

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Lukhanji 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 36 to 69.

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 1.1, and in the manner required by the 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(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing 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 entity's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.1.

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 the assets during the year under review. As a result the fixed asset register is not completely and accurately populated and is therefore not adequately maintained and supported by the appropriate documentation. Consequently, I was unable to verify the completeness and existence of infrastructure of R94 million and other assets of R10 million, included in fixed assets of R262 million per note 6 to the financial statements.

10. In addition, even to the value of R3.6 million are not registered in the name of the municipality. I was therefore unable to verify the right of ownership in respect of these assets.

11. Accounting policy note 3.2 states that the municipality depreciates assets, however no depreciation was calculated for any assets during the financial year. The depreciation could not be quantified due to the fixed asset register not containing information such as purchase dates, classification and method of financing.

12. In terms of the entity-specific basis of accounting the carrying value of assets should agree to the underlying finance sources as loans are repaid over the useful lives of assets. The carrying value of assets per note 6 to the financial statements amounting to R262 million (2007: R179 million) does not agree to the underlying sources of finance amounting to R260 million (2007: R261 million) which has resulted in an unexplained difference of R1.8 million (2007: R1.1 million).

Value added tax (VAT)

13. The municipality is using an apportionment rate of 83.99% when claiming input VAT while 100% of all input VAT can be claimed on taxable supplies if taxable supplies represent more than 95% of all supplies in terms of section 17(1)(i) of the Value Added Tax Act, 1991 (Act No. 89 of 1991). In addition, it was found that output VAT was not declared on all taxable supplies due to the municipality not identifying all revenue streams which meet the definition of a taxable supply in terms of section 1 of the VAT Act.

14. As a result, the VAT debtor of R1.7 million disclosed in note 10 to the annual financial statements is overstated by R403 982 and consequently operating expenditure and revenue is overstated by R1 million and R1.4 million, respectively. I am unable to conclude on the existence and completeness of the VAT debtor as disclosed.

Provisions

Leave provision

15. Due to the inadequate leave records and discrepancies in such records, I was unable to determine whether the leave gratuity amount of R5.9 million disclosed in note 11 is accurate and complete. Therefore I am unable to determine the accuracy and completeness of the related contribution of R3.6 million included in contributions of R29.5 million as disclosed per appendix D.

Landfill provision

16. The municipality, which operates landfill sites, has an obligation in terms of section 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 community services department.

17. 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

18. 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 R629 630 were found to have been procured from suppliers without having followed the required SCM procedures. The municipality has subsequently disclosed the amount identified above in note 29 to the financial statements. However, I was unable to determine if all the supply chain management regulations as set out in the MFMA were complied with and the completeness of the related irregular expenditure incurred.

Qualified opinion

19. In my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I been able to satisfy myself as to the matters described in the Basis for qualified opinion paragraphs, the financial statements of Lukhanji 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 1.1 and in the manner required by the MFMA and DoRA.

OTHER MATTERS

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

Internal controls

20. 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
Basis for qualified opinion					
Fixed assets			✓		
Value added tax			✓		
Provisions			✓		
Irregular expenditure			✓		

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 form and time frame that allows people to carry out their financial reporting duties.

Monitoring: 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

21. In terms of sections 8(1) and (2) of the Property Valuation Ordinance 148 of 1993, a local authority shall from time to time cause a general valuation to be performed on all property. The general valuation must be performed at least every four years and the MEC may extend the period on request for one year. The last general property valuation was performed in 1997 and the council is therefore in contravention of the above-mentioned legislation.

Matters of governance

22. 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
Audit committee		
<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	
<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		✓
Internal audit		
<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		✓
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for audit as per the legislated deadlines for municipalities (section 126 of the MFMA). 	✓	
<ul style="list-style-type: none"> The annual report was submitted to the auditor for consideration prior to the date of the auditor's report. 		✓
<ul style="list-style-type: none"> The financial statements submitted for audit were not subject to any material amendments resulting from the audit. 		✓
<ul style="list-style-type: none"> No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management. 	✓	
<ul style="list-style-type: none"> The prior year's external audit recommendations have been substantially implemented. 		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
<ul style="list-style-type: none"> 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. 	✓	
<ul style="list-style-type: none"> 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. 	✓	

Matter of governance	Yes	No
<ul style="list-style-type: none"> 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. 	✓	

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

23. I have reviewed the performance information as set out on pages 15 to 29.

Responsibility of the accounting officer for the performance information

24. 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

25. 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.

26. 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.

27. 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

Content of integrated development plan

28. The integrated development plan of Lukhanji Municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by section 26(i) of the MSA.

Measurable objectives not consistent

29. I draw attention to the fact that the measurable objectives reported in the annual performance report of Lukhanji Municipality are materially inconsistent when compared with the predetermined objectives as per the integrated development plan.

Lack of sufficient appropriate audit evidence

Lack of systems generating performance information

30. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of Lukhanji Municipality, as the system used for generating information on the target of electricity distribution was not adequate for purposes of the evaluation.

Changes to planned performance information not approved

31. Changes to the indicators and targets in the current year's annual performance plan were not approved.

APPRECIATION

32. The assistance rendered by the staff of Lukhanji Municipality during the audit is sincerely appreciated.

Auditor-General

East London

30 November 2008



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

