

**REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE
AND THE MUNICIPAL COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF INTSIKA YETHU MUNICIPALITY FOR THE
YEAR ENDED 30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Intsika Yethu 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 IMFO 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 98 of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the 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*. Because of the matter(s) discussed in the Basis for disclaimer of opinion paragraph(s), however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
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 Intsika Yethu Municipal policy is to prepare financial statements on IMFO, as set out in note 1 to the financial statements.

Basis for disclaimer of opinion

9. Manual system used at the municipality

The municipality uses a manual system for the capturing of all transactions with the exception of revenue and receivables. Subsequent to financial year end the municipality contracted consultants to capture the manual information on an electronic application system and prepare the financial statements. The general ledger provided for auditing purposes however does not provide an audit trail as all transactions were captured as balancing totals per month via journal entries on the application system. Reconciliations between the monthly totals as per the manual system to the application system were not performed. In addition, the trial balance does not reconcile to the financial statements.

As alternative the audit team attempted to reconcile the manual system to the electronic system where significant variances were identified which could not be supported by documentation or explanations. We are unsure as to why the municipality maintains a manual system as the revenue and receivables are monitored on e-venus.

We consider the payments to the consultants to be fruitless and wasteful as value for money was not achieved by the municipality. Due to the lack of the audit trail the amount paid to the consultants could not be quantified.

10. Funds and Reserves

Appendix A to the financial statements details total funds amounting to R5 904 171 and project funds amounting to R11 494 165 which was disclosed as part of accumulated surplus on the balance sheet. As these funds are not regarded as the surplus of the municipality a separate line item detailing these funds should have been disclosed on the face of the balance sheet (detailing trust and project funds) and the corresponding notes. Management however regard the trust and

project funds to be a part of the reserves and differ from the required classification.

Furthermore, documentation supporting debit journals passed on the trust and project funds to the value of R14 853 894 and credit journals to the value of R12 082 946 and debit journals passed on the reserve account amounting to R25 049 621 and credit journals amounting to R26 861 244 could not be provided by management. Alternative procedures could not be performed to verify the transactions passed on the accounts as the general ledger does not detail an audit trail.

11. Investments

The investment register details total investments held amounting to R14 684 545 whilst the financial statements details total investments held to the value of R39 162 849. The variance of R24 478 304 was partly identified to be a result of investments to the value of R15 067 364 not disclosed on the investment register whilst the remaining variance of R9 410 940 could not be supported with documentation and management could not provide explanations thereto. As alternative we issued bank confirmations to the financial institutions which were not returned.

An investment to the value of R2 961 817 was disclosed on the financial statements for the year ended 30 June 2007. Documentation supporting either the closing of this investment or the ongoing monitoring could not be provided to enable the audit team to quantify the balance that should have been disclosed on the financial statements for the current year.

12. Statutory funds

Paragraph 5.1 of the Accounting Policy in the financial statement requires a total contribution of 7.5% of the total rates of the preceding financial year (2007) to be contributed to the revolving fund. Recalculation of the required contribution however indicated that the required contribution had not been made. A contribution amounting to R109 396 is required whilst the contribution made amounts to R67 344. The under-provision of R42 052 could not be explained by management.

13. Fixed Assets

The fixed asset register details assets held amounting to R80 057 365 whilst the asset register amounts to R99 116 020. The variance could not be explained or supported by documentation.

The value of land and buildings recorded in the asset register was understated. Recalculations performed (totaling R9 086 583) indicated a variance of R1 191 458. Furthermore, upon recalculating the value of land and buildings contained in the fixed asset register it was identified that the asset register (detailing R7 895 228) is understated with R1 191 355.

Journals supporting debit transactions to the value of R567 514 and credit transactions to the value of R4 439 297 could not be provided for auditing purposes. Alternative procedures could not be performed due to the lack of the audit trail on the accounting records.

14. Debtors

The list detailing sundry debtors details debtors to the value of R1 953 204 whilst the general ledger and financial statements amounts to R2 014 345. The variance could not be supported by documentation or explained by management. The existence and completeness of the debtors disclosed on the financial statements could not be verified as subsequent payments were not identified on the financial records.

Documentation supporting debit journals to the value of R1 357 287 and credit journals amounting to R3 175 476 could not be provided by management. Furthermore the basis established for the calculation of the provision for bad debts amounting to R3 753 753 could not be provided. Alternative procedures could not be performed due to the lack of an audit trail on the accounting records.

Evaluation of the Credit Control Policy implemented at the municipality interest is to be charged on late account payments whilst evidence thereof could not be identified. In addition management has not adopted procedures to follow up on outstanding debt such as reminder letters to defaulting debtors, legal action and discontinuance of services.

15. Provisions

Upon recalculating the provision for leave pay disclosed on the financial statements amounting to R1 032 641, an overstatement of R20 977 was identified (recalculated balance: R1 011 643) was identified which could not be explained by management and whereto documentation could not be provided.

16. Revenue

The receipts relating to monies received on behalf of the Department of Transport (e-natis) and the relating overpayment to the Department is not reconciled. The completeness and accuracy of the total traffic income recognised amounting to R846 754 on the financial statements could not be verified as reconciliations are not performed.

In addition, it was revealed that the agreed percentage allocated to the municipality is allocated to the agency fees account in the general ledger, which amounts to R65 286. The remainder of the traffic income should be paid over to the Department as the revenue does not fall due to the municipality but is collected on behalf of the Department.

Intsika Yethu Municipality renders water to the community whereto a contractual agreement to authorise the municipality to provide water could not be obtained. The total water revenue recognised to the value of R113 184 was thus considered to be outside the scope of the services provided by the municipality.

The municipality only keeps the current valuation roll and does not have a supplementary valuation roll. The municipality also does not have a register of properties that are exempt from valuation and there are no annual updates done on the existing register. The total rates earned during the financial year amounting to R2 693 764 could thus not be confirmed to be complete.

The rental income contracts were not provided for the audit. Total rent received during the financial year ended 30 June 2008 to the value of R366 344 could thus not be verified.

The total grants allocated to the municipality amounts to R45 020 304 whilst the financial statements details grants received amounting to R48 768 566. Documentation and explanations to the variance of R3 748 262 could not be provided.

Alternative procedures could not be performed to verify the completeness and accuracy of revenue received due to the lack of the audit trial on the accounting records.

The municipality does not charge a connection fee from customers on the provision of water services. As a result the lack of consumer deposits might cause significant losses to the municipality as no monies will be recovered on payment defaulting customers.

17. Inventory

The balance of inventory amounting to R46 262 disclosed on the financial statements agrees to the inventory listing. However, documentation supporting the inventory listing is not maintained at the municipality as stock records or alternative documentation is not safeguarded. Furthermore, the general ledger details total inventory to the value of R151 208 held at financial year end. It is not clear how the variance of R104 946 resulted. Alternative procedures could not be performed to verify the existence and valuation of inventory at year-end as the auditors were not invited to the inventory count and documentation is not available.

18. Payables

The list of accruals details total payables as at 30 June 2008 to the value of R908 368 whilst the financial statements details R882 220. The understatement of R26 148 could not be supported by documentation or explained by management. Due to the insufficient audit trial alternative procedures could not be performed to verify the variance.

19. Expenditure

Documentation supporting total expenditure to the value of R66 459 could not be provided. Alternative procedures could not be performed to verify these expenses due to the insufficient audit trial.

20. Salaries and wages

A salary increase of 6.43% was approved by the South African Bargaining Council which was correctly applied by the municipality. However, in addition to the approved increase management awarded an additional 2,5% increase to employees subsequent to the adjustment to salaries. This subsequent increase to the value of R2 970 203 was considered to be unauthorized but was not disclosed as such on the financial statements.

An advance of R20 000 was paid to the family of the deceased as the advanced amount is reimbursed by the pension fund to be municipality. Documentation supporting the reimbursement of the advance from the pension fund could however not be provided for auditing purposes.

21. Value Added Tax

The total Value Added Tax returns submitted to the South African Revenue Services (SARS) to the value of R6 536 562 does not agree to the amount disclosed on the financial statements which totals R6 708 805. The overstatement on the financial statements of R172 243 could not be supported by documentation. Alternative procedures could not be performed to verify the variance identified due to the lack of the audit trail on the financial records. Furthermore, the VAT returns submitted to SARS were not submitted on/before the 25th of the month following the end of the tax period. All returns relating to the period January to June 2008 were only submitted on 21 August 2008. Correspondence detailing the possible fruitless and wasteful expenditure incurred by the municipality relating to the fines and penalties could not be obtained to quantify the fruitless expenditure that needed to be disclosed on the financial statements.

Furthermore, the rental income is not recorded in the VAT control account which resulted in an overstatement of revenue and an understatement of the VAT. This amount could not be quantified due to the lack of the audit trail.

22. Commitments

The schedule detailing commitments to the value of R8 590 035 does not agree to the financial statements detailing R8 865 025. The variance of R274 990 could not be explained by management.

Disclaimer of opinion

Because of the significance of the matter(s) described in the Basis for disclaimer of opinion paragraph(s), I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Intsika Yethu Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter(s)

I draw attention to the following matter(s):

23. Going concern

The financial statements have been prepared on the going concern basis which assumes that the municipality will be able to meet its existing and future service obligations and commitments during the ordinary course of business.

However, certain matters have come to our attention which places uncertainty over the municipality's ability to continue as a going concern as the total revenue generated during the financial year ended 30 June 2008 amounting to R58 990 297 a total of R48 768 566 was received in respect of grants.

OTHER MATTERS

I draw attention to the following matter(s) that relate to my responsibilities in the audit of the financial statements:

Internal controls

24. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the [type of entity] 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/adverse/disclaimer of] 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
Manual system			√		
Funds and Reserves			√		
Investments			√		
Statutory Funds			√		
Fixed Assets			√		
Debtors			√		
Provisions			√		
Revenue			√		
Inventory			√		
Payables			√		
Expenditure			√		
Salaries & wages			√		
VAT			√		
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 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

25. The municipality did not comply with the following sections of the Municipal Finance Management Act 56 of 2003: 33,63,64(1), 64(3), 71, 75, 95,114,116,118,121(1), 129(1), 132(1), 119(4)

Matters of governance

26. 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 [type of entity] 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 in 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. 		√
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the 		√

Matter of governance	Yes	No
National Treasury and the relevant provincial treasury before 31 March 2008.		

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

27. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

28. 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

29. 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.

30. 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.

31. I believe that the evidence I have obtained is sufficient and appropriate to report that no significant findings have been identified as a result of my review.

Audit findings (performance information)

32. Performance information documentation was not submitted with the financial statements for auditing.

APPRECIATION

33. The assistance rendered by the staff of the Intsika Yethu during the audit is sincerely appreciated.

Auditor-General

Mthatha

28 November 2008



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