

REPORT OF THE AUDITOR-GENERAL TO THE O.R. TAMBO DISTRICT MUNICIPAL COUNCIL AND THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF O.R. TAMBO MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

Introduction

1. I was engaged to audit the accompanying financial statements of the O.R. Tambo District Municipality (the municipality) which comprise the statement of financial position as at 30 June 2007, statement of financial performance, statement of changes in net assets 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 [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 basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: 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), 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 a comprehensive basis accounting as determined by the National Treasury, as set out in accounting policy note 1 of the annual financial statements.

Basis for disclaimer of opinion

Opening balances

5. A disclaimer audit opinion was issued on the annual financial statements of the municipality for the financial year ended 30 June 2006. Therefore I am unable to determine whether the opening balances in the general ledger are complete, valid or accurate and therefore I am unable to determine the full financial effect this may have on the balances audited for the financial year ended 30 June 2007.

Accounts receivable

6. The municipality does not have a bad debt policy which enables it to identify potential bad debts. The municipality increased the provision by R15.4 million in the current year to R39.3 million at 30 June 2007, as disclosed in note 19 to the financial statements; however we were not able to assess the reasonableness of this provision as no evidence was provided in support thereof. In addition the municipality does not have any consumer deposits on hand to cover outstanding amounts and does not charge interest on overdue balances. As a result it was not possible to verify the adequacy of the provision and the accuracy of the current year increase.
7. Furthermore the municipality could not submit documentation and explanations in support of indigent debtor applications, approvals and monitoring requested for audit purposes and there were no alternate procedures I could perform. In addition the value of indigent debtors was not separately identifiable. The significance thereof represented a limitation on the scope of the work that could be performed. As a result I was unable to determine whether the subsidies awarded to indigent debtors were complete, valid and accurate.

Revenue

8. In terms of section 95(b) of the MFMA, the accounting officer should ensure that full and proper records of the financial affairs of the entity are kept. However management monitoring and supervision of systems that were intended to store and later retrieve the stored documentation were inadequate. This has resulted in ineffective systems which did not always make the retrieval of documents possible or resulted in inadequate and incomplete documentation. As a result thereof requested supporting documentation and related explanations for revenue transactions and billing estimates requested amounting to R17.8 million was not provided for audit purposes.
9. The billing system and collection of water revenue were also found to be inadequate. Instances were noted where pipe leakages were not repaired, locations were identified where meters were either not installed or meter readings were not taken even though water services were provided. In addition, a calculation of distribution losses incurred during the year was not performed. As a result the full impact of the poor billing system is not known. I was therefore unable to determine the completeness of the sale of water revenue
10. The significance of the above placed a limitation on the scope of audit work which could be performed and there were no alternate procedures I could perform to obtain additional assurance. Consequently, it was not possible to verify the completeness, validity and accuracy of service charge revenue amounting to R62.8 million, as disclosed in note 16 to the annual financial statements. In addition, due to the limitations indicated above the valuation, existence and completeness of consumer debtors as reported in note 13 amounting to the financial statements could not be verified.

Government grants and subsidies

11. Government grants and subsidies received for the current year are disclosed in note 17 to the financial statements as R557 million. This amount is made up of equitable share received of R190.3 million and Conditional grants and subsidies of R366.7 million. The total amount per the Division of Revenue Act, 2006 (Act No.2 of 2006)

(DoRA) was R527.6 million. The documentation provided in support of the conditional grants received did not agree to what was disclosed in the financial statements by an amount of R29.4 million. Management was not able to provide adequate explanation for the difference. I was therefore unable to verify the completeness and accuracy of the government grants and subsidies revenue.

Property, plant and equipment

12. In terms of section 95(b) of the MFMA the accounting officer should ensure that full and proper records of the financial affairs of the entity are kept. However adequate control was not exercised over the assets during the year under review. This is as a result of asset records not being continuously and effectively monitored by management. The asset register is deficient in that it is not completely and accurately populated and therefore not adequately maintained and not adequately supported by the appropriate documentations. Based on the above deficiencies, it was also not possible to locate assets for physical verification.
13. In addition, periodic reconciliations between the general ledger and the fixed asset register were not performed. A comparison between the asset register and the annual financial statements revealed unreconciled differences amounting to R2.3 million.
14. In the absence of adequate fixed asset records, it was not possible to verify the valuation, accuracy, existence, completeness and ownership of assets of the municipality to the value of R47.5 million as disclosed in the statement of financial position.

Funds and reserves

15. Documentation adequately supporting prior year corrections to the government grant reserve of R23.7 million and the unappropriated surplus of R76.9 million amounting to R35 million as disclosed in note 24 to the annual financial statements was not submitted for audit purposes. This is as a result of ineffective reviewing, checking and reconciling of source documentation.
16. Consequently it was not possible to obtain all the information and explanations that were considered necessary to gain assurance as to the validity, accuracy and completeness of the prior year adjustment.

Expenditure

17. The municipality could not submit any supporting documentation for tenders and contracts awarded for audit purposes amounting to R414 million and there were no alternate procedures I could perform to obtain additional assurance. The significance thereof represented a limitation of scope on the audit work that could be performed. Consequently I was unable to determine the validity of general expenditure amounting to R485.1 million as reported in the statement of financial performance and capital expenditure amounting to R13.2 million as reported in note 8 to the financial statements.
18. As a result of the above limitation I also was unable to determine if all the Supply Chain Management Regulations as set out in the MFMA were complied with and if any irregular expenditure has been incurred as a result of non-compliance.

19. In addition as a result of the limitation above we were unable to determine the completeness of the commitments as reported in note 30 to the financial statements.

Value-added tax (VAT)

20. According to the South African Revenue Services (SARS) the municipality is registered for VAT on the invoice basis for the year under review. The municipality accounts for VAT on the payment basis. The timing difference between these two approaches will result in unaccounted VAT debtor and VAT creditor balances. The full extent of such differences could not be determined.
21. VAT due from SARS amounting to R25.4 million is disclosed in note 5 to the financial statements. Due to the lack of a proper management framework for reconciliations, these balances remain unreconciled, as a result no documentation is available to support the valuation and existence of the balances. In addition there is an unexplained difference of R4.2 million between amounts disclosed in note 5 to the annual financial statements and the VAT balance in the statement of financial position.
22. Consequently, it was not possible to confirm the completeness, existence and valuation of the VAT debtor of R25.4 million. In addition due to the inability to satisfactorily audit VAT I am unable to determine the value of any adjustments required to affected transactions recorded including expenses, revenue, purchases and disposals of property, plant and equipment.

Payables

23. A reconciliation between the unspent conditional grant liability of R174.9 million as reported in note 4 to the annual financial statements and related bank balances amounting to R232 million was not submitted for audit purposes. In addition management was not able to provide an adequate explanation for the difference of R57.1 million. As a result I was not able to verify the completeness, existence and accuracy of this balance. This finding is due to the lack of a proper management framework for reconciliations.

Provisions

24. Provisions amounting to R10 million are reported in note 21 to the financial statements. This amount is made up of a provision for leave pay of R5.9 million and a provision for bonus of R4.1 million. The provision for bonus was found to be overstated by R1.7 million being the prior year's provision which has yet to be reversed.
25. The provision for leave pay was found not to meet the definition of a provision in terms of GAMAP19: *Provisions, contingent liabilities and contingent assets* as the municipality does not have an obligation to make these payments. The amount should have been reported under accounts payable. Furthermore this balance was found to be understated by an amount of R285 798 due to calculation errors.

Related parties

26. The municipality have not documented and implemented procedures to identify related parties, as well as any transactions and balances with such related parties.

Consequently it was not possible to obtain sufficient appropriate audit evidence to support the completeness and accuracy of related party disclosure.

27. In addition a contract to the value of R200 000 was awarded to a close corporation, to which the daughter of the executive mayor of the municipality is a member. This interest was not disclosed in the register of interests in contracts or included in related party disclosure in the annual financial statements.
28. As a result of the above instances, it was not possible to determine whether the information contained in the register of interests in contracts or the related party disclosure in the financial statements was complete and accurate.

Disclaimer of opinion

29. Because of the significance of the matters discussed 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 the O.R. Tambo District Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter:

Basis of presentation

30. There is no mention in the annual financial statements of the fact that the municipality has elected the exemption, as allowed by the National Treasury, not to prepare consolidated financial statements.

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

31. As part of the audit process management is required to issue a letter of representation on the annual financial statements. The representations are in respect of the fair presentation of the annual financial statements, known fraud and error and compliance with legislation. Management was requested numerous times to submit this representation in writing before the 29th April 2008. At the date of this audit report the required representations had not been received. The non-submission of requested information is in contravention of section 74(1) of the MFMA, which states that the accounting officer must submit to the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as may be required.
32. Section 89(a) Municipal entity remuneration: The municipality did not determine the upper limits of the remuneration of the chief executive officer and senior managers of the entity. Furthermore, the municipality did not report to the council on staff remuneration matters according to prescribed categories.

Income Tax Act

33. The executive mayor has received a fringe benefit in terms of paragraph 2 of the 7th Schedule of the Income Tax Act by leasing a property from the municipality for R200 per month, which is significantly less than market related rentals of similar properties. This fringe benefit was not taken into account in calculating the executive mayor's employees' tax to be paid over to the South African Revenue Service

Fraud risk

34. There is no approved fraud prevention plan at the municipality. This increases the risk of fraud and error within all major business cycles.

Performance management system

35. Sections 39 and 40 of the Municipal Systems Act, 2000 (Act No.32 of 2000) require the development of a Performance Management System and the establishment of mechanisms to monitor and review the Performance Management System. There is no evidence that the council complied with these statutory requirements during the period under review.

Internal control

36. 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 paragraphs below depict the root causes of the matters indicated, as they relate to the five components of internal control.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Opening balances	X				
Accounts receivable	X				
Revenue	X		X		
Property, plant and equipment	X				
Funds and reserves	X				
Expenditure	X				
VAT			X		
Payables			X		
Provisions			X		
Related parties	X				
Emphasis of matter					
Basis of presentation					X
Other matters					
Non-compliance	X				

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
with applicable legislation					
Risk assessment	X				
Performance management system	X				

Late finalisation of the audit report

37. In terms of section 126(3)(b) of the MFMA I am required to submit my report to the accounting officer within three months of the receipt of the financial statements. In the interest of improving accountability and due to the process implemented by me to ensure consistency in the manner in which material audit findings are reported I have delayed the finalisation of my report to the date reflected on the audit report.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

38. 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

39. 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.

40. 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 audit procedures selected depend on the auditor's judgement.

41. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (Performance information)

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

APPRECIATION

43. The assistance rendered by the staff of the O.R. Tambo District Municipality during the audit is sincerely appreciated.

Auditor - General

EAST LONDON

30 April 2008



AUDITOR - GENERAL