

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Maletswai Municipality which comprise the balance sheet as at 30 June 2008, income statement, statement of changes in net assets/equity 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 the entity-specific basis of accounting, as set out in the accounting policy note 1.1 to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). 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), my responsibility is to express an opinion on these financial statements based on my audit
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but

not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

8. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.1 to the financial statements.

Basis for adverse opinion

Bank and cash

9. Bank and cash balances of R15.1 million were disclosed in note 19 to the annual financial statements, while the bank confirmation received stated that the balance was R10.5 million. Management did not perform bank reconciliations for the period under review and was therefore unable to provide a comprehensive explanation of the variance of R4.6 million. The entity's books and records did not permit us to perform alternative procedures. Sufficient and appropriate audit evidence on the valuation, completeness, rights and obligations of bank and cash amounting to R15.1 million could not be obtained.

Fixed assets

10. Appendix C of the annual financial statements disclosed fixed assets amounting to R98 million, whereas fixed assets amounting to R113.7 million were recorded in the fixed asset register. Management could not provide a reconciliation or a comprehensive explanation of the variance of R15.7 million. The entity's books and records did not permit us to perform alternative procedures. Sufficient and appropriate audit evidence of the valuation, completeness, rights and obligations of fixed assets amounting to R98 million could not be obtained.
11. Assets with a value of R43 529 could not be verified to determine their physical existence. Assets with a value of R615 546 were sold during the period under review but were not removed from the fixed asset register. Fixed assets amounting to R384 944 were found not to be in working order upon physical verification but were still included in the fixed asset register of the municipality. Management could not provide a comprehensive explanation on these discrepancies. Therefore fixed assets and contributions were overstated by R384 944 as recorded in the annual financial statements, while the fixed asset register was overstated by R615 546.
12. Property owned by the municipality amounting to R1.2 million as per the property title deeds was not recorded in the fixed asset register. Therefore fixed assets as

recorded in appendix C of the annual financial statements are understated by R1.2 million.

13. Per inspection of appendix C to the annual financial statements, contributions to capital expenditure from current income amounted to R11.3 million. This figure comprises the amount for contribution from income of R2.7 million as well as the amount for provisions, reserves and other receipts of R8.5 million. Per inspection of appendix D to the annual financial statements contributions to fixed assets amounted to R9.9 million. Management could not provide a comprehensive explanation of the non-compliance to IMFO code of accounting practice relating to the variance of R1.3 million. The municipality's books and records did not permit us to perform alternative procedures. Sufficient appropriate audit evidence could not be obtained on the accuracy of contributions to fixed assets.

Debtors

14. In terms of section 62(2)(f) of the Municipal Finance Management Act, the accounting officer of the municipality must take all reasonable steps to ensure that the municipality has and maintains a system of internal control in respect of debtors and revenue, as may be prescribed. Audit procedures identified debtors amounting to R4.9 million where no payments were received during the period under review and debtors amounting to R300 308 that have been outstanding for more than three years. This indicates that debtors amounting to R5.2 million were not collectable while the municipality's provision for impairment of debtors amounted to R3.3 million. Management could not provide an explanation for the understatement of R1.9 million of the impairment provision.
15. Management could not provide sufficient and appropriate supporting documentation for a journal entry amounting to R1.2 million that was passed by debiting the customer general ledger account and crediting the appropriation account to agree the debtors sub-ledger to the general ledger. The entity's books and records did not permit us to perform alternative procedures. Sufficient appropriate audit evidence could not be obtained on the accuracy, occurrence and classification on this journal.

Revenue

16. Section 64 of the MFMA states that the accounting officer of a municipality is responsible for the management of the revenue of the municipality and must take all reasonable steps to ensure that the municipality has and maintains a system of internal control in respect of revenue. Section 62(1)(d) further states that the accounting officer of a municipality is responsible for managing the financial administration of the municipality and must for this purpose take all reasonable steps to ensure that losses are prevented. The municipality lost 9 952 732 units of electricity during the period under review or 16,62% of units purchased, as disclosed in appendix F to the annual financial statements. Losses in excess of the 12% were non-technical losses and were avoidable, therefore 2 681 075 units were avoidable. Revenue and debtors were understated by the value of the units lost amounting to R3.7 million.
17. The municipality recorded grants received from the Department of Health amounting to R1.5 million while the service agreement annexure H states that the grants amounted to R1.9 million. The municipality could not provide a

comprehensive explanation on the variance of R400 000. Revenue and debtors is therefore understated by R400 000.

18. Interest received amounting to R1.4 million was duplicated in prior years. The correcting entry was passed during the current year and not in the comparative period. This resulted in the understatement of R1.4 million in interest received in the current year.
19. A variance of R232 605 was identified when the total rates per the manual valuation roll was compared to the property rates raised by the municipality's financial accounting systems. Management was unable to provide an explanation for the understatement of property rates raised in the financial records. The accuracy and completeness of revenue could not be confirmed.
20. Property rates revenue of R4.6 million was understated as the municipality was unable to provide appropriate audit evidence for the inclusion of property improvements in the valuation roll used to calculate the property rates due to the municipality. The entity's books and records did not permit us to perform alternative procedures. Therefore the accuracy and completeness of revenue could not be confirmed.

Value-added tax

21. The municipality failed to adhere to the VAT Act on rental transactions amounting to R8 657 by not recording and paying over the output tax portion on rental revenue. In terms of section 8(8) of the VAT Act 89 of 1999, indemnity payments received under a contract of a short-term insurance were a deemed supply in the hands of the municipality. It follows that any payment received as a guarantee against loss, damage, injury or risk of any kind is subject to output tax unless the input VAT could not be claimed on the expenditure. In addition, the municipality failed to record and pay over output VAT amounting R113 438 on an insurance claim received.

Leave provision

22. A number of variances were identified between attendance registers, leave files and the electronic leave register. Audit evidence was obtained that the leave records of the municipality were not accurate. The leave provision was based on the leave records of the municipality. The leave provision amounting to R1.9 million as disclosed in note 10 to the financial statements was not accurate.

Provision for restoration of landfill sites

23. The municipality did not comply with section 28 of National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 20 of the Environmental Conservation Act, 1989 (Act No. 73 of 1989) (ECA). The municipality has not disclosed a provision of the current costs required to restore the environment of the landfill sites at Aliwal North and Jamestown in the annual financial statements.

Adverse opinion

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 the Maletswai 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 accounting policy note 1.1 and in the manner required by the MFMA.

OTHER MATTERS

I draw attention to the following matters 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 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 categorized 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
Bank and cash	✓				
Fixed assets	✓				
Debtors	✓				
Revenue	✓				
Provisions	✓				

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 annual financial statements were not submitted for audit purposes as per the legislated deadlines in section 126 of the MFMA.
26. In terms of section 69 (3) of the MFMA, the accounting officer must by no later than 14 days after the approval of an annual budget submit to the mayor a draft service delivery and implementation plan for the budget year and drafts of the annual performance agreements as required in terms of section 57(1)(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) for the municipal manager and all senior managers. Audit evidence of compliance with sections 69 and 57 of the MFMA was not provided by management.
27. The municipality did not comply with section 14 2(a) of Local government: Municipal Planning and Performance Management Regulations, 2001, regarding the annual appointment of a performance audit committee.
28. The municipality did not comply with Schedule 1: Code of Conduct for Councillors' per the MSA, section 7 which states that an elected councillor must within 60 days declare in writing to the municipal manager all financial interests held.
29. The municipality has not adhered fully to the provisions of section 20(4) of the VAT Act regarding the requirements of valid invoices. The requirements of a "tax invoice" are very specific and any information that is omitted on invoices is non-compliance with the above act.
30. The municipality did not perform an annual fixed asset count as required by the the Municipality's Supply Chain Management Policy, chapter 3, section 3.40 - 3.41. and thereby failed to adhere to section 78 of the MFMA.

Matters of governance

31. 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		
• The municipality had an audit committee in operation throughout the financial year.		✓
• The audit committee operates in accordance with approved, written terms of reference.	✓	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	✓	
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.		✓
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓

Matter of governance	Yes	No
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for auditing 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)1		
<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 National Treasury and the relevant provincial treasury before 31 March 2008. 		✓

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

34. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

35. 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

36. 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.
37. 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.
38. 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

39. The municipality did not comply with the following regulatory requirements:
 - a. Municipal Systems Act, section 26(c). The council's development priorities and objectives for its elected term could not be found in the IDP.
 - b. Municipal Systems Act, section 26(h). The IDP budget projections for the next three years have not been included in the IDP.
 - c. Municipal Systems Act, section 26(i). Key performance indicators and performance targets have not been set.

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

40. While performing system verification procedures on performance information it was ascertained that the municipality has not developed documented policies and procedures over the following relating to information disclosed under performance information:
 - developing and evaluating output performance measures
 - collecting, coordinating and compiling performance information
 - ensuring data integrity and quality assurance over performance information
 - monitoring and managing data measurement and reporting processes
 - reporting sufficient and appropriate information to stakeholders
41. During the audit of the performance information, the following discrepancies were identified:
 - key performance areas for the municipality as a whole were not set in the IDP
 - key performance targets were not set in the IDP
 - an approved SDBIP was not obtained from the client, therefore we were unable to identify the annual targets set
 - the goals set on the IDP did not agree to the goals set per the fourth quarterly report.

We were therefore unable to determine whether the performance reported according to the objectives set by the municipality has actually been achieved.

APPRECIATION

42. The assistance rendered by the staff of the Maletswai Municipality during the audit is sincerely appreciated.

Auditor-General

East London

31 January 2009



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