

# REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NDLAMBE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying financial statements of the Ndlambe Municipality which comprise the balance sheet as at 30 June 2008, income statement 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 entity-specific basis of accounting, 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) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

### Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on 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 the entity-specific basis of accounting, as set out in accounting policy note 1 to the financial statements.

### **Basis for qualified opinion**

#### **Fixed assets**

9. In terms of section 62(1)(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 assets during the year under review, as the asset register is not completely and adequately populated and not supported by the appropriate documentation. Based on the above deficiencies, I could not obtain sufficient appropriate audit evidence regarding infrastructure assets totalling R164 million included in the amount of R235,547 million disclosed in note 6 to the financial statements.
10. In addition, adequate evidence could not be obtained in support of the existence and ownership of properties totalling R7,397 million.
11. I was unable to confirm by alternative means, the carrying value of fixed assets reported.
12. Consequently it was not possible to confirm the completeness, existence, rights, classification and valuation relating to fixed assets amounting to R46,873 million as disclosed in note 6 to the financial statements.

#### **Debtors**

13. In terms of the entity-specific basis of accounting the municipality is required to provide for amounts included in debtors who are considered to be irrecoverable and to adjust such provision annually. The municipality does not have a bad debt provision policy which enables it to identify all potential bad debts. In addition, no evidence could be provided in support of the quantification or adequacy of the bad debt provision amounting to R31,540 million as reported in note 10 to the financial statements.
14. I was also unable to confirm by alternative means the carrying value of the provision as reported above.
15. Furthermore, an analysis of debtor ageing revealed debtors totalling R37,471 million as having been outstanding for a period exceeding 90 days. Debtors are therefore considered to be overstated by an estimated amount of R5,930 million.

### **Creditors**

16. Section 63(2)(a) of the MFMA states that the accounting officer must ensure that the municipality has and maintains a system of internal control over liabilities. Trade creditors amounting to R4,632 million are reported in note 12 to the financial statements. Included in this amount is a balance of R1,4 million (2007: R1,1 million) in respect of building deposits, for which adequate supporting documentation could not be provided.
17. I was also unable to confirm by alternative means the carrying value of the balance as reported above.
18. It was therefore not possible to confirm the existence, valuation and completeness of this amount.

### **Provisions**

19. The municipality, which operates landfill sites, has an obligation in terms of section 28 of the National Environment Management Act, 1998 (Act No. 107 of 1998) to restore such sites. The municipality does not assess the remaining useful life of landfill sites. Detailed records of the capacity of landfill sites are not maintained by the municipality's engineers.
20. Consequently, a provision for the rehabilitation of landfill sites has not been raised in the financial statements. Due to the specialist nature of such a provision and lack of appropriate records, I was unable to determine the extent of the misstatement.

### **Irregular expenditure**

21. In terms of section 111 of the MFMA, the accounting officer must ensure that the municipality has and implements a supply chain management policy (SCM). However, goods and services totalling R5,758 million were found to have been procured from suppliers without having followed the required SCM procedures. The municipality subsequently disclosed the said amount in note 34 to the financial statements. However, I was unable to determine if all the SCM regulations as set out in the MFMA were complied with and the completeness of any related irregular expenditure.

### **Qualified opinion**

22. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Ndlambe Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended have 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 and DoRA.

## Emphasis of matter(s)

I draw attention to the following matters:

### Highlighting critically important matters presented or disclosed in the financial statements

#### Unauthorised expenditure

23. As disclosed in note 33 to the financial statements, unauthorised expenditure to the amount of R10,152 million was incurred for the year ended 30 June 2008.

#### Statutory funds

24. Approximately R21,605 million of the underlying investments for fund balances reported in note 1 to the financial statements was borrowed to fund the operations of the municipality. Should these amounts not be repaid timeously, this could affect the completion of capital projects as delays may be experienced due to a shortage of available funds.

#### Post-balance sheet events

25. Attention is drawn to paragraph 5 of the Chief Financial Officer's report and note 34 to the financial statements which detail a post-balance sheet event involving an entity, namely the Albany Regional Water Services Scheme, which is in the process of being formed by Ndlambe municipality.

## OTHER MATTERS

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

#### Internal controls

26. 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 that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed assets					✓
Debtors					✓
Creditors					✓
Provisions			✓		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
risks to achieve predetermined financial reporting objectives.					
<u>Control activities</u> : policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.					
<u>Information and communication</u> : supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.					
<u>Monitoring</u> : covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.					

## Matters of governance

27. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.	✓	
• The audit committee operates in accordance with approved, written terms of reference.	✓	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	✓	
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.	✓	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	✓	
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.	✓	
• The prior year's external audit recommendations have been substantially implemented.		✓
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the		✓

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
relevant provincial treasury before 30 October 2007.		
<ul style="list-style-type: none"> <li>The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.</li> </ul>		✓

## **OTHER REPORTING RESPONSIBILITIES**

### **REPORT ON PERFORMANCE INFORMATION**

28. I have reviewed the performance information as set out on pages xx to xx.

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

29. 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**

30. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

31. 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.

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

#### **Audit findings (performance information)**

#### **Non-compliance with regulatory requirements**

#### **No reporting of performance information**

33. Section 46 of the MSA, as required by section 121(3)(c) of the MFMA, was not complied with as the annual report of Ndlambe Municipality did not include the annual performance report of the municipality.

### **Content of integrated development plan**

34. Section 26(i) of the MSA was not complied with as the integrated development plan of Ndlambe Municipality did not include the key performance indicators and performance targets with which to measure the objectives.

### **No regular reporting on performance information**

35. No regular reporting was done to measure progress on the objectives set out in the integrated development plan against actual performance.

### **Lack of sufficient, appropriate audit evidence**

36. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the municipality, as the system used for generating information was not adequate for purposes of such evaluation. Under these circumstances it was not possible to confirm that this information is complete and accurate.

### **APPRECIATION**

37. The assistance rendered by the staff of the Ndlambe Municipality during the audit is sincerely appreciated.

East London

28 November 2008



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