

REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NKONKOBÉ MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Nkonkobe Municipality which comprise the balance sheet as at 30 June 2009, the income statement, and the 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 ... to

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity specific basis of accounting as determined by 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 for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*

The Auditor-General's responsibility

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 the 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 described in the Basis for disclaimer of opinion paragraphs, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Comparatives

4. In my previous audit report dated 30 November 2008, I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2008. The disclaimer matters have not been adequately resolved and my audit report is modified regarding the corresponding figures.
5. In addition, these uncorrected disclaimer matters are of a pervasive and material nature and the impact on the current year balances could not be determined. As a result my opinion on the current period financial statements is also modified.

Provisions

6. The municipality does not have permits or a restoration plan for its landfill sites and is in breach of Sections 20 and 28 of the National Environmental Management Act 1998 (Act No. 106 of 1998). No provision or contingent liability in respect of the obligation for restoring/rehabilitating these landfill sites or for any penalties that may be imposed by regulatory authorities in terms of Section 29 of this Act is disclosed in the financial statements.
7. Due to the specialist nature of the calculations required and the lack of available information it was not possible to determine the effect of this non-compliance on the provisions, expenditure and contingent liabilities disclosed in the financial statements.
8. Although attendance and leave registers were used to ensure that all leave taken was recorded, the leave records of employees are generally inaccurate and leave records per the attendance register do not reconcile to that per the leave register. Based on the audit testing performed, significant uncertainty exists with regards to the accuracy and completeness of employee costs and more specifically to the leave pay provision disclosed in note 11, to the amount of R1.8 million, of the annual financial statements. Although the full extent of the misstatement is not known, it is likely to be material.
9. The municipality's credit and collection policy approved during December 2008 does not address the basis for calculation of bad debts. This together with the fact that the basis for bad debts is not reflected in the accounting policies leads to significant uncertainty as to the adequacy and appropriateness of the provision for bad debts amounting to R65 million.

Accumulated surplus

10. The accumulated surplus/(deficit) account amounting to R26 million was included in the manual trail balance used for compiling the financial statement but was not recorded in the accounting records/general ledger.

Long-term liabilities

11. A confirmation received from the Development Bank of Southern Africa (DBSA) reflected that in addition to the loan disclosed in the financial statements to the amount of R3.1 million, another long term liability, to the amount of R4.4 million, relating to Nkonkobe Municipality at year end was not disclosed in the financial statements.
12. In addition, interest on arrears to the amount of R515 606 is disclosed in the financial statements. However, the interest on arrears has been written off by DBSA subsequent to the preparation of the financial statements.
13. The financial statements reflect amounts totaling R1.2 million regarding vehicle financing, as owing to a banking institution. However, a confirmation received from the bank concerned points out a difference of R14 million with the amount reflected in note 4 to the financial statements.

Investments

11. Journals to the amount of R7.7 million were processed relating to investments. The journals could not be submitted for audit purposes. In addition, no written authorisation, other than the signatories on the actual transfers, could be provided for transfers of R16.6 million between the main account and the other investment accounts.

Fixed assets

12. I was unable to reconcile the asset register to the accounting and subsidiary records of the municipality and was unable to verify the existence, rights and obligations, completeness and valuation of fixed assets as disclosed in the balance sheet, due to insufficient recordkeeping and a lack of supporting documentation. The asset register was last updated in 2005.

Purchases & payables

13. It was established that the municipality did not account for material expenditure amounting to R86 million. These transactions were identified from bank statements during the preparation of financial statements and were not recorded in the accounting records. As a result, we were unable to verify occurrence, accuracy, classification, cut-off and completeness of purchases and payables as disclosed in the AFS.
14. Supporting documentation for journals relating to purchases and payables amounting to R2.5 million could not be provided for audit purposes resulting in a material limitation of scope.

Revenue and receivables

15. Receipts to the value of R 80 million were identified from bank statements during the preparation of financial statements and were not recorded in the accounting records. As a result, we were unable to verify occurrence, accuracy, classification, cut-off and completeness of revenue and receivable as disclosed in the financial statements.

Disclaimer of opinion

16. 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. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter(s)

I draw attention to the following matters on which I do not express a disclaimer of opinion:

(Highlighting critically important matters presented or disclosed in the financial statements)

Basis of accounting

17. The municipality's policy is to prepare financial statements on the standards prescribed by IMFO in the Code of Practice (1997) and the Report of Financial Statements (2nd edition, January 1996) as set out in accounting policy note 1.

Delegations of authority

18. Section 59 of the Municipal Systems Act No 32 of 2000 and Section 79(1)(a) of the MFMA *inter alia* requires that an accounting officer to develop an appropriate system of delegation that will maximise administrative and operational efficiency, and provide adequate checks and balances in the municipality's financial administration. Section 79(3) also requires that such delegations must be in writing and may either be to a specific individual or to the holder of a specific post in the municipality. During the audit it came to light that the municipality did not have delegations in place for the 2008/2009 financial year.

Going concern

19. During the audit it was established that management did not perform a proper and concise assessment of the municipality's ability to continue as a going concern. A detailed review of the municipality's financial position, results of its operations and the related cash flows indicates that there is significant uncertainty regarding the going concern concept. This matter was not disclosed in the municipality's annual financial statements. The following are highlighted:

- The municipality has failed to make payments as and when due.
- The municipality had an operating deficit in excess of five per cent of revenue in the most recent financial year for which financial information is available.
- The municipality is late in submitting its annual financial statements to the Auditor-General in accordance with section 126.
- The Auditor-General has withheld an opinion or issued a disclaimer due to inadequacies in the financial statements or records of the municipality, or has issued an opinion which identifies a serious financial problem in the municipality.

Other matters

Internal audit

20. Nkonkobe Municipality and Amatole District Municipality have a shared internal audit service. Only one draft audit report was received from the internal auditors during the year under review. The audit was not scheduled for the current financial year or approved by the Audit Committee. The shared internal audit function is assessed as ineffective for the period under review.

Material inconsistencies in information included in the annual report

21. The draft annual report was not received in time for audit purposes and it was therefore not possible to determine whether there were any material inconsistencies in the report.

Un-audited supplementary schedules

22. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Risk management framework.

23. The municipality did not have a risk management and fraud prevention strategy in place for the 2008/09 financial year.

Internal control deficiencies

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 deficiencies 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. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. No.	Basis for disclaimer of opinion	CE	R A	CA	IC	M
4-5	Comparatives	5; 6	5			1; 3
6-9	Provisions	5; 6; 7	5	5; 6	3	1; 3
10	Accumulated deficits	5; 6	5	5; 6		1; 3
11-13	Long term Liabilities	5; 6				1
	Fixed assets	5; 6				1; 3
	Revenue and receivables	5; 6; 7	5	5; 6		1; 3
	Investments	5; 6; 7	5	5; 6	3	1; 3
	Employee costs	5; 6; 7		1	3	1; 3
	Expenditure and payables	5; 6; 7		5; 6		1; 3
Legend						
CE = Control environment						
The organizational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.						1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.						2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.						3
Integrity and ethical values have not been developed and are not understood to set the						4

standard for financial reporting.	
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyze the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorized, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

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 key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✓
Quality of financial statements and related management information			
2	The financial statements were not subject to any material amendments resulting from the audit.	✓	
3	The annual report was submitted for consideration prior to the tabling of the auditor's report.		✓
Timeliness of financial statements and management information			
4	The annual financial statements were submitted for auditing as per the legislated deadlines (Section 126 of the MFMA).		✓
Availability of key officials during audit			
5	Key officials were available throughout the audit process.	✓	
Development and compliance with risk management, effective internal control and governance practices			
6	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.		✓
7	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		✓
8	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✓
10	The information systems were appropriate to facilitate the preparation of the financial statements.		✓
11	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in Section 62(c) of the MFMA.		✓
12	Delegations of responsibility are in place, as set out in Section 79 of the MFMA.		✓
Follow-up of audit findings			

13	The prior year audit findings have been substantially addressed.		✓
14	Oversight resolutions have been substantially implemented.		✓
Issues relating to the reporting of performance information			
15	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
17	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Municipality against its mandate, predetermined objectives, outputs, indicators and targets Section 68 of the MFMA municipalities.		✓
18	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

Overall reflections/conclusion on the governance framework based on other key governance requirements

26. Monitoring of controls are not in place to ensure that all information disclosed in the annual financial statements are valid, accurate and complete. The lack of availability of key officials, with institutional knowledge pertaining to the 2007/08 financial year, has contributed to the delays experienced throughout the audit.

27. The control environment within the municipality applicable to the 2007/08 financial year, was not conducive to good governance and accountability as management have not ensured that the risk management processes and internal audit function have received the appropriate attention. The audit committee is an essential component in achieving good governance and accountability and is effective although it is hampered by the poor control environment and the ineffective internal audit function.

28. The root causes indicated in the two preceding paragraphs were compromised further by the following:

- Lack of personnel and skills in the finance section
- The commitment of personnel in the finance section
- Lack of funding to provide required training to finance personnel

29. Due to the matters that give rise to the limitation of scope, the extent of non compliance with relevant government prescripts, the lack of controls and risk management and fraud prevention strategies, the possibility that the financial statements are materially misstated resulting from fraud and errors, either on individual balances or the financial statements taken as a whole, cannot be excluded

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

30. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

31. 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).

32. 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.

33. 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.

34. 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)

Performance information

Non submission of performance information.

35. A full evaluation could not be completed of the quality of the reported performance information as set out on pages xx to xx of the annual report, since the municipality did not submit its performance report as part of its financial statement submission, as required by section 46 of the MSA read with section 121(3)(c) of the MFMA. The performance information was only received during the council meeting held on 28 January 2010.

36. The annual report of Nkonkobe Municipality (07/08 financial year) that was presented for audit purposes, did not include the annual performance report of the municipality, prepared in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

Integrated Development Plan

37. It was noted that Nkonkobe Municipality had its IDP reviewed in the 2008/09 financial year but no documentary evidence could be found that a performance assessment of the institution was conducted.

38. Municipal Systems Act sec 25 (4)(a) states that a municipality must, within 14 days of the adoption of its IDP give notice to the public of the adoption of the plan and that copies of or extracts from the plan are available for public inspection at specified

places. We could not be provided with a copy of a publication issued to the public notifying them of the adoption of the IDP.

Performance Management System

39. Section 40 of Municipal Systems Act states that a municipality must establish mechanisms to monitor and review its performance management system. We noted that Nkonkobe Municipality had adopted a performance management system framework during the financial year under review. Documentary evidence could however not be produced that the system was implanted successfully and monitored for the period throughout. In addition no evidence could be found that policies and procedures were designed in this regard.
40. In addition, the Municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Performance agreements

41. In terms of Section 57 of the Municipal Systems Act No.32 of 2000 a person to be appointed as a municipal manager of a municipality, and a person to be appointed as a manager directly accountable to the municipal manager may be appointed to that position subject to a separate performance agreement concluded annually. During the audit of performance information, no evidence could be found that the municipal manager and managers directly accountable to the municipal manager (except for the senior manager: community services) had performance agreements during the 2008/09 financial year.

Service Delivery Implementation Plan

42. During the audit of performance information it was noted that the municipality's SDBIP had not been updated with service delivery targets and performance indicators for all quarters in the financial year. Documented evidence could only be found for the updating of two quarters. Through review of council minutes no proof of review of the updates in the SDBIP by the council/mayor could be found.

APPRECIATION

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

Auditor General

EAST LONDON

22 February 2010



**AUDITOR-GENERAL
SOUTH AFRICA**

Auditing to build public confidence