtain full value for money in relation to the expenditure on capital and infrastructure projects. The following are the findings made:
- Formal agreements/contracts were not signed with contractors.
 - Formal tender contracts were not available at the municipality, or made available to the auditors on request.
 - The contractors awarded capital projects at the municipality were not registered with the Construction Industry Development Board.

Internal control

63. 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.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Revenue and income	X		X		
Accounts receivables	X		X		
Expenditure	X		X		
Payables	X		X		
Property, plant & equipment	X		X		
Cash and bank	X		X		
Accumulated surplus	X		X		
Provisions	X		X		

Control environment

64. Accordingly, the municipality did not establish the key elements of a control environment to achieve sound financial management. This resulted in a general lack of adequate policies and procedures in place to cover all financial cycle processes. An action plan to address matters reported in the special investigation on procurement and expenditure irregularities was not in place. Service level

Fin 25

agreements signed between the municipality and the transferring departments and service providers were lacking. Budget variances could not be explained by management.

Control activities

65. The effectiveness of control activities over business and accounting processes was not adequate and contributed to the matters reported relating to poor completion of indigent application forms, quarterly reports on grants expenditure not signed and tender documents not kept, a lack of control over cash receipts and deposits, and non-compliance with legislation.

Monitoring

66. The monitoring of controls such as review of interest earned on investments, updating of property ratepayers and debtors' records, keeping of payment documentation, controlling private use of telephone, VAT and creditors' reconciliations, updating leave records, reviewing investment registers, etc. was not always effective.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

67. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

68. 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

69. 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. 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.
70. 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)

71. Non-compliance with regulatory requirements

The Performance Management System has not yet been established and implemented at the municipality. As a performance report was not compiled at

Fin 26

Sakhisizwe Municipality for the financial year ended 30 June 2007, the performance objectives could not be tested.

APPRECIATION

72. The assistance rendered by the staff of the Sakhisizwe Municipality during the audit is sincerely appreciated.

Auditor-General

East London

29 April 2008



AUDITOR - GENERAL