

REPORT OF THE AUDITOR-GENERAL TO THE MUNICIPAL COUNCIL AND KWAZULU-NATAL PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF UMKHANYAKUDE DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

RECEIVED

Introduction

15 MAY 2008

1. I was engaged to audit the accompanying financial statements of the Mkhanyakude District 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 1 to 19.

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 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; and
 - 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) and section 128(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 described in the Basis for disclaimer 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 basis of accounting determined by the National Treasury as set out in accounting policy note 1.

Basis for disclaimer of opinion

Non-compliance with Government Gazette 30013 & MFMA Circular no.44

5. The municipality chose to early adopt GRAP, GAMAP and GAAP with the full set of deviations as listed in Government Gazette 30013, with effect from 2006/07 financial year ended. However the municipality did not comply with the timing framework of the MFMA Circular no.44 which expressly states that the municipality must apply for the deviations by 31 July 2007 and would need to receive the written confirmation co-signed by National Treasury by 15 August 2007. The municipality only applied for the deviations in mid December 2007, and at the time of finalising the audit they had not yet received written approval from National Treasury.

RECEIVED

13 MAY 2009

Consequently, the municipality has prepared the financial statements applying the principles of GRAP, GAMAP and GAAP, with the following exemptions without prior approval from National Treasury:

- The review of useful life of items of Property, Plant and Equipment need not be assessed;
- Review of depreciation method need not be assessed;
- Impairment of assets need not be assessed nor performed;
- Employee Benefits in relation to defined benefit and contribution plans;
- Revenue: initial recognition of fair value discounting all future receipts using imputed rate of interest;
- Recognition and disclosures relating to financial instruments; and
- Exemption from the classification, measurement and disclosure of non-current assets held for sale.

The effect of these deviations can not be quantified.

Fixed assets

6. Audit of fixed assets revealed the following:
- From my sample of additions testing, I identified unrecorded prior year additions of R124.8 million which have been recorded in the current financial year fixed asset additions. The full extent of this error has not been quantified by management. In addition, accumulated depreciation attributable to these previously unrecorded additions was not determined instead only current year depreciation was determined. Also, I was unable to verify the accuracy and validity of any of the recorded current year additions, as the supporting documentation was not made available for inspection.
 - From my sample of 55 assets selected for physical verification, assets with a recorded net book value of R618 000 which had been disposed of in prior years have not been removed from fixed asset register. 42 assets were not physically verified as the municipality was unable to locate the remainder of the selection.
 - The fixed asset register reflects 5 properties of land owned by the entity, however, no title deeds were provided in respect of the land held by the municipality.
 - From my selections of capital work in progress, unexplained discrepancies of R11.1 million were identified between the recorded project amount in the fixed asset register of R104.6 million and the recorded project amount in the general ledger of R93.6 million.
 - A credit of R39.5 million was reflected in the current year fixed asset additions movement. Management could not provide evidence to support the validity and accuracy of this adjustment.
 - Airstrip and land with a recorded cost of R7.5 million are being depreciated, management have not componentised this asset between land and airstrip and hence the land element should not be depreciated.

The entity's records did not permit the application of alternative procedures regarding the fixed assets. Consequently, I did not obtain sufficient audit evidence to satisfy myself as to validity, accuracy, completeness and valuation of fixed assets.

Government grant reserve / accumulated surplus

7. The following adjustments were determined based on the recorded fixed assets balance. However given the significant errors identified with the recorded fixed assets balance, I am unable to determine the accuracy, completeness and validity of these adjustments:
- 2005 – Implementation of GAMAP R 25.6 m
 - 2006 – PPE Purchased R 0.4 m
 - 2006 – Capital grants used to purchase PPE R187.3 m
 - 2006 – Offsetting of depreciation R 11.2 m
 - 2006 – GAMAP GRAP adjustments R 13.4 m
 - 2007 – Capital grants used to purchase PPE R220.1 m

▪ 2007 – Offsetting of depreciation	R 14.7 m
▪ 2007 – GAMAP GRAP adjustments	R 56.9 m
▪ 2007 – Other adjustments	R 5.8 m
▪ 2007 – Prior year adjustments	R 7.7 m
▪ 2007 – PPE Purchased	R 0.3 m

Grant revenue

8. The municipality has applied the principle of counter-funding to fixed asset purchases. This principle accounts for input VAT, claimed on fixed asset purchases, to be recognised as a credit to grant revenue and not to the recorded cost of fixed assets purchases. The principle of counter-funding is in contravention of the accounting framework and consequently has resulted in an overstatement of fixed assets and grant revenue.

The municipality was unable to quantify the extent of this error and consequently, I am unable to determine the effect on grant revenue and fixed assets.

In addition, conditional grants contain the following adjustments:

▪ Adjustment to receipts (credit)	R5,289 m
▪ Adjustments conditions met (debit)	R18,70 m

The municipality determined these adjustments based on the accuracy of the recorded fixed asset balance and accordingly, no supporting documentation was made available to support the validity and accuracy of these adjustments.

I noted that interest income earned on conditional grants is not reflected as grant revenue but instead it is reflected in the income statement as interest income. Management was unable to quantify the extent of this misallocation.

Consequently, I did not obtain sufficient audit evidence to satisfy myself as to validity, accuracy and completeness of grant revenue.

Long term liabilities

9. The municipality was unable to present documentary evidence to support the recorded government long term liability of R2.9 million, together with the terms of this loan.

I was unable to satisfy myself as to the validity, accuracy and valuation of the above mentioned long term liabilities.

Water revenue and water losses

10. No reconciliations were performed between water purchases and water sales arising from a lack of controls over the completeness of water revenue and water losses for the year under review. I selected 10 water meters to ensure that the monthly meter readings was captured and billed, however, 6 metres were not captured and billed on a monthly basis. The entity's records did not permit the application of alternative procedures relating to testing the completeness of water revenue and water losses.

Whilst testing water and sanitation sales, I was unable to agree the tariff charged per the billings to approved tariff. The entity's records did not permit the application of alternative procedures relating to testing the accuracy of water and sanitation sales.

Consequently, I did not obtain sufficient audit evidence to satisfy myself as to the completeness of water revenue and water losses.

Consumer debtors

11. The bad debt provision was determined based on the consumer debtors in 120 + days. I was unable to verify the accuracy of the ageing of the consumer debtors listing and accordingly I am unable to verify the adequacy of the bad debt provision. Furthermore, the ageing of the individual debtors' balances did not agree to the detailed age report.

Limitation of scope

12. I could not obtain the documents to support the bulk water purchases amounting to R4.3 million and electricity purchases amounting to R145 000. Consequently, I did not obtain sufficient audit evidence to satisfy myself as to the validity, accuracy and completeness of the bulk water purchases and electricity purchases.

Misclassification of expenses reflected as bulk water expenditure

13. The sample of 223 transactions recorded under bulk water purchases, revealed that 94 of these selections amounting to R3.3 million related to repairs, engineering costs, and other costs unrelated to bulk water purchases.

Performance bonus provision

14. The municipality did not provide me with supporting documentary evidence for the performance bonus provision of R407 000 and accordingly, I was unable to determine the accuracy and completeness of the performance bonus provision.

Correction of prior year errors

15. In the current year, the municipality detected material errors, as detailed in note 20 to the financial statements, which related to the prior year financial statements. The comparative financial results and position have not been corrected retrospectively to reflect these errors but instead the municipality has recorded the adjusting journals in the current financial statements. The following adjustments were made in the current year but which related to the prior years:
- | | |
|---|----------|
| • Correction of previously unrecognised interest income (debit) | R0.131 m |
| • Recognition of previously unrecorded bank account (debit) | R0.095 m |
| • Correction of water purchases expenses (credit) | R4.569 m |
| • Clearing of fleet management suspense account (credit) | R3.396 m |
| • Net reduction in accumulated surplus (debit) | R7.738 m |

Consumer deposits

16. The municipality has not maintained a detailed listing of consumer deposits and accordingly I was unable to verify the validity, completeness and valuation of consumer deposits balance of R431 000 reflected in note 2 of the financial statements.

Creditors listing not maintained

17. The municipality has not maintained a detailed creditors listing and accordingly I was unable to verify the accuracy, completeness and valuation of recorded creditors of R17.4 million.

Sundry receivables

18. Included in sundry receivables is an amount of R3.9 million, relating to the alleged fraud which resulted in the misappropriation of municipal funds. The municipality has proceeded with legal action and is attempting to recover the misappropriated funds. No documentary evidence was made available to support the recoverability of these funds and accordingly I am unable to conclude on the appropriateness of the valuation of sundry receivables balance.

VAT receivable

19. Included in the VAT receivable of R12.4 million is R7.5 million which the municipality has raised relating to the under recovery of input VAT. No supporting documentation was made available to me and accordingly I was unable to test the validity, completeness and accuracy of the recorded VAT receivable.

Uncleared suspense account

20. My review of the suspense account reflected that the expenses incurred in relation to the Diners Club cards have not been appropriately allocated out of the suspense account. In the current year, expenses amounting to R45 000 were incurred but not yet allocated to expenses. Whilst the remaining balances of expenses amounting to R672 000 relate to expense incurred in prior years. These amounts were carried forward from the 04/05 financial year.

Disclosure Information In financial statements

21. Disclosure information reflected in notes 24.4, 24.5, 24.6 and 25 – capital commitments, of the financial statements was not audited as the information was not made available timeously by the municipality.

Infrastructure projects

22. From my selection of 2 infrastructure projects amounting to R19.6 million, the municipality was unable to provide me with the tender documentation and signed agreements for either of the infrastructure projects and accordingly, I was unable to test the tender process for compliance.

Disclaimer of opinion

23. 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 Mkhanyakude District 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 responsibility in the audit of the financial statements:

Non-compliance with applicable legislation

Value-Added Tax Act, 1991

- 24. The municipality has accounted for VAT on payment basis and not on invoice basis. Section 15(2) (a) (i) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) allows municipalities to account for VAT on payments basis, subject to a written application to SARS. The municipality was unable to provide documentary evidence from SARS which grants them permission to account for VAT on the payment basis.

Basic Conditions of Employment Act, 1997

- 25. The municipality has not complied with the section 10(1) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), relating to overtime claims which exceed 30% of employee's monthly salary. From a sample of 22 employees selected for testing, 11 employees were identified with overtime in excess of 30% of the employee's monthly salary.

Collective Agreement on Conditions of Service

- 26. The municipality has 42 employees with more than 48 days accumulated leave as at 30 June 2007, which is in contravention of paragraph 7(4) of the Collective Agreement on Conditions of Service between South African Local Government Association and Independent Municipal and Allied Trade Union and South African Municipal Workers' Union. This agreement limits leave accumulated subsequent to 1 January 2004 to a maximum of 48 days.

Supply Chain Management Regulations

- 27. In terms of regulation 6(4) of the supply chain management regulations, the municipality must make public the municipal reports on the implementation of the supply chain management policy. No evidence could be provided by the municipality to prove that the reports on the implementation of the supply chain management policy were made public.

Income Tax Act, 1962

- 28. In terms of paragraph 13 of the Fourth Schedule, an employer must furnish employees to whom remuneration is paid or has become payable and from which employees' tax in respect of a tax period was deducted, with an IRP 5 certificate within the prescribed period. If for a valid reason no employees' tax was deducted from the remuneration paid to an employee, an IR 3(a) return must be issued to the employee instead of an IRP 5 form. The municipality did not furnish 3 employees out of my selection of 50 employees with an IRP 5 form or an IR 3(a) resulting in non compliance with the Income Tax Act.

Municipal Finance Management Act, 2003

29. The mayor has not tabled, in the municipal council, the annual report of the municipality within 7 months after the end of the previous financial year.
30. The financial statements for the year ended 30 June 2007 should have been submitted to the Auditor-General on the 31 August 2007, however the 2006/07 financial statements were only submitted to the Auditor-General on 16 October 2007.
31. A formal internal audit unit was not in place as required by section 165(1) of the MFMA for the year under review.
32. The municipality could not present me with evidence that the annual budget was submitted to National Treasury.
33. A formal approved fraud policy and plan was not in place for the year under review as required by section 62(3)(c) of the MFMA.

Material corrections made to the financial statements submitted for audit

34. The financial statements, approved by the accounting officer and submitted for audit on 16 October 2007, have been significantly revised in respect of the following misstatements identified during the audit:
 - Water purchases relating to the 2005/06 financial year were not recorded in the prior year, resulting in an adjustment of R4.6 million to water purchases expense and accumulated surplus. The prior year effect was incorrectly adjusted in the current year.
 - Fleet management suspense account had not been cleared for the current and prior financial years, resulting in an adjustment of R6.3 million to the suspense account and expenditure.
 - The 13th cheque provision was not accrued, resulting in an adjustment of R589 000 to creditors and salary and wages expense.
 - Interest income was incorrectly classified as sales, resulting in a reallocation adjustment of R525 000 to revenue and interest earned.
 - Understatement of creditors, resulting in an adjustment of R3.4 million to creditors and expenditure.

Internal control

35. 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 component.

Basis of Disclaiming Opinion				
Non-compliance with Government Gazette 30013 & MFMA Circular no.44	✓		✓	✓
Fixed assets	✓	✓	✓	✓
Government grant reserve and accumulated surplus	✓		✓	✓
Grant revenue	✓		✓	✓
Long term liabilities			✓	✓
Water revenue and water losses	✓		✓	✓
Consumer debtors			✓	✓
Litigation of scope	✓		✓	✓
Misclassification of expenses reflected as bulk water expenditure				✓
Performance bonus provision			✓	✓
Correction of prior year errors	✓		✓	✓
Related parties			✓	✓
Consumer deposits			✓	✓

Creditors listing not maintained				✓		✓
Sundry receivables			✓	✓		✓
VAT receivable			✓	✓		✓
Uncleared suspense account		✓		✓		✓
Disclosure information in financial statements					✓	
Infrastructure projects					✓	
Non-compliance with applicable laws and regulations						✓
Material corrections made to financial statements	✓			✓		✓

Investigation In progress

36. There was an un-reconcilable amount of R\$. 1 m on the 2005/6 bank reconciliation as a result of alleged fraud. This office, has at the date of finalising the report not been provided with a copy of the forensic report or the progress thereon.

Unaudited supplementary schedules

37. The supplementary schedules on pages 20 to 31 do not form part of the financial statement and is presented as additional information. I have not audited these schedules and accordingly do not express an opinion on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

38. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

39. In terms of section 124(3)(c) of the MFMA, the annual report of the municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

Responsibility of the Auditor General

40. I conducted my engagement in accordance with section 13 of the PA, read with General Notice 646 of 2007, issued in Government Gazette No. 29919 of 25 May 2007 and section 45 of the MSA.

41. 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.

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

Non-compliance with regulatory requirements

No reporting of performance information

43. The annual report of the Mkhanyakude District Municipality did not include the annual performance report of the municipality as required by section 46 of the MSA and section 121(3) (c) of the MFMA.

Existence and functioning of a performance audit committee

44. The Mkhanyakude District Municipality did not appoint and budget for a performance audit committee, neither was the audit committee utilised as the performance audit committee, as required by section 166(1) of the MFMA.

Internal auditing of performance measurement

45. The Mkhanyakude District Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA.

Late finalisation of the audit report

46. In terms of section 126(3)(b) of the MFMA the Auditor-General is required to submit the audit report to the accounting officer within three months of receipt of the financial statements. In the interest of improving accountability and due to the process implemented to ensure consistency in the manner in which material audit findings are reported, I have delayed the finalisation of the audit report to the date reflected in the audit report.

APPRECIATION

47. The assistance rendered by the staff of the Mkhanyakude District Municipality during the audit is sincerely appreciated.

Dudley General

Pietermaritzburg

30 April 2008



AUDITOR GENERAL

RESPONSES TO THE REPORT OF THE AUDITOR GENERAL TO THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF UMKHAYAKUDE DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007.

PARAGRAPH 5.

NON-COMPLIANCE WITH GOVERNMENT GAZETTE 30013 AND MFMA CIRCULAR NO. 44

As a medium capacity municipality it was necessary to be GAMAP/GRAP compliant in 2007.

Accordingly the municipality commenced with GAMAP/GRAP implementation in March 2007 and appointed a professional firm of chartered accountants to do the conversion and finalise the statements.

Subsequently in late June 2007 National Treasury issued circular allowing Municipalities one further year for implementation.

This dispensation allowed those Municipalities to apply for deviations in regard to presentation (as listed in the audit report) provided they apply for these deviations in presentation by 31 July 2007 and receive approval by 15 August 2007 (the municipal financial year ends on 30 June 2007 and statements are required to be completed within 2 months i.e. 31 August 2007!!!!)

Nevertheless UDM continued with GRAP implementation (considering the work and expenses already incurred by beginning the process in March 2007) and the statements were finally completed late but handed to the auditors on 16 October 2007, in GRAP format. This not only required the restatement of previous years figures into the same format for comparatives but also the conversion of the assets register into GAMAP/GRAP format to be able to calculate depreciation and remaining lifespans of assets.

The Municipality did omit to apply for the deviations by 15 August 2007. However, NT also required of Municipalities to submit implementation plans by 31 October 2007 and this WAS DONE BY 31 OCTOBER 2007. This plan specifically notes that conversion was done in 2007 and that the deviations were accepted. The Auditors were pertinently made aware of and were shown this plan. No mention of this is made in the audit report! During the audit, the auditors demanded the letter requesting acceptance of the deviations and this was accordingly submitted to NT in December 2007 but no response has been forthcoming.

Furthermore cognisance should be taken of the circular which clearly states that municipalities must be encouraged to convert to GAMAP/GRAP and that reversion to previous formats is to be discouraged!!!

The bullet points mentioned in paragraph 5 all relate to the deviations.

The first three bullet points relate to assets, useful life, impairment and depreciation method. Although council has presently tendered for the valuation, decomponentization, maintenance plan for assets (impairment) etc., depreciation was calculated on the historical value of assets and as per the useful life of the asset as indicated in the assets register.

Although these bullet points relate to deviations and the auditors concern is whether these be allowed or not, on the strength of a three sentence letter to NT, the plot seems to have been lost, no cognizance or credit for the implementation plan has been noted , or the spirit of the circular from NT . Furthermore, the fact that an asset register in GAMAP/GRAP format, balanced to the financial statements has been produced, seems to have gone unnoticed!

For the record, the internal planning was (i) balance assets register to financials 2005/2006

(ii) gamap/grap compliant asset register 2006/2007

(iii) physical verification 2007/2008

(iv) decomponentization and valuation of infrastructure

assets and maintenance plan 2008/2009.

The balance of the bullet points relate to issues which have little bearing on this district council which a little investigation would have indicated.

Therefore in short these were all allowable deviations which the AG has chosen to disallow on the strength of a letter not sent to NT , notwithstanding the spirit of the circular from NT and the circumstances surrounding early conversion and that the deviations in any event would have little or no effect on UDM.

Under these circumstances it is extremely difficult to comprehend that these matters are strength enough for a disclaimer, and aim of the opinion that "emphasis of matter" may have been a more balanced approach.

PARAGRAPH 6 FIXED ASSETS

The assets were transferred from local municipalities in the 2005/2006 financials. In respect of these assets the date of acquisition was deemed to be the inclusion date. A list of infrastructure assets not capitalized in previous years was prepared. It is perhaps interesting to note that this was not picked up by the AG in previous audits). These were processed in 2005/2006 and an amount of R293, 000 was brought to account, the entry being debit assets, credit loans redeemed and other capital receipts, creating effectively a nil book value. These assets were verified and an assets register was prepared which was in balance with the assets register. This was accepted by the AG in 2005/2006 as our service providers, Messrs Combined systems were in the process of preparing a fully compliant GAMAP/GRAP assets register which only had to be finalized by the end of June 2008 (window period for assets by NT) and now in terms of the implementation plan as submitted in October 2007 which requires full asset compliance by 2009!

Corrections in respect of infrastructure assets for 2005/2006 were indeed effected in the 2006/2007 statements and working papers were handed to various sets of auditors as the teams changed and also

explained to the changing teams. There was lack of continuity and understanding of the process, what was trying to be achieved, and that the corrective process was a continuance from previous years, and that these corrections are vital in the overall goal in terms of the implementation plan. Furthermore as these corrections (bullet points 1,4 & 5), all relate to infrastructure assets which in terms of the plan still have to be valued, perhaps the reform an exercise in futility, noting that the administration was merely trying to align the assets register to historic costs of assets not previously capitalized to ensure that depreciation is brought to account.

Again, with the dispensation given by NT, it seems extremely harsh to issue a disclaimer, noting the implementation plan and the evident lack of understanding or acceptance of the process as a result of changing audit teams.

Bullet point 2 – the sentence composition is misleading. Not all 55 assets referred to relate to the R618, 000 disposed of in prior years, the amount refers to vehicles disposed of by council resolution in prior years which indeed have not been removed from the assets register. These will be removed in the 2007/2008 year in accordance with the plan for physical verification.

Notwithstanding the above asset verification was commenced in 2006/2007 and the 42 assets referred to were mostly vehicles which the auditors were not able get to see as they were in the field busy with service delivery. There are however other methods of verification which the auditors could have employed to verify the existence of these vehicles such as log sheets etc.

Bullet point 3- land owned, similarly the auditors could have performed a deeds search, this being normal audit practice. The deeds for the airfield are readily available in any event.

Bullet point 6.-the land referred to for the airstrip is mainly the runway, the balance of the land having little intrinsic value, and as such is infrastructure, which needs to be maintained and accordingly depreciated. Notwithstanding this, and the window period for infrastructure asset valuation, I have great difficulty even understanding that this is included as a query yet alone its contribution to a disclaimer! Perhaps this is indicative of the dogmatic approach taken by the AG in his disallowance of the deviations, despite the reasonableness of the approach taken in depreciating the full historic value of the airstrip.

PARAGRAPH 7 GOVERNMENT GRANT RESERVE / ACCUMULATED SURPLUS

These all relate to the entries required to balance the inclusion and capitalization of previous years assets and the corrections referred to in paragraph 6 and the unbundling entries required in terms of GAMAP/GRAP. Similarly copies of working papers and explanations were given to the changing audit teams and am of the same opinion that this is largely due to a lack of continuity and understanding of the process.

These were grants received to purchase assets. Up to 2006 were mainly funded by grants which on the info basis was a means of depreciation which resulted in a nil book value. The amounts of R187, 3m and R 220, 1 m could be verified by checking the bank statements and indeed from the working papers, and

also by verification with Provincial or National government. On conversion from Info to gamap/grap the loans redeemed had to be reversed and depreciation calculated, the entry being debit depreciation and credit accumulated depreciation. The total amount of grants utilized would then be taken to revenue and on the net change of assets the profit would be debited and government grant reserve credited. Depreciation for these assets would be offset. The balance of the government grant reserve must agree to the carrying value of assets funded by grants. On conversion there are numerous adjustments associated particularly with assets and as this query indicates, prior funding mechanisms associated therewith compounded by the fact that infrastructure assets were not capitalized and the funding therefore not correctly accounted for.

Again, although these funding mechanisms in respect of assets are not specifically mentioned as deviations, they form an integral part of conversion and should be seen as part of the process. Similarly despite the deviations not being allowed, there has been a lack of understanding of conversion despite the working papers having been explained to the different auditee's on numerous occasions by the firm of chartered accountants employed for the conversion.

PARAGRAPH 8 GRANT REVENUE

An assumption is made that counterfunding was from VAT. Revenue contributions are also a source of counterfunding and these entries were associated with the funding entries as referred to in paragraph 7.

These were not errors but the funding adjustment entries necessary for the gamap/grap conversion together with the infrastructure asset capitalization corrections as previously referred to.

An assumption is made that interest is misallocated- this would only be true if the MOA required that interest be credited to the project. There is normally a quid ro-pro arrangement that the municipality incurs the administrative costs to carry out the project.

PARAGRAPH 9 LONG TERM LIABILITIES

The government loan portion of the liabilities relates to the cession of a loan from Mtshatuba in respect of sewer and water functions taken over by legislation.

There has been no change in respect of the figures presented in 2006 as against those presented in 2007, yet this was not considered an issue by the AG in 2006. This amount could have been confirmed by interrogating the records of Mtshatuba local municipality, or calling for amounts owing from the Development bank.

Again, the fact that this was transparently indicated as a liability rather than leaving it out, should not be cause for a disclaimer.

The Development bank has verbally acknowledged that the loan is due from UDM and they are presently preparing documentation for formal acknowledgement of the cession. Although this has been arranged, I am of the opinion that the transfer of assets and liabilities in terms of the act takes preference and am unable to accept that this is reason enough for disclaiming liabilities.

PARAGRAPH 10 WATER REVENUE AND WATER LOSSES

This query was as for the previous year. It was explained at length to the AG that council does not have the infrastructure to measure water purchases against water sales as there are no control meters /zone meters and further there are numerous unmetered stand pipes. Further the terminology used is misleading. Council does not purchase water. It purifies water drawn from various sources and pays all the purification costs associated therewith. Last year this was used as a reason for qualification of the audit report. Council has commenced with a water loss control programme in its largest supply area being Mtubatuba which includes the installation of zone control meters and will in the foreseeable future be able to compare purified water distributed to water sold.

Despite this improvement the audit report is downgraded from qualification to disclaimer.

The meters claimed not to be captured were subsequently proved to the auditors. The information provided does not allow us to prove or disprove this statement as we do not know if it is the same meters being referred to.

In terms of the tariffs for 2006/2007, these were approved as part of the budget meeting in June 2006 and implemented and billed as such. Indeed in any event they did not change from the previous year.

Under the circumstances including these issues as disclaimers seems extremely unfair.

PARAGRAPH 11 CONSUMER DEBTORS

The summary age analysis for 90 and 60 days agrees to the total reflected. In respect of current and 30 days these include journals for previous periods passed in the current month.

Debtors reflected as 120 days and over totals R35, 906,501. The provision of R34, 569,787 is considered more than adequate!

Individual debtors would not agree to the age analysis where journals have been processed.

PARAGRAPH 12 LIMITATION OF SCOPE

The details such as cheque numbers are required to adequately reply to this query.

PARAGRAPH 13 MISCLASSIFICATION OF BULK WATER EXPENSES

Water costs for 2006/2007 were not ringfenced. In addition council does not purchase water, it has a service provider who incurs expenditure to purify and distribute water.

The statement that these costs are unrelated to water purchases shows that the auditors have no understanding of the business of this council, and further that this should be cause for a disclaimer is ludicrous.

PARAGRAPH 14 PERFORMANCE BONUS PROVISION

The calculations in respect of these figures were supplied.

PARAGRAPH 15 CORRECTION OF PRIOR YEAR ERRORS

On gamap conversion, prior year errors are adjusted through the net change of assets. Accumulated profit/loss is debited or credited and referred to a note. This was discussed with the auditor who indicated that it should be shown as a prior year adjustment.

The complaint appears to be that comparative financial results have not been retrospectively corrected.

PARAGRAPH 16 CONSUMER DEPOSITS

These listings were all in respect of balances taken over from the 5 local municipalities. Lists were provided in respect of four of the councils and only BIG 5 was outstanding.

PARAGRAPH 17 CREDITORS LISTING NOT MAINTAINED

A monthly creditors listing is produced each month. This was shown to the auditors. Furthermore the outstanding orders report is also available.

PARAGRAPH 18 SUNDRY RECEIVABLES

This case is still sub-judicate, the amount outstanding is correct. Council is not yet in a position to write off this amount. Further there are indications from asset forfeiture unit that funds will be forthcoming and further an interdict against pension payment till after the case has been lodged.

PARAGRAPH 19 VAT RECEIVABLE

Maxprof supplied the auditors with a letter confirming their claim on behalf of council. This amount has subsequently been reduced by the Receiver. Full documents relating to the above are available.

PARAGRAPH 20 UNCLEARED SUSPENSE ACCOUNT

This is a valid query. Reconciliations are presently being effected and procedures and processes with a view to more rigid internal control will be introduced.

PARAGRAPH 21 DISCLOSURE INFORMATION FINANCIAL STATEMENTS

Statements were finalized in October 2007. The Audit Report was received in May 2008. All the information referred to is readily available.

PARAGRAPH 22 INFRASTRUCTURE PROJECTS

No infrastructure projects are commenced with without tender process or contract documentation.

PARAGRAPH 23 DISCLAIMER OF OPINION

From the foregoing it is evident that the disclaimer of opinion is extremely harsh treatment of this District Council and reflective of the approach to the Audit. A fairer representative opinion may have been emphasis of matter. No credit or recognition is given for early conversion and in fact the Auditors recognition of the spirit of Circular 44 from National Treasury is non-existent.

OTHER MATTERS

NON-COMPLIANCE WITH APPLICABLE LEGISLATION

PARAGRAPH 24 VALUE-ADDED TAX ACT, 1991

The Municipality is registered on the payments basis. A simple query with the Receiver could have confirmed this.

PARAGRAPH 25 BASIC CONDITIONS OF EMPLOYMENT ACT, 1997

The excessive overtime referred to is as a result of vacancies that were not able to be filled and overtime was required in respect of essential services.

PARAGRAPH 26 COLLECTIVE AGREEMENT ON CONDITIONS OF SERVICE

Noted. This will be addressed.

PARAGRAPH 27 SUPPLY CHAIN MANAGEMENT REGULATIONS

To the contrary. Public meetings were advertised and training sessions for the public sectors were undertaken.

PARAGRAPH 28 INCOME TAX ACT, 1962

The system automatically allocates IRPs Certificates for all employees on the Payroll.

MUNICIPAL FINANCE MANAGEMENT ACT, 2003

PARAGRAPH 29

Noted. The Audit Report was only received in May 2008.

PARAGRAPH 30

Noted. Submitted in October 2007 as a result of GAMAP/GRAP conversion.

PARAGRAPH 31

Noted. Internal Auditors were however appointed in 2007 / 2008.

PARAGRAPH 32

This could have been confirmed by National Treasury.

PARAGRAPH 33

The draft policy has subsequently been approved by the Audit Committee and will be submitted to Council for formal approval.

MATERIAL CORRECTIONS MADE TO FINANCIAL STATEMENTS SUBMITTED FOR AUDIT

PARAGRAPH 34

These corrections were effected in conjunction with the Auditors.

PARAGRAPH 35 INTERNAL CONTROL

The explanations have been given in the previous responses and where necessary internal control procedures will be improved.

PARAGRAPH 36 INVESTIGATION IN PROGRESS

This report was commissioned by DPLG.

PARAGRAPH 37 UNAUDITED SUPPLEMENTARY SCHEDULES

Noted.

OTHER REPORTING RESPONSIBILITIES

PARAGRAPH 38 TO PARAGRAPH 42

Noted.

NON-COMPLIANCE WITH REGULATORY REQUIREMENTS

PARAGRAPH 43 NON-REPORTING OF PERFORMANCE INFORMATION

The Annual Report for 2007 is still to be completed. Report for 2006 was not done due to the extremely late finalization of the Financial Statements and Audit as a result of the documents being with the Forensic Auditors. In respect of 2007, the Mayor tabled a report as required by the MFMA explaining the delays in submission of the Annual Report.

PARAGRAPH 44 EXISTENCE AND FUNCTIONING OF PERFORMANCE AUDIT COMMITTEE

Council have appointed the Audit Committee in a dual functionality also as its Performance Audit Committee.

PARAGRAPH 45 INTERNAL AUDITING OF PERFORMANCE MEASUREMENT

Council is far advanced in the development of its Organizational Performance Management System.

PARAGRAPH 46 LATE FINALISATION OF THE AUDIT REPORT

Noted.



Harlingen No. 13433, Kingfisher Road,
 Mkuze 3965
 PO Box 449, Mkuze,
 Tel: 035 573 8613
 Fax: 035 573 1809
 Email: mmathe@umkhanyakude.org.za

OFFICE OF THE CHIEF FINANCIAL OFFICER MR PH EMSLIE

TO : Sibuiso Mahaye	FROM: Khosi Ntuli (CFO's Office)
COMPANY : Provincial Treasury	PAGES INCL: 21
FAX NO : 033 342 3837	
DATE : 05 May 2009	SENDER'S TEL NO: 035 5736615 SENDER'S FAX NO: 035 5731809

SUBJECT : Auditor General's Report 2006 / 2007

MESSAGE

Kindly receive the attached Auditor General's Report 2006 / 2007 for your attention.
 Should you have any queries or require any further assistance, please do not hesitate to contact me.

**PLS
REPLY**

**PLS
CONFIRM**

**PLS
REVIEW**