

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF CHRIS HANI DISTRICT 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 Chris Hani District 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 municipal manager 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 note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), 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.

Basis of accounting

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

Basis for disclaimer of opinion

Unappropriated surplus

5. Debit journal entries of R967 million and credit journal entries of R992 million were processed to accumulated surplus in the general ledger. These transactions were not supported by appropriate documentation and explanations. The municipality's records did not permit the application of alternative to verify these journal entries. As a result, sufficient appropriate evidence could not be obtained to verify the valuation, existence and completeness of the unappropriated surplus balance of R65.5 million as disclosed in the statement of financial position and statement of changes in net assets, and the related expenditure, revenue, assets and liabilities as disclosed in the financial statements.

Deferred income

6. The opening balance of R13.2 million could not be confirmed as it formed the basis for an adverse opinion that was issued in the prior year. No evidence could be obtained that the municipality corrected the misstatements identified in the account balance in the prior year. Consequently the opening balance remained misstated.
7. The municipality recorded R1.8 million as a depreciation charge in the deferred income account. The basis of calculation of this depreciation charge could not be provided. In the absence of adequate records by the municipality, no alternative procedures could be performed to confirm this amount. In addition, the depreciation charge has been recognised directly in accumulated surplus. IAS 20 par 26 requires that the income be recognised as income over the useful life of the asset. Income is therefore understated and accumulated surplus overstated by the depreciation charge of R1.8 million.
8. As a result, I could not satisfy myself as to the valuation and existence of the deferred income balance of R12.6 million as disclosed in the statement of financial position.

Provisions

9. Leave records were generally found to be in an unsatisfactory state. Leave records had not been regularly updated and leave forms had not been timeously filed in personnel files. In certain instances, attendance registers were not submitted and errors in capturing leave were noted. A recalculation of leave days revealed a significant number of differences between the leave administration system and leave records. The leave days as per the leave administration system have been used as a basis for calculating the leave pay provision.
10. Consequently, the completeness, existence and valuation of provisions as disclosed in the statement of financial position and completeness and accuracy of the related expense in the statement of financial performance could not be verified.

Payables

11. The amount of R541 592 disclosed as other creditors in note 6 to the annual financial statements did not agree to the amount in the trial balance of R665 072. No explanation was obtained for the difference of R123 484. In addition, neither of these amounts agreed to the total on the creditors listing which amounted to R912 859. No explanations could be obtained for the difference.
12. Furthermore, it was noted that VAT on creditors listing amounting to R112 105 did not agree to VAT on outstanding creditors as disclosed in the annual financial statements which was R78 631. The difference of R33 474 could not be explained.
13. The total unspent grants as per the annual financial statements did not agree to the total per the unspent grants reconciliation submitted and Appendix F to the financial statements. This was due to the omission of the provincial grants from the reconciliation. The opening and closing balances were adjusted by journal entries totalling R18 million without adequate and appropriate supporting documentation and for which no proof of council approval was provided. The unspent grants balance of R120 million in the statement of financial position is understated and unappropriated surplus is overstated by the amount of R18 million.
14. Uncleared suspense accounts in the general ledger totalled R318 467 at year end. Journal entries in the amount of R5.6 million debit and R5.5 million credit were processed to suspense accounts with insufficient supporting documentation. Suspense accounts and the related expense accounts were therefore understated with these amounts.
15. The municipality's records did not permit the application of alternative procedures. Consequently appropriate sufficient evidence could not be obtained to verify the completeness, valuation, rights and obligations and existence of the creditors' balance of R38.8 million as disclosed in note 6 to the financial statements, as well as completeness, accuracy and occurrence of the related expenditure in the statement of financial performance.

Property, plant and equipment

16. In terms of section 95(b) of the MFMA, the accounting officer should ensure that full and proper records of the financial affairs of the entity are kept. However, the fixed asset register and related records were not continuously and effectively monitored by management. The fixed asset register is not completely and accurately populated, not adequately maintained and not adequately supported by appropriate documentation. It was also not possible to locate certain assets for physical verification.
17. The fixed assets register could therefore not be used as a base for verifying the balance of property, plant and equipment as disclosed in the statement of financial performance. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to satisfy myself as to completeness, existence, rights and obligations, valuation and classification of property, plant and equipment of R20.7 million as disclosed in note 9 of the financial statements.

Receivables

18. Included in other debtors balance of R34 million as disclosed in the statement of financial position and note 14 are debtors of R32 million that have not been repaid for a number of years. Although the municipality has provided for R12.9 million doubtful debts, a further R19.3 million is considered doubtful and should also be provided for. Consequently, debtors are overstated and expenditure is understated by R19.3 million.
19. Consumer debtors of Rnil are disclosed in the statement of financial position. This balance was reduced to Rnil by setting of a suspense account against consumer debtors, without appropriate and sufficient supporting documentation. As a result, debtors and suspense account are both understated by R5.9 million

Cash and cash equivalents

20. Long outstanding deposits of R707 910 have not been processed. As a result, the bank balance is understated and the debtors balance is overstated by R707 910.

Presentation and disclosure

21. The municipality did not disclose its exposure to interest rate and credit risk as required by IAS 32 (AC 125) Financial instruments: Disclosure and presentation par. 67-76.
22. No disclosure of related parties was made in the financial statements as required by IAS 24 (AC 126) Related party disclosures. The municipality does not have a process in place to identify and disclose related parties, and information submitted was not sufficient and appropriate to identify related party transactions not disclosed. Consequently, completeness of related parties could not be verified.

Contingent liabilities

23. The required disclosures as required by GAMAP 19 have not all been made in note 34 to the annual financial statements. In addition, the municipality has no documented process to identify contingent liabilities. The municipality's records did not permit the application of alternative procedures.
24. Consequently I was unable to satisfy myself as to the completeness, valuation and disclosure of contingent liabilities as disclosed in note 34 to the annual financial statements.

Expenditure

25. General journals with a credit value of R814 017 were processed without adequate and appropriate supporting documentation. The municipality's records and systems did not allow the application of alternative audit procedures. Consequently, it was not possible to obtain all the information and explanations that were considered necessary to gain assurance as to the completeness, occurrence, accuracy and classification of expenditure as disclosed in the statement of financial performance, and the related creditors in the statement of financial position.

26. The municipality did not maintain a register of operating leases and did not provide all lease agreements. As a result the existence and completeness of leased assets and completeness and accuracy of lease expenditure could not be verified. In addition the disclosures as required by IAS 17 Leases par 31 – 32 have not been made.

Unauthorised expenditure

27. Section 1(1) of the MFMA defines unauthorised expenditure as overspending of the total amount appropriated in the municipality's approved budget.

28. The municipality overspent the total amount appropriated in the approved budget by R6.5 million. The overspending has not been disclosed as unauthorised expenditure in the financial statements.

Fruitless and wasteful expenditure

29. As disclosed in note 31 to the financial statements, an amount of R350 866 has been written off to the statement of financial performance. However, no evidence that the requirements of section 32(2) of the MFMA were complied with could be provided. As a result, expenditure as disclosed in the statement of financial performance is overstated and debtors as disclosed in the statement of financial position is understated by R350 866.

Irregular expenditure

30. The municipality did not comply with its supply chain management policy as well as section 114 (1) of the MFMA during the year. As a result irregular expenditure of R15.7 million was incurred. The amount has not been disclosed as irregular expenditure in the financial statements.

31. In June 2004 the municipality advanced a loan of R2.5 million to a private company in contravention of section 164 (1) of the MFMA. The capital of R2.5 million together with interest of R1.2 million is considered to be irregular expenditure due to the forbidden activity. The amount has only been disclosed as fruitless and wasteful expenditure in note 31 of the financial statements and not also as irregular expenditure.

Opinion

Disclaimer of opinion

32. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, 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 Chris Hani District Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

I draw attention to the following matter:

Highlighting critically important matters presented or disclosed in the financial statements

Basis of accounting

33. As set out in accounting policy note 1, the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *General Notice 552 of 2007*, issued in *Government Gazette No. 30013 of 29 June 2007*.

OTHER MATTERS

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

Internal controls

34. 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
Presentation and disclosure			X		X
Deferred income	X				
Accumulated surplus	X				
Receivables			X		X
Cash and cash equivalents			X		X
Contingent liabilities			X		X
Provisions	X				
Payables			X		X

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property, plant and equipment	X				
Expenditure			X		X
Unauthorised expenditure			X		X
Fruitless and wasteful expenditure			X		X
Irregular expenditure			X		X

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

Municipal Finance Management Act

35. The annual report was not tabled within 6 months after the end of the previous financial year as required by section 127 of the MFMA. To date, no evidence has been supplied that the annual report has been tabled.
36. The annual budget was not produced in the prescribed format, the time schedule was not tabled before council 10 months before the start of the year, the budget was not submitted to Treasury and the monthly reports on the state of the budget were not sent to Treasury as required by Chapter 4 of the MFMA. In addition, all necessary correspondence regarding the budget was not retained and submitted for audit.

37. The 2007 annual report does not contain the following information as required by section 121 of the MFMA:

- An assessment by the municipality's accounting officer of the municipality's performance against the measurable performance objectives referred to in Section 17(3)(b) for revenue collection from each revenue source and for each vote in the municipality's approved budget for the relevant financial year;
- particulars of any corrective action taken or to be taken in response to issues raised in the audit reports by the Auditor-General;
- Names of the members of the audit committee.

38. Various weaknesses were identified in the internal audit function which was established in terms of section 165 of the MFMA.

39. No interest has been charged on the outstanding debtors as required by section 64 (2) (g) of the MFMA. My estimation of the interest that should have been charged as per the published prime rate is R3.9 million.

Matters of governance

40. 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.	X	
• The audit committee operates in accordance with approved, written terms of reference.	X	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA.		X
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.	X	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA.		X
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.		X
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for audit were not subject to		X

Matter of governance	Yes	No
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. 		X
<ul style="list-style-type: none"> The prior year's external audit recommendations have been substantially implemented. 		X
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. 		X
<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. 		X
<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. 		X

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

41. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

42. 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

43. 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.

44. 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.

45. 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

46. Although a performance audit committee has been appointed, no budget has been allocated for the performance audit committee and no annual performance report was prepared by the municipality as required by section 46 of the Municipal Systems Act.
47. By inspection of the council minutes, no reports by the performance audit committee have been submitted to council.
48. The Integrated Development Plan does not include the key performance indicators and performance targets as required by the section 26(1) of the Municipal Systems Act (2000). In some instances the link between the IDP and the SDBIP is not clear.
49. No assessment was done by Internal audit of the functionality of the PMS system and whether it complies with the relevant laws and legislation.
50. By inspection of the performance contracts of section 57 managers, it was confirmed that the performance reviews are not done quarterly as required by the contract agreements.

Lack of sufficient appropriate audit evidence

51. The following information was not provided:
 - The changes to the prior year IDP.
 - The explanations regarding the absence of a direct link between the Budget and the IDP in terms of the priorities and objectives.
 - Key controls regarding the input, processing and the output on the provision of basic water services.
 - The system used to generate performance information as regards to fire, and solid waste management.
52. As noted on the risk register compiled by internal audit, there is a lack of a standardised performance reporting system in place to record performance information. A service provider has been engaged to develop a Scorecard, but it is not yet in place.

OTHER REPORTS

Investigations

53. A forensic investigation was undertaken by KPMG into financial assistance that the municipality had provided to Dordrecht Dairy Producers during prior financial years to establish a cheese factory.
54. The cheese factory has since been closed down due to financial difficulties.
55. The report by KPMG did not indicate that any irregularity had occurred on the part of the municipality.

APPRECIATION

56. The assistance rendered by the staff of the Chris Hani District Municipality during the audit is sincerely appreciated.

Auditor-General.

East London

20 February 2009



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