

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Gariep 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 note 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) 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. 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 an entity-specific basis of accounting as set out in accounting policy note 1.

Basis for adverse opinion

Debtors

9. A detailed age analysis in support of consumer debtors could not be provided for audit purposes. Consequently, the accuracy, validity or completeness of consumer receivables of R40.7 million disclosed in the balance sheet at 30 June 2007 could not be verified. No provision for bad debts was raised to cover the possible level of irrecoverable debt. Alternate procedures to determine the value of the provision could not be performed due to the lack of adequate supporting documentation. Moreover, the municipality did not have a bad debt write-off policy.
10. Furthermore, a personnel loan amounting to R38 439 was incorrectly disclosed under debtors in the balance sheet at 30 June 2007 instead of long-term debtors. However, as the amount is fully redeemable in the 2007-08 financial year, the amount should have been disclosed as a short-term portion of long-term debtors under current assets. This resulted in the overstatement of debtors and a corresponding understatement of the short-term portion of long-term debtors by the said amount.

Creditors

11. A review of expenditure, performed after the financial year-end, revealed payments totalling R799 171 in respect of commitments relating to the financial year under review, which had not been accrued, resulting in the understatement of creditors and a corresponding overstatement of retained surplus as disclosed in the balance sheet at 30 June 2007.
12. Expenditure totalling R359 736 was allocated as expenses for the financial year under review, however, the cheques and electronic fund transfers (EFTs) issued were incorrectly allocated against the bank overdraft and not accrued as creditors. The above-mentioned cheques and EFTs were not mailed to the relevant creditors and the EFTs were not effected. This resulted in the understatement of creditors and a corresponding overstatement of the bank overdraft by the said amount.
13. Included in creditors were amounts, totalling R3.2 million, which showed no movement during the financial year under review. In the absence of supporting documentation for the amounts owing, it was not possible to verify the validity and accuracy thereof or whether the municipality had an obligation to pay these amounts.
14. The 1% skills development levy, as determined by section 3(1)(b) of the Skills Development Levy Act, 1999 (Act No. 9 of 1999) as amended, was not calculated on the total remuneration paid of R20 million during the financial year under review, with the result that the levy amounting to R200 058 was not paid to the Department of Labour. A liability for the amount of R200 058 had not been raised, with the result that the retained income was overstated and creditors understated by the said amount. Furthermore, the possible contingent liability in respect of interest and penalties incurred as a result of the above non-payment was not disclosed by the municipality.

15. Included in creditors was an amount of R554 216 in respect of a municipal support grant which was incorrectly disclosed as a liability instead of a reserve. Consequently the reserves were understated and creditors overstated by the said amount.

Services rendered on behalf of Ukhahlamba District Municipality (Water Services Authority)

16. The Gariiep Municipality (water service provider) renders water and sewerage services on behalf of Ukhahlamba District Municipality (UDM). An agreement has been drafted between the two parties which stipulates in paragraph 6.3 that the UDM shall allocate from the equitable share to the Gariiep Municipality, provided that such equitable share shall not be less than the net difference between actual expenditure and revenue collected to provide water services which the water service provider currently provides to the community. The municipality did not account for the water and sewerage function in accordance with the above-mentioned agreement and due to a lack of supporting documentation, it was not possible to verify the validity, accuracy and completeness of the amounts of R1.1 million and R4.7 million disclosed as a debtor and creditor, respectively, in notes 11 and 14 to the financial statements.
17. In addition, expenditure of R13.2 million and income of R11.3 million in respect of expenses incurred and income accrued on the above-mentioned services were incorrectly included in expenditure of R43.8 million and income of R44.4 million as disclosed in the income statement for the year ended 30 June 2007, resulting in the overstatement of expenditure and income by the said amounts and a corresponding understatement of retained income by an amount of R1.9 million. Furthermore, the expenditure had not been budgeted for and was considered to be unauthorised expenditure as reported in paragraph 25 below and was not disclosed as such in the financial statements.

Value-added tax (VAT)

18. No VAT reconciliation was performed between the general ledger accounts and the VAT 201 forms for the financial year under review. The accuracy, validity and completeness of the VAT liability totalling R5.7 million could therefore not be verified.

Provisions

19. Included in provisions was a provision for audit fees of R1.5 million. However, this amount should have been disclosed as a creditor at year-end and the omission resulted in the overstatement of provisions and a corresponding understatement of creditors.
20. Reserves totalling R131 779 were incorrectly disclosed as provisions at 30 June 2007, resulting in the overstatement of provisions and a corresponding understatement of reserves.
21. Also included in provisions was an amount of R8.6 million in respect of future depreciation. However, this amount represented fixed assets capitalised in respect of the former Steynsburg and Venterstad Transitional Local Councils, resulting in the overstatement of provisions and a corresponding overstatement of net fixed assets disclosed in the balance sheet at 30 June 2007. (The effect of the above has been reported under fixed assets, paragraph 30 below.)

Direct deposits

22. Included in creditors was an amount of R2.5 million (R1.9 million: 2006) in respect of unknown direct deposits into the municipality's bank account. Although the amount was disclosed in the financial statements the origin of the deposits could not be established. Consequently, the accuracy, validity and completeness of the amount of R2.5 million could not be verified. Furthermore, debtors and creditors could be overstated by this amount.

Inventory

23. Inventory as disclosed in the balance sheet at 30 June 2007 did not agree to the inventory listing supplied by the municipality in support thereof by R584 116. A reconciliation in support of this difference was not provided, however, it was ascertained that the municipality did not record inventory issued during the financial year under review in the general ledger. However, the extent of the omission could not be determined. Consequently, the accuracy, validity and completeness of inventory in the amount of R869 317 could not be verified.

Unauthorised expenditure

24. Expenses totalling R519 757 (included in R13 531 418 under grants and subsidies in paragraph 25 below) were incurred during the financial year under review in respect of a private company, Lake Gariep Resort (Pty) Ltd, with whom the municipality entered into a public-private partnership in 2003. As no amounts were budgeted for the public-private partnership for the 2006-07 financial year, the amount of R519 757 is regarded as unauthorised expenditure. The amount was also not disclosed as unauthorised expenditure as required by section 125(2)(d)(i) of the MFMA.
25. In terms of the definitions in chapter 1 of the MFMA, overspending of the total amount appropriated for a vote in the approved budget constitutes unauthorised expenditure and should be reported as such. The necessary disclosure was not made in the financial statements. The approved budgets for the following individual votes were exceeded for the period under review, for which council approval was not obtained, and no municipal adjustments budget as determined by section 28 of the MFMA was performed for the financial year under review.

Vote description	Budget	Actual	Variance
Council	R2 735 365	R3 290 171	R554 806
Libraries	R624 479	R768 906	R144 427
Traffic services	R960 755	R1 125 134	R164 379
Housing	R383 753	R633 815	R250 062
Grants and subsidies	R3 090 000	R13 531 418	R10 441 418
			R11 555 092

Fruitless and wasteful expenditure

26. An amount of R65 465 was paid as interest to the former municipal manager due to the fact that the severance package was not paid to him as agreed upon, but in monthly instalments. In addition R31 558 was paid by the municipality to various service providers due to late settlement of accounts. These amounts are regarded as fruitless and wasteful expenditure and were not disclosed in the financial statements as required by section 125(2)(d) of the MFMA.

Cash and bank

27. It was noted that the last attempt to perform a bank reconciliation was in January 2007 and that it did not reconcile. No further reconciliations were performed. Consequently, the accuracy, validity or completeness of the bank overdraft of R8 175 661 as disclosed in the balance sheet at 30 June 2007 could not be verified. Due to the absence of bank reconciliations the unexplained difference of R600 718 between the amount disclosed in the balance sheet and the general ledger and the correctness of bank charges and interest on bank overdrafts could not be verified.
28. It was also noted that bank reconciliations performed were reviewed by senior management but this was not done regularly and the responsible officials did not sign the reconciliation as evidence of their review. In the absence of bank reconciliations and regular review thereof, the municipality was vulnerable to possible misappropriation of funds through invalid bank transactions.
29. The favourable cashbook balance of the "waterprojek" (water project) bank account amounting to R351 032 was not disclosed as a current asset, but was set off against the bank overdraft, resulting in the understatement of current assets and current liabilities by the said amount. Furthermore, the cashbook balance showed no movement for the financial year under review.

Fixed assets

30. The municipality recognised assets to the value of R8 654 695 in respect of the former Venterstad and Steynsburg Transitional Local Councils as additions in the current year as per the asset register and general ledger. The funding source was incorrectly recognised as a provision, resulting in the overstatement of provisions and net fixed assets. The assets in question therefore had no carrying value at 30 June 2007. (The effect of the above has been reported under provisions, paragraph 21 above.)
31. In addition it was noted that a physical count and observation of all recorded assets was not performed by the municipality during the financial year under review to confirm the completeness of the asset register, and the existence and operational condition of assets.
32. Net fixed assets amounting to R11 953 507 as disclosed in appendix C to the financial statements at 30 June 2007 did not agree to internal and external advances as disclosed in appendix B by an amount of R8 141 839. A reconciliation in support of the difference could not be provided for audit purposes. Consequently, the accuracy, validity and completeness of net fixed assets could not be verified.

Journals

33. Journals totalling R6.4 million processed during the financial year under review were not supported by appropriate supporting documentation. Furthermore, journal worksheets totalling R18.4 million were not reviewed and signed as evidence thereof by a senior official before the journals were processed. No alternative procedures were possible. Consequently, the effect on the financial statements could not be determined.

Finance leases

34. The municipality directly expensed monthly payments relating to finance leases 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 all leased assets of the municipality and an accounting policy for leased assets, the effect on the financial statements could not be determined.

Contingent liabilities

35. Contingent liabilities were not disclosed in the financial statements as required by section 125(2)(c) of the MFMA in respect of the suspension of the former municipal manager and the chief financial officer. In addition, no contingent liabilities in respect of possible claims against the municipality due to the non-payment of medical aid and pension fund contribution deductions (as reported in paragraph 41 below) were disclosed in the financial statements. Consequently, the effect on the financial statements could not be determined.

Restoration of landfill sites

36. The municipality does not have a restoration plan for its landfill site 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 the landfill sites situated at Burgersdorp and Venterstad.

Going concern

37. The ability of the municipality to continue to render uninterrupted services to stakeholders in future has been considered and in this regard the following matters identified that have not been disclosed by the municipality in the financial statements suggest that the outlook for future trading activities is not favourable:

- (i) The collection of overdue amounts due to the municipality by customers remains a constant factor facing the municipality. Although management has introduced additional measures during the course of the year under review to facilitate cash collection, the likelihood of significant success in the immediate future is doubtful. As a result, the adverse effect on cash flows is expected to remain in the foreseeable future.
- (ii) The council made use of overdraft facilities during recent years as a result of inadequate cash flows.
- (iii) The municipality did not receive any funding from UDM in respect of equitable share for the providing of water and sewerage services as per signed agreement during the financial year under review, which had a negative impact on the cash flows of the Gariiep Municipality.

Additional disclosure requirements of the MFMA

38. The additional disclosures as required by sections 123 (disclosures on intergovernmental and other allocations) and 124 (disclosures concerning councillors, directors and officials) of the MFMA were not made in the annual financial statements. Furthermore, the following other compulsory disclosures as required by section 125 were also not made in the annual financial statements:

- (i) The total amount of contributions to organised local government for the financial year, and the amount of any contributions outstanding as at the end of the financial year as required by section 125(1)(b).
- (ii) The total amounts paid in audit fees, taxes, levies, duties and pension and medical aid contributions, and whether any amounts were outstanding as at the end of the financial year as required by section 125(1)(c).

- (iii) Information regarding each bank account held by the municipality, the name of the bank where the account is or was held, the type of the accounts and year-opening and year-end balances of these bank accounts as required by section 125(2)(a).
- (iv) A summary of investments as required by section 125(2)(b).
- (v) Fruitless and wasteful, irregular or unauthorised expenditure (section 125(2)(d))
No disclosure was made of fruitless and wasteful, irregular or unauthorised expenditure. The municipality had no formal policies and procedures in place to identify and record expenditure that would be regarded as fruitless and wasteful, irregular or unauthorised.
- (vi) Particulars of non-compliance with the MFMA (section 125(2)(e)).
- (vii) Any other matters that may be prescribed (section 125(2)(f)).

Financial statements

39. The 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 the Report on Published Annual Financial Statements (January 1996, 2nd edition). In addition, there were a number of errors and discrepancies in the compilation of the annual financial statements. This is evidenced by the number of findings in the audit report and that the trail balance did not balanced at year end.

Adverse opinion

40. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements of the Gariiep Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended have not been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 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

- 41. Section 65(f) of the MFMA requires that the accounting officer must take all reasonable steps to ensure that the municipality complies with its tax, levy, duty, pension, medical aid, audit fees and other statutory commitments. However, although the amounts were accrued for as a liability in note 14 of the notes to the financial statements, the municipality was not able to effect obligatory statutory payments totalling R2.61 million to the South African Local Authorities Pension Fund (SALA) (R639 040), various Pension Funds (R121 701), Eastern Cape Department of Transport (R378 962), Auditor-General (R1.01 million), various medical aid funds (R363 450), Department of Labour in respect of workmen's compensation (R135 723) and various medical aid savings plans (R20 347).
- 42. The municipality did not submit an implementation plan, detailing full progress towards full compliance with section 122(3) of the MFMA to the National and Provincial Treasuries before 30 October 2007 as required by *General Notice 552 of 2007*, issued in *Government Gazette No. 30013 of 29 June 2007*.

Matters of governance

43. Related-party transactions to the value of R519 757 were not disclosed in the financial statements. These transactions related to expenditure incurred by the municipality in respect of a public-private partnership in which a senior municipal official was a director of the company.

Material corrections made to the financial statements submitted for audit

44. The financial statements, approved by the accounting officer and submitted for audit on 31 August 2007, have been significantly revised because of the following misstatements identified during the audit:

- Long-term liabilities disclosed in the balance sheet was overstated by an amount of R2 576 551, being internal advances incorrectly disclosed as long-term liabilities. The short-term portion of long-term liabilities amounting to R145 232 was disclosed as current assets.
- Debtors was overstated by an amount of R6 555 641, being internal advances (R1 999 258) and advances to general account (R4 818 043) and “Kontrolle: Primêre gesondheid” account (R261 660) incorrectly disclosed as debtors.
- Bank overdraft was reduced by an amount of R776 698 (balancing figure, as bank reconciliations had not been performed since February 2007).

Internal control

45. 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
Basis for adverse opinion					
Debtors			X		
Creditors			X		
Services rendered on behalf of Ukhahlamba District Municipality			X		
Value-added tax			X		
Provisions					
Direct deposits			X		X
Inventory			X		X
Long-term debtors					
Unauthorised expenditure			X		X

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Fruitless and wasteful expenditure			X		X
Cash and bank			X		
Fixed assets			X		
Journals			X		
Finance leases			X		
Long-term liabilities			X		
Restoration of landfill sites			X		
Going concern			X		X
Additional disclosure requirements of the MFMA			X		X
Financial statements			X		
Other matters					
Non-compliance with applicable legislation			X		
Matters of governance		X	X		
Material corrections to the financial statements			X		

Risk assessment

46. It was noted that a risk assessment was not performed and a risk management policy and fraud prevention plan were not in place during the financial year under review.

Investigation in progress

47. The former municipal manager and the chief financial officer were suspended on 10 July 2006. At the date of finalising this report, the outcome of the cases was still pending further investigation.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

48. 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

49. 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.

50. 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.

51. 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

52. The following instances of non-compliance with regulatory requirements of the MSA were noted during the course of the audit:

- Section 25 – The municipality did not consult the local community in adopting the process for drafting the integrated development plan (IDP).
- Section 28 – The municipality did not adopt a process in writing to guide the planning, drafting, adoption and review of its IDP and did not consult the local community in the process of adopting the IDP.
- Section 32 – There was no proof that the municipal manager submitted a copy of the IDP to the MEC for local government in the province within 10 days after the adoption of the IDP by the municipal council.
- Section 42 – The community did not participate in the setting of key performance indicators by means of an appropriate municipal-wide structure for community participation or an appropriate forum.

Performance information not received

53. The municipality did not prepare and present any performance information for audit purposes in terms of section 46 of the MSA and section 121(3)(c) of the MFMA.

APPRECIATION

54. The assistance rendered by the staff of the Gariep Municipality during the audit is sincerely appreciated.

Auditor-General

East London

30 November 2007



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