

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

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Tsolwana 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 4 to 20.

### **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 to the financial statements 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) and section 126 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 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 adverse opinion**

#### **Fixed assets**

9. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The municipality reflected gross fixed assets of R68,6 million in note 6 to the annual financial statements. This balance should be supported by a detailed asset register detailing each asset sufficiently for it to be identified individually. Assets to the value of R3,1 million were not individually recorded in the fixed asset register by management. There were no satisfactory audit procedures I could perform to obtain reasonable assurance that the fixed asset register was complete. Consequently I was unable to satisfy myself as to the completeness and accuracy of assets included in the fixed asset register amounting to R3,1 million.
10. In terms of section 74(1) of the MFMA the accounting officer of a municipality must submit to the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or required. No supporting documentation could be supplied in relation to the following:
  - Cheque payments amounting to R23 224.
  - Transfer between contributions from income and grants and subsidies amounting to R642 000.
  - List of all DoRA-funded assets.
  - List of all erf numbers relating to land and buildings of R5,4 million.
  - Contracts in relation to capital expenditure of R1,5 million.
11. There were no satisfactory audit procedures I could perform to obtain reasonable assurance for the items stated above without the appropriate supporting

documentation, consequently I was unable to satisfy myself as to the existence, completeness and accuracy of the transactions detailed above.

12. In terms of the IMFO standards the net asset value reflected in appendix C of the annual financial statements should agree with the total balance of internal and external loans as reflected in appendix B. The net asset value was misstated by R165 461 which related to the difference between the total of internal and external loans of R2 million and the net asset value of R1,8 million.
13. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The municipality reflected a balance of motor vehicles in appendix C in the amount of R551 788. This balance should be supported by a detailed asset register detailing each asset sufficiently for it to be identified individually. This register is not complete as a number of vehicles have not been included. As no supporting documentation could be presented for the acquisition thereof, the valuation could not be determined, nor could additional procedures be performed.

#### **Trust funds**

14. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. No register was kept by management for conditional grants of R1 million received by the municipality. In addition, the original contracts for these trust-funded projects could not be provided, and a register of contracts awarded was not maintained. In the absence of the registers and contracts no audit procedures could be performed to provide reasonable assurance that all grants had been properly recorded. Consequently I was unable to satisfy myself as to the completeness of the revenue and the occurrence of expenditure relating to the trust monies received.

#### **Expenditure**

15. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control.
  - Expenditure to the amount of R347 448 was not supported by returned paid cheques. I was therefore unable to ensure that the payments had been made to the correct suppliers and as monthly reconciliations of supplier statements had not been done either, no suitable alternative audit procedures could be performed.
  - Expenditure amounting to R238 059 had no supporting documentation, therefore no suitable alternative audit procedures could be performed.
16. As a result I was unable to satisfy myself as to the occurrence and accuracy of the above amounts disclosed under expenditure
17. Journals to the amount of R81 451 had no supporting documentation; therefore, as no suitable alternative audit procedures could be performed, the occurrence and accuracy of these amounts could not be assured.

## **Creditors**

18. All amounts disclosed in the balance sheet must be classified in the correct accounts. An amount of R2,8 million was reflected on the balance sheet as creditors. This included an account detailed as "Unidentified income". Transactions in this account amounting to R772 056 were not supported by any documentation. Therefore, as no suitable alternative audit procedures could be performed to determine the nature and cause of these transactions, I was unable to satisfy myself as to the classification and accuracy of this amount.
19. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. Journals to the amount of R101 701 had no supporting documentation; therefore, as no suitable alternative audit procedures could be performed, the occurrence and accuracy of these amounts could not be assured.

## **Customer deposits**

20. In terms of section 74(1) of the MFMA the accounting officer of a municipality must submit to the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as may be required. No listing of consumer deposits could be provided. The completeness, existence and valuation of customer deposits to the amount of R147 443 could not be determined and no suitable alternative audit procedures could be performed.

## **Revenue**

21. In terms of section 62(1)(c)(i) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control.
- Interest earned on receivables to the amount of R801 480 per the financial statements could not be recalculated due to a lack of supporting documentation and documented policy, and inconsistency of the calculation basis.
  - Completeness and accuracy of hall rentals could not be determined due to the lack of reconciliations between hall rentals and the hall rental register, as there were no suitable alternative procedures which could be performed.
22. As a result of the above I was unable to satisfy myself as to the completeness and accuracy of revenue.

## **Commitments**

23. In terms of section 74(1) of the MFMA the accounting officer of a municipality must submit to the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as may be required. It was found that no listing could be provided for the current outstanding capital commitments. The valuation, existence and completeness of capital commitments could therefore not be ascertained and no suitable alternative audit procedures could be performed.

## **Adverse opinion**

24. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements of the Tsolwana Municipality as at 30 June 2008 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 to the financial statements and in the manner required by the MFMA and DoRA.

## **Emphasis of matters**

I draw attention to the following matters:

### **Going concern**

25. The net liability position, poor budgeting controls and poor liquidity of the municipality were identified as going concern risks. The mitigating factor regarding these risks is the fact that the national government would assist the municipality.

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

Unauthorised, irregular or fruitless and wasteful expenditure as well as material losses through criminal conduct

Irregular expenditure

26. In the absence of a tailored supply chain management policy expenditure in the amount of R1.6 million disclosed in note 26.1, which was expended without the required documentation being obtained as required by the Supply Chain Management Framework, as irregular.

27. An amount of R132 085 as per note 26.1 was expended without the requisition forms being signed by the appropriate official, which is considered to be irregular.

Fruitless and wasteful expenditure

28. A cost of R245 100 was incurred on a Municipal Valuation Roll in a prior year and is currently accounted for under accumulated surplus. This valuation can no longer be legally implemented and as such the expenditure is considered to be fruitless and wasteful and is disclosed in note 26.2.

29. Payment to an employee under suspension to the amount of R144 626 is considered fruitless and wasteful per note 26.2, being remuneration still paid two years after suspension commenced.

30. R78 685 was paid for performance evaluation of managers. Recommendations from the consultants were not implemented and the payment for the consultant's services is disclosed as fruitless in note 26.2. In addition the HR manager's bonus of R22 420 is considered fruitless in view of the significant number of control weaknesses identified and the fact that the consultant recommended that the bonus should not be paid.

Unauthorised expenditure

31. The capital budget was exceeded on electricity services to the extent of R277 912 which is considered to be unauthorised per note 26.3. Budgeted capital expenditure disclosed per Appendix C was overstated by R3,8 million.

**OTHER MATTERS**

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

**Internal controls**

32. 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 adverse 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
Revenue	✓				
Expenditure	✓				
Salaries and wages	✓				
Customer deposits	✓				
Fixed assets	✓				
Trust funds	✓				
Creditors	✓				
Provisions	✓				
Commitments	✓				

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 risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
form and time frame that allows 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.					

## Non-compliance with applicable legislation

### Municipal Finance Management Act

33. Section 21(2)(b) states that when the budget is prepared, realistic revenue and expenditure projections need to be used when revising the integrated development plan. Other income as per the income statement for the current year was R19,7 million and the budgeted amount was R26 million compared to the prior year actual of R14,7 million Total expenditure as per the income statement for the current year was R18,8 million and the budgeted amount was R24,1 million compared to the prior year actual of R15,1 million. These projections are considered to be unrealistic.
34. No fraud prevention plan was documented or implemented, which is a requirement in terms of section 62(1)(d) and (e).
35. Disclaimers of opinion issued during the past five financial years along with the accumulated deficit are indicators of financial difficulties as defined in section 135. No reporting of financial problems was done as required under this section to either the National or Provincial Treasury.
36. No by-laws were adopted to give effect to the municipality's credit control and debt collection policy as required in terms of section 98.
37. Debtors accounts from other state entities which were regularly in arrears for more than 30 days were not reported to the National Treasury as required by section 64(3).
38. The capital budget was not allocated to specific capital projects but rather on a vote basis, thereby not ensuring adherence to section 19 which requires that municipalities only expend funds on specifically budgeted capital projects.
39. Section 98(b) requires monthly reconciliation of all accounts. The creditors control accounts were not reconciled to the supplier statements on a monthly basis and consequently this duty was not discharged.
40. Section 63(1)(a) requires the safeguarding of assets, which was not properly discharged as loose assets or inventory was neither counted nor accounted for at year-end.
41. Section 63(2)(a) and (c) was not complied with as the fixed asset register was not reconciled to the general ledger, nor was the source of funding stated for certain assets.

42. Section 13(2) which requires the development and implementation of an investment policy was not complied with as no investment policy had been adopted by the municipality.
43. Section 64(2)(a) requires effective revenue collection systems. No revenue collection policy existed nor was any action being taken to ensure collection of long outstanding debt, including that from ex-councillors who owed R97 220 arising out of the destruction of municipal assets in a prior year. Consequently I do not believe that this requirement has been discharged.
44. Section 65(2)(h) requires that the municipality's available working capital is managed effectively and economically in terms of the prescribed cash management and investment framework. The net current liability situation indicates non-compliance with this section.
45. In terms of section 62(1)(c) the municipality should maintain an effective, efficient and transparent system of internal control. The lack of proper controls, procedures, policies and oversight was specifically evident in the Human Resources department. There were no wage registers, employee files were incomplete (lack of contracts and job descriptions), casual wage earners did not sign an attendance register or timesheet when collecting wages, no performance contracts could be supplied, no external registers for overtime payments made, employment register and contracts for wage earners existed and there was a lack of effective controls over the appointments process.

#### Municipal Systems Act

46. Section 67 requires appropriate systems and procedures to be developed and adopted to ensure fair, efficient, effective and transparent personnel administration. Significant control and operational weaknesses were found, which significantly hampered the effectiveness and efficiency of the municipality, indicating that this section was not complied with.

#### Environmental Conservation Act

47. The waste disposal site currently used by the municipality has not been approved as required in terms of section 20.

#### National Environmental Management Act

48. The Municipality, which operates landfill sites, has an obligation in terms of S 28 of the National Environment Management 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. 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.

#### Basic Conditions of Employment Act

49. Employee's salary deductions were not authorised by employees as required in terms of section 34.



50. Wages were not always paid within the stipulated period of seven days after the completion of the period for which the remuneration was payable in accordance with section 32(3).

**Property Rates Act**

51. Municipal valuations done in 2004/05 were not implemented in contravention of sections 30 and 88. The current valuations in force are dated 1989 and 1995 for Hofmeyer and Tarkastad respectively.

52. In contravention of section 17, Part b of the property rates register was not maintained.

**Matters of governance**

53. 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>		
<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		✓
<b>Internal audit</b>		
<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		✓
<b>Other matters of governance</b>		
<ul style="list-style-type: none"> <li>The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.</li> </ul>		✓

Matter of governance	Yes	No
<ul style="list-style-type: none"> <li>The financial statements submitted for audit were not subject to any material amendments resulting from the audit.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The prior year's external audit recommendations have been substantially implemented.</li> </ul>		✓
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)<sup>1</sup></b>		
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.</li> </ul>	✓	
<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

54. I was engaged to review the performance information.

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

55. 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**

56. 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.
57. 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.
58. 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**

#### **Municipal Systems Act**

59. The municipality's Integrated Development Plan did not include and contain the areas of the council's operational strategies, disaster management plan, financial plan and key performance indicators and performance targets as required by section 26.
60. Section 38 was not adhered to, as no dedicated performance management system had been implemented or developed.

#### **Municipal Finance Management Act**

61. No mid-year performance assessment, comparing the performance of the municipality in terms of the predefined performance indicators was conducted as required in terms of section 72.

#### **Measurable objectives and/or indicators and/or targets not consistent**

62. The performance targets and objectives contained in the performance contracts of the section 57 managers were not based on the key performance indicators set out in the Integrated Development Plan, which is in contravention of section 57 (5).

#### **Performance information not received in time**

63. Performance information was not presented for the purposes of the audit.

## APPRECIATION

64. The assistance rendered by the staff of the Tsolwana Municipality during the audit is sincerely appreciated.

A handwritten signature in black ink on a light yellow background. The signature is cursive and appears to read "Auditor-General".

East London

30 November 2008



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