



AUDITOR - GENERAL

NGQUSHWA MUNICIPALITY

Audit Report

30 June 2008

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE NGQUSHWA 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 Ngqushwa Municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting 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) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, 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 entity-specific basis of accounting, as set out in accounting policy note 1 to the financial statements.

Basis for disclaimer of opinion

Fixed Assets

5. In terms of section 62(1)(b) of the MFMA, the accounting officer should ensure that full and proper records of the financial affairs of the entity are kept. However, adequate control was not exercised over the assets during the year under review. As a result the fixed asset register is not completely and accurately populated and is

therefore not adequately maintained and supported by the appropriate documentation. Consequently, it was not possible to locate assets for physical verification nor trace assets to the asset register.

6. In the absence of adequate fixed asset records, it was not possible to verify the valuation, accuracy, existence, completeness and ownership of assets of the municipality to the value of R37.2 million as disclosed in note 3 to the financial statements.

Debtors

7. The municipality did not have a bad debt provision policy to identify all potential bad debts. The municipality's bad debt provision amounted to R3.4 million as reported in note 6 to the financial statements; however, I was unable to assess the reasonableness of this provision as no suitable evidence was provided in support thereof. An analysis of debtors ageing and receipts after year-end revealed a possible understatement of the provision by R1.3 million and consequently debtors were also overstated by this amount. Furthermore, I was unable to determine the existence of debtors.

Employee costs

8. In terms of section 62(1)(b) of the MFMA, the accounting officer should ensure that full and proper records of the financial affairs of the entity are kept. However, adequate control was not exercised over employee costs during the year under review. As a result there was insufficient documentation to substantiate salaries, wages and allowances. In addition, the payroll was not subject to proper review and authorisation. Consequently, I am unable to determine the accuracy, occurrence and completeness of employee costs amounting to R16.2 million as disclosed in appendix D to the financial statements.

Creditors

9. Included in Creditors amounting to R9.9 million per note 9 to the financial statements was an amount owing to Amathole District Municipality of R760 244, for which no supporting documentation could be provided. In addition, the municipality did not prepare supplier reconciliations and did not have an adequate alternative system of ensuring that all goods and services received prior to year-end, but not yet paid, were accrued. As a result, creditors amounting to R610 837 were not included in creditors reported.

Value-Added Tax (VAT)

10. The VAT receivable of R1.2 million disclosed in note 6 to the financial statements did not reconcile to the VAT returns submitted to the South African Revenue Service due to the incorrect basis being used for calculating VAT. As a result, it was not possible to obtain sufficient, appropriate audit evidence to verify the existence, accuracy and completeness of the VAT receivable of R1.2 million. Therefore we are unable to determine the accuracy of the related revenue and expenditure.

Provisions

Leave provision

11. Due to the inadequate leave records and discrepancies in such records, I was unable to determine whether the leave provision amount of R471 966 disclosed in note 8 is accurate and complete. Therefore I am unable to determine the accuracy and completeness of the related leave paid of R50 619.

Landfill provision

12. The Municipality, which operates landfill sites, has an obligation in terms of section 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 community services department.
13. 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.

Revenue

14. No supporting documentation for revenue journals amounting to R6 million could be provided for audit purposes. Furthermore it was found that revenue of R86 576 was not recorded in the year under review. The completeness and occurrence of revenue could therefore not be established.
15. Disclosed in the analysis of operating income is grants and subsidies amounting to R22.8 million which were overstated by R292 546. In addition, income from tariffs and service charges amounting to R859 249 was understated by R291 066.

Goods and services

16. Supporting documentation relating to expenditure to the estimated value of R6.3 million could not be provided for audit purposes. This amounts to a scope limitation for which no alternative audit procedures were available. I am therefore unable to conclude as to the occurrence, accuracy and classification of expenditure amounting to R31.7 million as disclosed in appendix D to the financial statements.

Operating leases

17. A complete register of lease commitments and contracts was not kept and as a result I could not determine the completeness of operating lease expenditure amounting to R68 715 paid during the year. In addition, operating leases were not separately disclosed in terms of the Institute of Municipal Finance Officers requirements.

Irregular expenditure

18. In terms of section 111 of the MFMA, the accounting officer must ensure that the municipality has and implements a supply chain management policy (SCM). However, goods and services totalling R913 699 were found to have been procured from suppliers without having followed the required SCM procedures. In addition, tender documentation requested could not in all instances be presented for audit

purposes. I was therefore unable to determine whether all the SCM Regulations as set out in the MFMA were complied with and confirm the completeness of irregular expenditure incurred for the year under review.

19. Sufficient supporting documentation in support of the municipal infrastructure and the financial management improvement grants to the value of R6.5 million could not be provided for audit purposes. As a result I was unable to determine if all the conditions applicable to these grants as prescribed by DORA were complied with and if any irregular expenditure was incurred as a result of this non compliance.

Capital Commitments

20. Sufficient supporting documentation was not provided in support of capital commitments. I was therefore unable to verify the completeness and accuracy of capital commitments to the value of R1 million as disclosed in note 24 to the financial statements.

Going concern

21. The financial statements were prepared on the assumption that the municipality would continue as a going concern into the foreseeable future and did not disclose any factors that indicated that the municipality might not be a going concern. However, during the audit a number of factors were identified that suggested that the municipality might not be a going concern. Therefore the municipality's ability to continue as a going concern is dependent on the intervention and support of the government. In the absence of such support it is unlikely that the municipality will be able to continue to provide uninterrupted services to its stakeholders.

Disclaimer of opinion

22. 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 Ngqushwa 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

Unauthorised expenditure

23. Unauthorised expenditure of R 3.2 million as disclosed in note 26 to the financial statements was incurred. This disclosure is however not adequate as it does not indicate if this amount is recoverable and if any criminal or disciplinary steps have been initiated as required by section 125(2) of the MFMA.

OTHER MATTER(S)

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

Internal controls

24. Section 62(1)(c)(i) of the MFMA states that the accounting office 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 disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed assets			✓		
Debtors			✓		
Employee cost	✓				
Creditors	✓				
Value-Added Tax (VAT)			✓		
Provisions			✓		
Revenue			✓		
Goods and Services			✓		
Leases	✓				
Irregular expenditure	✓				
Capital commitments			✓		
Statutory funds			✓		
Going concern			✓		

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.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
<p>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.</p>					

Matters of governance

25. 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.		✓
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National	✓	

Matter of governance	Yes	No
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

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

Responsibility of the accounting officer for the performance information

26. 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

27. 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.

28. 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.

29. 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

Content of strategic performance plan

30. The integrated development plan of the Ngqushwa Municipality failed to meet the regulatory requirements of section 26(h) and section 41(1)(a) of the MSA.

31. The key performance indicators set by the Ngqushwa Municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA. Furthermore, the key performance indicators

set failed to meet the regulatory requirements of Regulations 9 and 12(2)(a-b) of the MSA.

Adoption of performance management system

32. I draw attention to the fact that the performance management system of the Ngqushwa Municipality should have been adopted with the integrated development plan; however, it was only adopted by council on 14 March 2008 while its integrated development plan was adopted in May of 2007.

Lack of adopted service delivery and budget implementation plan

33. I draw attention to the fact that per National Treasury MFMA Circular No. 13 the Ngqushwa Municipality should have adopted a service delivery and budget implementation plan for the 2007-08 budget; however, it was discovered that due to gaps identified in the integrated development plan, council could not approve the service delivery and budget implementation plan for the 2007-08 budget.

Content of performance information report

34. The performance information report failed to meet the regulatory requirements of Regulation 13(3) and section 46 of the MSA.

Measurable objectives not consistent

35. I draw attention to the fact that the objectives reported in the annual report of the Ngqushwa Municipality are inconsistent when compared with the predetermined objectives as per the budget.

Lack of sufficient appropriate audit evidence

36. An evaluation of the implementation of the performance management system could not be adequately performed as I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the Ngqushwa Municipality. The assessments of performance measures/indicators/targets were not substantiated by adequate evidence or source documentation.

APPRECIATION

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

Auditor General

East London

30 November 2008



AUDITOR - GENERAL