



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

The Mayor  
Elundini Municipality  
PO Box 1  
Maclear  
5480

Enquiries M.Rasmeni  
Reference 18384reg07/08

**02 December 2008**

Dear Sir

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Elundini Municipality which comprise the balance sheet as at 30 June 2008, income statement, 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, and the accounting officer's report, 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 92 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 IMFO, as set out in note 1 to the financial statements.

#### **Basis for qualified opinion**

##### **9. Fixed Assets**

Fixed assets amounting to R470 833 were physically identified at the premises of the municipality but could not be identified on the fixed asset register as these assets have not been bar-coded or marked. Furthermore, the fixed asset register detailing gross assets held at the municipality to the value of R71 million does not indicate any bar-codes or serial numbers to ensure physical assets can be agreed to the theoretical assets. Alternative procedures to verify the completeness and accuracy of the fixed assets disclosed in the financial statements could not be performed as asset counts and reconciliations were not performed to ensure complete and accurate disclosure of assets in the financial statements.

##### **10. Revenue**

The total rates income generated during the financial year amounts to R3,6 million, as detailed in annexure D to the financial statements. The completeness and accuracy of this rates income could not be verified as the valuation roll supporting the rates levied was last updated in 1999. Furthermore, the municipality does not maintain registers detailing transfers of properties to ensure that the rates levied are in actual fact levied to the correct property owner. Alternative procedures to verify the completeness and accuracy of the rates income could not be performed as the municipality does not have any interim valuations or registers supporting improvements to properties which might result in increased rates.

##### **11. Inventory**

The total inventory to the value of R649 472 could not be verified to be complete and accurate as the stock count was not attended by the audit team or any independent official and reconciliations between theoretical and physical stock is not performed. Alternative procedures could not be performed to verify the completeness and accuracy of the inventory at year-end as documentation substantiating the inventory could not be provided for auditing purposes.

##### **12. Provisions**

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.



## **Qualified opinion**

13. 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 matter(s) described in the Basis for qualified opinion paragraph(s), the financial statements present fairly, in all material respects, the financial position of the Elundini Municipality as at 30 June 2008 financial performance and cash flows for the year then ended, in accordance with IMFO and in the manner required by the MFMA and DoRA.

## **Emphasis of matter(s)**

I draw attention to the following matter(s):

### **14. Going concern**

A total of 45% of the total revenue generated during the financial year relates to grants received from Government. Elundini Municipality is thus dependent on grants as a total of R45,8 million (R25,2 million relates to equitable share and R20,6 million relates to other government grants) from the total revenue amounting to R102,5 million which was received during the financial year.

### **15. Significant uncertainty**

The recoverability of the total debtors amounting to R6,8 million (after the provision raised amounting to R36,9 million) disclosed on the balance sheet was considered to be doubtful as subsequent payments on the accounts were not identified and legal action was not taken to recover the outstanding balances (Debtors amounting to R36,9 million were identified to be outstanding for longer than 180 days). Furthermore, the municipality did not enforce action to discontinue services to arrear customers as correspondence from NERSA indicated that the municipality should establish two different credit control policies on the water and electricity credit control. As per this correspondence the municipality may not refuse or restrict the provision of water to a customer when an electricity account is in arrears.

## **OTHER MATTER(S)**

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

### **16. Internal controls**

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed Assets					√
Revenue			√		
Inventory			√		

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

##### 17. Non-compliance with the Municipal Finance Management Act, 2003 (Act 56 of 2003)

- (a) Section 65(2)(e) requires money owing by the municipality to be paid within 30 days of receiving the relevant expenditure. Payments have not been made within the stipulated time frame.
- (b) The municipality did not comply with Section 32(4) as management did not notify the MEC and the Office of the Auditor General regarding the fruitless and wasteful expenditure amounting to R316 278 for the incorrect deduction of PAYE and R38 132 in respect of overspending of a budgetary line disclosed under note 24 of the Financial Statements
- (c) The municipality did not comply with the following sections of the Act: Section 11(4), 12, 15, 22, 28, 29, 33, 44, 45, 46, 47, 48, 50, 59(1), 64(1) & (2), 64(3), 75

##### 18. Non-compliance: Municipal Systems Act

The municipality did not comply with the following sections of the Municipal System Act 36 of 2000: Section 6, 12, 15, 59, 70, 75, 95, 119(4), and 5



## Matters of governance

19. 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 we have assessed as follows:

No.	Matter of governance	Yes	No
	<b>Audit committee</b>		
1(a)	The municipality had an audit committee in operation throughout the financial year.	√	
1(b)	The audit committee operates in accordance with approved written terms of reference.	√	
1(c)	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	√	
	<b>Internal audit</b>		
2(a)	The municipality had an internal audit function in operation throughout the financial year.		√
2(b)	The internal audit function operates in terms of an approved internal audit plan.	√	
2(c)	The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		√
	<b>Other matters of governance</b>		
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.		√
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.	√	
	<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
15	The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National	√	



No.	Matter of governance	Yes	No
	Treasury and the relevant provincial treasury before 30 October 2007.		
16	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.	√	
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.	√	

## OTHER REPORTING RESPONSIBILITIES

### REPORT ON PERFORMANCE INFORMATION

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

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

21. 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

22. 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.

23. 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.

24. 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

25. Confirmation could not be obtained that the municipality, through appropriate mechanisms, processes and procedures consulted the local community before adopting the process set out in writing to guide the planning, drafting, adoption and review of its integrated development plan and the development, implementation and review of the PMS as required by Section 28(2) and 42 of the Local Government: Municipal Systems Act, 2000 (32 of 2000)

26. Development priorities were not included in the annual budget as required by Section 6 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 2001)



27. The key performance indicators and targets set by the municipality as a yardstick for measuring performance, including outcomes and impact, with regards to the municipality's development priorities and objectives set out in its IDP, did not include the general KPI's as required by section 10 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 2001) and section 43 of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000).
28. The municipal council did not review its integrated development plan in accordance with an assessment of its performance measurements in terms of section 41 of the MSA, as required by section 34(a) of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000)
29. Internal audit relating to performance and performance management was not performed during the period under review as required by Section 7 and 14 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 2001).
30. Evidence that the municipality notified the local community of the approval of the IDP process plan, as required by Section 28(3) of the Local Government: Municipal Systems Act, 2000 (32 of 2000), could not be obtained for audit purposes.
31. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan is submitted to the council for adoption, as required by Section 15(3) of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 2001).

#### **Insufficient monitoring controls**

32. The municipality did not have sufficient monitoring controls to ensure adherence to the internal policies and procedures at a programme or objective level as well as for purposes of taking corrective action as no monthly reports relating to performance objectives and/or key performance indicators and targets, as required in terms of Paragraph 3.3.9 of the PMS Legislative Compliance Manual, could be obtained for audit purposes.
33. The municipality did not have sufficient monitoring controls to ensure adherence to the internal policies and procedures at a programme or objective level as well as for purposes of taking corrective action as quarterly performance audits were not performed by the Performance Audit Committee, as required in terms of Paragraph 9 of the PMS Implementation Policy.
34. The municipality did not have sufficient monitoring controls to ensure adherence to the internal policies and procedures at a programme or objective level as well as for purposes of taking corrective action as a singular formal system for the collection, recording, processing and reporting of performance information was not developed and implemented during the period under review.



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

35. The actual achievement of the objectives/indicators/targets could not be substantiated by adequate evidence/source documentation as no monthly/progress reports relating thereto was submitted for audit purposes. Quarterly reporting was done in terms of the MFMA whilst the monthly reporting is required by the municipal policies.

### **APPRECIATION**

36. The assistance rendered by the staff of Elundini 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