



AUDITOR - GENERAL

The Mayor
Sakhisizwe Municipality
PO Box 21
Elliot
5460

Enquiries M.Rasmeni
Reference 03564reg07/08

03 December 2008

Dear Sir

REPORT OF THE AUDITOR-GENERAL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF SAKHISIZWE LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

1. The attached report on the audit of financial statements of the Municipality for the year ended 30 June 2008 is hereby submitted.
2. As is required by section 121(3)(d) of the Municipal Finance Management Act (MFMA), 2003 (Act 56 of 2003), the report is to form part of the Municipality's annual report, which report is to be tabled within seven months after the end of the financial year [section 127(2)].
3. As Chairperson, you are requested to ensure that the provisions of section 46(3) and (4) of the Municipal Systems Act read with section 127(5) of the MFMA are duly complied with. In addition, copies of the minutes of the meeting at which the annual report was tabled must please be submitted to this office as well. The minutes should contain the comments of the Council, indicating, where necessary, what steps were taken or are contemplated in connection with any matter revealed in the report.
4. Kindly acknowledge receipt of the report.

Yours faithfully

AUDITOR-GENERAL

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Sakhisizwe local municipality which comprise the statement of financial position as at 30 June 2008, 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 [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 basis of accounting determined by the National Treasury, as set out in accounting policy 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the *Auditor-General audit circular 1 of 2005*. 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 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. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Sakhisizwe local municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by National Treasury as set out in accounting policy note 1 to the financial statements.

Basis for adverse opinion

Bank balances and cash

10. Bank balances and cash was disclosed at R17,3 million on the face of the statement of financial position and note 21 to the annual financial statements. The validity of journals to the amount of R915,054 passed against the accounting records underlying the disclosure could not be confirmed in the absence of supporting documentation or an adequate audit trail.
11. Independent confirmations and supporting schedules presented by management contradicted the municipality's underlying accounting records by un-reconciled and unexplained differences of R13,814 and R709,090 respectively.
12. Documentation supporting the validity of correction of errors disclosed at R1,1 million in notes 19 to the annual financial statements was not provided.

Consumer debtors and provision for bad debts

13. Consumer debtors before a provision for bad debts was disclosed at R36,6 million in note 7 to the annual financial statements. The disclosure contradicted the underlying debtors age analysis and debtors listing by R2,8 million and R2,9 million respectively. Management was unable to provide documentation or explanations, to reconcile a difference of R8,4 million identified between the corresponding disclosure and the prior year annual financial statements or to

validate a correction of error disclosed at R5,5 million in note 19 to the annual financial statements.

14. Management was unable to provide evidence of the implementation of the indigent policy. Reliable and complete subsequent ledgers after year end were not provided and impaired my ability to confirm the recoverability of consumer debts or perform alternative procedures to confirm the existence of consumer debtors. Furthermore the underlying accounting records supporting the disclosure contradicted each other by an amount of R2,9 million.
15. Provision for bad debts was disclosed at R31,9 million in note 7 to the annual financial statements. Management was unable to provide documentation or explanations supporting a correction of error of R500 000 or schedules and assumptions embodying the calculation of the provision. I could not confirm the existence, valuation and completeness of consumer debtors and the completeness and valuation of the provision for bad debts as disclosed in the annual financial statements.

Employee related costs and remuneration of councillors

16. Employee related costs and remuneration of councillors was disclosed at R13,6 million and R2,3 million respectively on the face of the statement of financial performance and notes 13 and 14 to the annual financial statements. Management could not provide explanations or reconciliations for the difference of R496 777 identified between the annual financial statement disclosures and the underlying accounting records.
17. Management could not provide documentation to support contributions to organised local government and pension and medical aid contributions disclosed at R59 737 and R2,3 million respectively in note 24 to the annual financial statements or a listing of employees who have terminated their services with the municipality during the year under review. Furthermore performance bonuses amount of R46 108 was not disclosed in the annual financial statements.
18. Management could not provide explanations or reconciliations for a difference of R558 123 identified between the amounts per the salary journals and the underlying accounting records or the difference of R81 114 identified between schedules presented for audit and the underlying accounting records. Furthermore, supporting documentation for salary increases to the amount of R265 595 and acting allowances amounting to R18 637 or explanations for the material variances identified between the current year and the corresponding figures for employee related costs and remuneration of councillors could not be produced.
19. I could therefore not confirm the validity, accuracy and completeness of employee related costs and remuneration of councillors disclosed in the annual financial statements.

Property, plant and equipment (PPE)

20. PPE was disclosed at R36,2 million in the statement of financial position and note 5 to the annual financial statements. No evidence of rights to PPE to the amount

of R9,7 million could be produced, whilst PPE to the amount of R4,3 million and belonging to third party's was inappropriately accounted for as assets of the municipality. Documentation, to validate a correction of error disclosed at R5,1 million in note 19 to the annual financial statements was not provided.

21. Documentation supporting the disclosure to the amount of R10,2 million could not be provided. The valuation of PPE as per the fixed asset register contradicted the underlying accounting records by an unexplained and un-reconciled difference of R2 million. Management inappropriately capitalised expenditure to the amount of R99,018 whilst assets to the amount of R302,470 could not be physically verified.
22. Additions to PPE were inappropriately accounted for and capitalised inclusive of Value added taxation (VAT) to the amount of R438 262. Management was unable to provide documentation in support of additions to the amount of R63 132 or purchases made on behalf of third party's. Note 5 to the annual financial statements had a cast error of R9,3 million.
23. Management could not provide explanations or information to support, the computation of residual values disclosed in the fixed asset register or the variance of R671 463 identified between depreciation disclosed in the statement of financial performance and my re-computation. Furthermore differences between the estimation of the useful life of assets disclosed per the fixed asset register and the accounting policy resulted in a contradiction of R138 936 in the depreciation computation. I could not confirm the existence, rights, valuation and completeness of PPE disclosed in the annual financial statements.

Creditors

Trade creditors

24. Trade creditors were disclosed at R3,9 million in note 2 to the annual financial statements. Management could not provide a reliable creditors listing, creditor reconciliations or documentation to the amount of R1,7 million in support of the disclosure. Furthermore, no documentation to support journals amounting to R4,2 million or validate the correction of error to the amount of R927,656 as disclosed in note 19 to the annual financial statements.
25. Inadequacies in the design of the accounting framework and the absence of internal control mechanisms contributed to management omitting creditors to the amount of R235,544 and not accounting for accrued staff bonuses. Furthermore management was unable to explain a contradiction of R1 million identified between the underlying accounting records supporting the disclosure.

Provision for staff leave

26. Supporting documentation for the provision for staff leave amounting to R477 354 as disclosed in note 2 to the annual financial statements could not be produced.

Consumer deposits

27. Management could not provide documentation, supporting journals to the amount of R98 711 or validate a correction of error to the amount of R46 003. I could not

confirm the completeness and valuation of consumer deposits disclosed in the annual financial statements.

Other creditors

28. Management could not provide any documentation in support of an amount of R203 365 as disclosed in note 2 to the annual financial statements. I could not confirm the valuation and completeness of creditors as disclosed in the annual financial statements.

Revenue

Rates

29. Revenue from rates was disclosed at R1,5 million on the face of the statement of financial performance. The valuation roll which provides the basis from which rates were charged was identified to be outdated and was the key attribute for rates being undercharged by an estimated amount of R232,839. Furthermore management failed to maintain rates register or provide evidence of an approved rates and tariff policy. The municipal records did not permit the application of alternative procedures.

Interest on arrears

30. Contrary to the prescripts of paragraph 60 of GAMAP 9, *Revenue* interest on long outstanding consumer debtor accounts was raised and disclosed at R2,7 million on the face of the statement of financial performance. Management could not provide reliable evidence of the probability that the economic benefit associated with interest raised on long outstanding consumer debtors will flow to the municipality.

Service charges

31. Revenue from water service charges was disclosed at R2,6 million in note 10 to the annual financial statements. An unexplained and un-reconciled difference of R685,323 was identified between the annual financial statement disclosure and the underlying accounting records. Furthermore management could not provide explanations or documentation to corroborate material fluctuations in the recording of monthly water service revenue or for the inconsistent relationship between the number of water consumers charged and the monthly billings. Water meter readings were inconsistently taken and contradicted the underlying accounting records. Daily receipt summaries were not provided for audit. Management could furthermore not provide the service level agreement governing the agency relationship shared with the district municipality over the sale of water on the district municipality's behalf.
32. Revenue from electricity service charges was disclosed at R2,4 million in note 10 to the annual financial statements. An unexplained and un-reconciled difference of R576 424 was identified between the annual financial statement disclosure and the underlying accounting records. No explanation or documentation to corroborate material fluctuations in the recording of monthly electricity revenue or for the inconsistent relationship between the number of electricity consumers

charged and the monthly billings could be provided. Furthermore, electricity service charges listing and daily receipt summaries were not provided for audit purposes. No explanation for the actual loss in electricity sales to the amount of R65 417 could be provided.

33. Revenue from refuse service charges was disclosed at R4,1 million in note 10 to the annual financial statements. An unexplained and un-reconciled difference of R2,2 million was identified between the annual financial statement disclosure and the underlying accounting transactions. No explanation or documentation for the inconsistent relationship between the number of consumers charged and the monthly billings could be provided.

34. Revenue from sanitation services was disclosed at R1,1 million in note 10 to the annual financial statements. An unexplained and un-reconciled difference of R489,370 was identified between the annual financial statement disclosure and the underlying accounting records. No explanation or documentation for the inconsistent relationship between the number of consumers charged and the monthly billings could be produced.

Government grants and subsidies and Government grants and subsidies - PPE

35. Government grants and subsidies and government grants and subsidies – PPE were disclosed at R18,9 million and R3,2 million respectively on the face of the statement of financial performance. The statement of financial performance disclosure for government grants and subsidies contradicted the supporting note 11 by an unexplained and un-reconciled difference of R2,5 million. Similarly the statement of financial performance disclosure of government grants and subsidies – PPE and the underlying accounting records contradicted registers presented by management in support of the balance by an unexplained and un-reconciled difference of R527 205.

Other income

36. Other income was disclosed at R3,6 million on the face of the statement of financial performance and note 12 to the annual financial statements. Composition of other income in note 12 was not disclosed. In the absence of source documentation or other corroboratory information in the form of schedules, registers and receipts I was unable to perform alternative procedures or confirm the accuracy, completeness and validity of other income.

Gain on disposal of PPE

37. Gain on disposal of PPE was disclosed at R231 886 on the face of the statement of financial performance. Management could not provide documentation supporting the disclosure.

38. Due to limitations placed on the scope of my work coupled with municipal records not permitting the application of alternative audit procedures, I could not confirm the validity, accuracy and completeness of the different categories of revenue as disclosed in the annual financial statements.

Expenditure

General expenses

39. General expenses were disclosed at R6,4 million on the face of the statement of financial performance. Support documentation for expenses to the amount of R2 million and journals to the amount of R620 372 respectively could not be produced for audit purposes. Expenditure to the amount of R229,768 incurred in the prior year was inappropriately accounted for in the year under review.

Repairs and maintenance

40. Repairs and maintenance was disclosed at R324 182 on the face of the statement of financial performance. No documentation to support expenses to the amount of R99 776 could be produced for audit purposes.

Bulk purchases

41. Bulk purchases were disclosed at R2,5 million on the face of the statement of financial performance. Purchases incurred in the prior year to the amount of R191 996 were inappropriately accounted for in the year under review. Furthermore, municipal consumption of electricity to the amount of R90 849 was inappropriately accounted for as bulk purchases rather than general expenditure.

42. I could not confirm the validity, accuracy and completeness of the different categories of expenditure disclosed in the annual financial statements due to limitation of scope.

Unspent conditional grants and receipts

43. Unspent conditional grants and receipts was disclosed at R2,7 million on the face of the statement of financial position and note 3 to the annual financial statements. The grants register provided in support of the disclosure was incomplete and unreliable, noting a cast error of R115 000. The corresponding figure for unspent conditional grants and receipts contradicted the prior year annual financial statements by an unexplained and un-reconciled difference of R229,106. Furthermore, documentation validating correction of errors disclosed at R228 186 and R1,5 million in note 19 to the annual financial statements were not provided. Furthermore and contrary to section 123 of the MFMA, note 11 to the annual financial statements did not disclose how the allocations received by the municipality from organs of state in the national and provincial sphere of government have been spent. Furthermore, there was no disclosure on whether the conditions of the allocations received have been met by the municipality.

44. Due to limitations placed on the scope of my work coupled with municipal records not permitting the application of alternative audit procedures, I could not confirm the completeness and valuation of unspent conditional grants and receipts disclosed in the annual financial statements.

Long term receivables

45. Long term receivables were disclosed at nil amount in the statement of financial position and note 6 to the annual financial statements. Documentation supporting the validity of correction of errors disclosed at R228 186 and R198 364 in note 19 to the annual financial statements was not provided. Furthermore documentation detailing the terms and conditions of staff loans were not provided. Consequently the valuation of long term receivables as disclosed in annual financial statements could not be confirmed.

Other debtors

46. Other debtors were disclosed at R375 542 on the face of the statement of financial position and note 8 to the annual financial statements. Documentation validating correction of errors disclosed at R356 046 and R81 208 in note 19 to the annual financial statements was not provided. Consequently the valuation of other debtors disclosed in the annual financial statements could not be confirmed. Similarly documentation to substantiate journals passed against the underlying accounting records supporting the disclosure to the amount of R309 799 could not be provided.

Value added taxation (VAT)

47. VAT was disclosed at R853,193 in note 4 to the annual financial statements. Management was unable to provide documentation supporting a correction of error passed against the underlying accounting records supporting the disclosure to the amount of R6,6 million. Similarly management was unable to provide documentation supporting VAT input claims to the amount of R8,2 million or demonstrate evidence of declaring VAT on grants received in accordance with Section 8(5A) of the VAT Act.
48. Management did not provide the computation of the VAT apportionment formula or the evidence of the submission of a complete set of VAT returns to South African Revenue Services. The validity of VAT input claims and VAT declarations on expenses incurred and revenue generated to the amount of R205,271 and R4,5 million respectively in relation to water and sanitation services transactions could not be confirmed in the absence of a service level agreement governing the relationship between the municipality and district municipality. Further information on the reported matter is disclosed in paragraph 96 of this report. Consequently valuation and completeness of VAT disclosed in the annual financial statements could not be confirmed.

Accumulated surplus

49. Accumulated surplus was disclosed at R48,9 million on the face of the statement of financial position and the statement of changes in net assets. Documentation supporting the validity of a correction of error to the amount of R11,8 million was not provided.

Long term liabilities and current portion of long term liabilities

50. Long term liabilities and the current portion of long term liabilities was disclosed at R896 134 and R297 189 respectively on the face of the statement of financial position and note 1 to the annual financial statements. Sufficient appropriate documentation to support payments to the amount of R81 600 made against the underlying accounting records supporting the long term liabilities disclosure could not be produced. Furthermore, schedules provided in support of the current portion of the liabilities were unreliable and contradicted the disclosure by an unexplained and un-reconciled difference of R235 249. The current portion of finance leases was not accounted for in the underlying accounting records or the annual financial statements. Contrary to paragraph 23 of the South African Statements of Generally Accepted Accounting Practice, IAS 17 (AC 105), *Leases*, the current portion of the finance lease liability was not categorically and separately disclosed in note 1.

Cash flow statements

51. Cash receipts from ratepayers, government and others and cash paid to suppliers and employees was disclosed at R55 million and R36,5 million respectively on the face of the cash flow statement. No documentation or reconciliations supporting the composition of the said disclosures could be produced for audit purposes.

Provisions

52. The municipality, which operates landfill sites in, Cala and Elliot, has an obligation in terms of section 28 of the National Environment Management Act, No 107 of 1998 to restore such sites. The municipality did not assess the remaining useful life of the landfill sites. Detailed records of the capacity of landfill sites were not maintained by the municipality's engineers. Consequently, a provision for the rehabilitation of landfill sites had 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.
53. Contrary to paragraph 96 of GAMAP 19, *Provisions, contingent liabilities and contingent assets*, management failed to raise and disclose a provision for performance bonus. In the absence of reliable documentation, I was unable to quantify the extent of the misstatement. Consequently, completeness and valuations of provisions could not be confirmed.

Retirement benefit information

54. Note 26 to the annual financial statements reads "All councilors and employees belong to 6 defined benefit funds administered by the Provincial Pension Fund. These funds are subject to a triennial actuarial valuation. The last valuation was performed in 2007. These valuations indicate that the funds are in sound financial position". Management could not provide the rules governing the pension fund, independent or corroboratory documentation supporting the said actuarial valuation or evidence supporting the sound financial position of the fund. Furthermore, documentation in support of pension fund payments to the amount of R193,670 was not provided whilst transactions recorded in the general ledger to the amount of R38,654 could not be agreed to the payroll. Similarly documentation supporting the validity of a correction of error disclosed

at R167 270 in note 19 to the annual financial statements was not provided. Consequently accuracy, validity and completeness of retirement benefit information could not be confirmed

Fruitless and wasteful expenditure

55. Section 1 of the MFMA defines fruitless and wasteful expenditure as "expenditure that was made in vain and would have been avoided had reasonable care been exercised". Management identified and reported fruitless and wasteful expenditure incurred on interest and penalties resulting from the late submission of documentation to regulatory bodies to the amount of R175 363 in note 23 to the annual financial statements. Documentation in support of the disclosure to the amount of R50 353 was not provided whilst documentation provided contradicted the disclosure by an amount of R26 551. Furthermore, fruitless and wasteful expenditure to the amount of R426 742 identified and reported in paragraphs 28 and 29 of my previous report was not disclosed in the comparative to note 23. No evidence or disclosure of council condonement of the identified irregularity was provided to support the omission from the comparative.

Contingent liabilities

56. Contrary to the prescripts of paragraph 19 of GAMAP 19, *Provisions, contingent liabilities and contingent assets*, possible obligations from pending litigation and dispute hearings identified from the inspection of the underlying accounting records were not disclosed in note 28 to the annual financial statements. The primary reason for the non disclosure owed to the inadequacies in the design of the accounting framework and the absence of internal control mechanisms that readily recognised and completely and accurately accounted for possible obligations incurred. Consequently the total effect of contingent liabilities on the annual financial statements could not be quantified.

Capital commitments

57. Capital commitments approved and contracted for, by the municipality was disclosed at R9,6 million in note 25 to the annual financial statements. Documentation provided in support of the disclosure contradicted the note by an unexplained difference of R36 882. Inadequacies in the design of the accounting framework and the absence of internal control mechanisms that readily recognised and completely and accurately accounted for commitments incurred contributed to management being unable to provide a listing of outstanding orders or tenders committed. Consequently the total effect of capital commitments on the annual financial statements could not be quantified.

Unauthorised expenditure

58. The total approved expenditure budget per the underlying accounting records contradicted the appendix D(1) disclosure to the annual financial statements by an unexplained and un-reconciled difference of R4,1 million. Furthermore the reliability of the said appendix was doubtful in light of a cast error of R69,1 million between the difference of actual expenditure versus budgeted expenditure.

59. Paragraph 14 of GRAP 1, *Presentation of financial statements*, prescribes that "Where the financial statements and the budget are not on the same basis of accounting, a reconciliation between the statement of financial performance and the budget shall be included in the financial statements". Management could not provide schedules supporting the reconciliation of the accrual driven statement of financial performance to the cash driven budget for the year under review. Furthermore management could not provide reliable documentation or corroboratory information allowing for the application of alternative audit procedures. In the absence of the reconciliation and an adjusted budget I am consequently unable to quantify the extent of unauthorised expenditure.

Leases

60. Management could not provide a complete set of finance lease agreements or provide corroboratory explanations for differences between my computation of nominal lease payments outstanding and the schedule presented for audit.

61. The municipality failed to disclose the effect of lease transactions in accordance with paragraph 35 of IAS 17 (AC105), *Leases*. An audit of the underlying accounting transactions supporting the annual financial statements noted transactions that meet the definition of operating leases.

62. Due to limitations placed on my scope and municipal records not permitting the application of alternative audit procedures regarding leases I could not quantify the effect of finance and operating leases on the annual financial statements

Adverse opinion

63. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of Sakhisizwe local municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended in accordance with the basis of accounting described in note 1 and in the manner required by the MFMA.

Emphasis of matters

I draw attention to the following matters:

Significant uncertainty

64. The municipality had contracted to render water and sanitation services to all households within its jurisdiction on behalf of the district municipality. The relationship, rights and obligations of each of the concerned parties was not governed and formalised with a service level agreement. The absence of the service level agreement has opened the municipality to dispute over the risks and rewards over, water and sanitation services, income and debtors and furthermore the amount of the obligation due to or from the district municipality on the profits made from rendering of the concerned services. Resolution of matter and the ratification of a service level agreement are currently ongoing. At reporting date the absence of the service level agreement has created significant uncertainty as to the validity of water and sanitation revenue and the rights to water and sanitation debtors disclosed in note 10 and 12 respectively.

Restatement of corresponding figures

65. Corresponding figures per the statement of financial position have been restated. Details and reasons for the restatement have been disclosed in note 19 to the annual financial statements. The effect of the restatement is tabulated as follows.

Account balance	Corresponding figure	Actual balance per the 30 June 2007 Annual financial statements	Difference
Government grant reserve	R0	R2,3 million	R2,3 million
Accumulated surplus	R46 million	R34,2 million	R11,8 million
Creditors	R3,9 million	R2 million	R1,9 million
Unspent conditional grants and receipts	R2 million	R3,7 million	R1,7 million
Value added taxation (VAT)	R5,2 million	R1,4 million	R3,8 million
Property, plant and equipment	R33,1 million	R38,2 million	R5,1 million
Intangible assets	R5,020	R 0	R5,020
Long term receivables	R70,854	R524,263	R453,409
Consumer debtors	R11 million	R2,6 million	R8,4 million
Other debtors	R695,538	R339,492	R356,046
Bank balances and cash	R2 million	R2,1 million	R100, 000

OTHER MATTERS

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

Internal controls

66. 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
Basis for adverse opinion					
Bank balances and cash			✓		

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Consumer debtors and provision for bad debts			✓	✓	
Employee related costs and remuneration of councilors	✓		✓		
Property, plant and equipment			✓		
Creditors	✓		✓		
Revenue			✓		
Expenditure			✓		
Unspent conditional grants and receipts			✓		
Long term receivables			✓		
Value added taxation (VAT)			✓		
Long term liabilities			✓		
Provisions			✓		
Fruitless and wasteful expenditure			✓		
Contingent liabilities			✓		
Unauthorised expenditure			✓		
Leases			✓		
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><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.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for the 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.</p>					

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

The following sections of the MFMA were not complied with;

67. Section 45, 62(1)(b), 62(1)(c)(i), 65(2)(e), 80, 111, 63 and 125(2).
68. Management could not provide evidence that the finance department was adequately staffed or that adequate control procedures were implemented to identify and record related party transactions.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

The following sections of the MSA were not complied with ;

69. Section 66 : an approved staff establishment was not provided. Section 6(2)c : fraud prevention plan was not formalised and implemented.

Environment Conservation Act no. 73 of 1989

70. Contrary to section 20, documentation to support the legal establishment of the municipal disposal sites was not provided.

National environmental management Act No 107 of 1998

71. Contrary to sections 28 the municipality's documented plan to rectify the degradation caused to the environment by its landfill sites was not provided.

Matters of governance

72. 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:

No.	Matter of governance	Yes	No
	Audit committee		
1(a)	The municipality had an audit committee in operation throughout the financial year.		✓
	Internal audit		
2(a)	The municipality had an internal audit function in operation throughout the financial year.		✓
	Other matters of governance		
3	The annual financial statements were submitted for audit as per the legislated deadlines in Section 126 of the MFMA.	✓	
4	The annual report was submitted for the auditor for consideration prior to the date of the auditor's report.		✓

No.	Matter of governance	Yes	No
5	The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	✓	
6	No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
7	The prior year's external audit recommendations have been substantially implemented.		✓
8	There are documented policies and procedures and control systems to ensure the reliability of financial reporting.		✓
9	There are documented policies and procedures and control systems to ensure compliance with applicable laws and regulations.		✓
10	The information systems were appropriate to facilitate the preparation of financial statements that are free from material misstatement.		✓
11	Delegations of responsibilities are in place.		✓
12	Supply chain management policies and procedures were appropriately applied.		✓
13	There is a functioning performance management system.		✓
14	Based on the available information, performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓
	Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
16	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.		✓
17	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.		✓
18	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.		✓

Value for money matters

73. Management could not provide evidence of advertising tenders with and only contracting construction service providers registered with the Construction industry development board (CIDB).
74. Management could not provide explanations for variances between actual expenditure versus budgeted expenditure on infrastructure projects or reasons for the under expenditure on certain projects to the amount of R7,1 million.

75. Electricity infrastructure projects completed in the year under review to the amount of R1,5 million were not being utilised for public consumption as the municipality is still awaiting power supply from Eskom.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

76. I was engaged to audit the performance information.

Responsibility of the accounting officer

77. 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

78. 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.
79. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgment.
80. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

81. I was not able to complete an evaluation of the quality of the performance information, since the report on performance information was not submitted together with the annual financial statements.

OTHER REPORTS

Investigations

82. The municipality conducted two special investigations during the year under review. The first concerned an investigation into the conduct of affairs of the former chief financial officer in running of the municipality's finances. The second concerned the remuneration of councillors. A report on both investigations is pending and will be followed up in my next report.

APPRECIATION

83. The assistance rendered by the staff of the Sakhisizwe local municipality 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