

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Tsolwana Municipality which comprise the statement of financial position as at 30 June 2009, statement of financial performance, statement of changes in net equity 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 3 to 35.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the basis of accounting 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 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) and section 126(3)(c), 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 read with *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 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that

my audit of any disclosures made by the Tsolwana Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Cash suspense account

8. A cash suspense account balance of R169 889 is included in the creditors balance of R2.7 million disclosed on the face of the balance sheet and in note 6 to the financial statements. This cash suspense account consists of unallocated expenditure transactions of R4.6 million and unallocated consumer receipts and/or unallocated revenue of R4.8 million. The impact of these uncleared accounts is a misstatement of accounts receivable, revenue, unspent conditional grants, and expenditure.

Irregular expenditure

9. The municipality has omitted disclosure of irregular expenditure of at least R2.3 million in note 33.3 to the annual financial statements. This irregular expenditure was incurred in contravention of the municipality's supply chain management policy, salary payments which were not authorised and overtime payments in contravention of the Basic employment Act.

Fruitless and wasteful expenditure

10. The municipality has omitted disclosure of fruitless and wasteful expenditure of R80 129 in note 38.2 to the annual financial statements. The fruitless and wasteful expenditure was incurred during the year under review, as a result of the encashment of leave which was not in terms of the employee's employment contract.

Qualified opinion

11. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Tsolwana Municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the basis of accounting determined by National Treasury as set out in accounting policy note 1 and in the manner required by the MFMA.

Emphasis of matters

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

Basis of accounting

12. The municipality's policy is to prepare financial statements on the basis of accounting as set out in accounting policy note 1 to the financial statements.

Unauthorised, irregular and fruitless and wasteful expenditure, as well as material loss through criminal conduct

13. As disclosed in note 33.1 to the financial statements, unauthorised expenditure to the amount of R459 957 was incurred due to salaries and councilor allowances and capital expenditure being more than what was budgeted for 2008/2009.

Restatement of corresponding figures

14. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors discovered during 2009 in the financial statements of Tsolwana Municipality as at, and for the year ended, 30 June 2008.

OTHER MATTERS

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

Non compliance with applicable legislation

Division of Revenue Act

15. The performance of the programmes funded by schedule 4 and 6 allocations was not evaluated and such evaluations were not submitted to the transferring officer within two months after the municipal year end.

Environmental Conservation Act

16. The municipality does not have a permit to operate its landfill sites as required by section 20 of the Environment Conservation Act.

Municipal Finance Management Act

17. The accounting officer did not submit a report of supply chain management awards above R100 000 to National Treasury, Provincial Treasury, Department of Local government and the Auditor-General as required by Section 74(1) of the Municipal Finance Management Act.

Property Rates Act

18. The valuation roll was not updated every four years as required by section 32(1)(b) of the Property Rates Act.

Governance framework

19. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and other governance responsibilities addressed below

Internal control deficiencies

20. 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 qualified 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 qualified opinion	CE	RA	CA	IC	M
8	Cash suspense accounts			3		1
9	Irregular expenditure			5		
10.	Fruitless and wasteful expenditure			5		

Conclusion on the governance framework based on internal control deficiencies

Cash suspense account

21. Management does not monitor and review the cash suspense account in order to ensure that all transactions are valid and have been allocated on a timely basis.

Irregular expenditure

22. Management does not have a designated supply chain management officer in order to ensure compliance with management's supply chain management policy. Payments are authorised by personnel who do not have the delegated authority to do so and because of a lack of review and monitoring by management.

Fruitless and wasteful expenditure

23. Management does not ensure compliance with the terms and conditions of contracts which the municipality has entered into.

Legend	
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 authorised, 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
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

24. 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		
	<ul style="list-style-type: none"> Tsolwana Municipality had an audit committee in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		✓
7.	Internal audit		
	<ul style="list-style-type: none"> Tsolwana Municipality had an internal audit function in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
	<ul style="list-style-type: none"> 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)(i) of the MFMA.		✓

No	Matter	Y	N
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 Tsolwana Municipality against its mandate, predetermined objectives, outputs, indicators and targets as required by section 68 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

Conclusion on the governance framework based on other key governance requirements

25. Significant delays were experienced during the execution of our audit as a result of the municipality not providing documentation and explanations required for audit purposes. A structured process was followed in an attempt to obtain the documentation and explanations. Management was regularly informed of the delays experienced. Most documentation and explanations required were only submitted after several attempts.
26. The financial statements were subject to material adjustment as a result of a lack of controls being in place to ensure that complete, valid and accurate information is captured into the financial system. There is a lack of an adequate documentation management system to ensure easy retrieval of documentation. Most of the adjustments made were as a result of a lack of monitoring by management to ensure that their policies and procedures are being adhered to.
27. Key officials were not available throughout the audit processes to respond to audit queries and to provide us with information to which they only had access to; thus resulting in excessive delays in the audit process.
28. There was a lack of evidence of review of management's processes for identifying and responding to the risk of fraud.
29. The significant deficiencies in the design and implementation of internal control in respect of financial and risk management were attributed to a lack of approved and implemented policies being in place for the whole of the year under review

and to key internal controls and processes that were either not in place or not functioning as intended.

30. The significant deficiencies in the design and implementation of internal control in respect of the compliance with applicable laws and regulations were attributed to a lack of implemented controls not being adhered to and a lack of monitoring and supervision by management. Management has not taken sufficient action to clear all audit findings..
31. The municipality has performed a risk assessment for the year under review. Council minutes in which the fraud prevention plan was approved was not provided for audit purposes.
32. Not all the issues reported in the prior year management report was addressed as these issues were reported on also in the 2008/2009 audit.
33. The reliability of the source information and systems utilised to gather the information was not found to be reliable
34. There are no documented and approved policies and procedures are in place for the reporting of performance information.
35. The mid year performance bonus assessment was not submitted for audit purposes for that of the technical manager.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

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

The accounting officer's responsibility for the performance information

37. 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).

The Auditor-General's responsibility

38. 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.

39. 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 judgment.

40. 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

41. Performance information did not contain the following as required by section 46 of the MSA:

- Development priorities or objectives
- Key performance indicators per output
- Targets per output

- Actual performance achieved
- Comparison of performance with prior year
- Measures to improve performance.

Usefulness and reliability of reported performance information

42. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
- **Relevance:** Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
- **Reliability:** Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

43. The municipality's development priorities, key performance indicators and targets are not in all cases consistent with the IDP, SDBIP and organisational score card. Examples include the developmental goal to provide clean drinking water to all residents within the municipal boundaries, and electrification and housing projects that are not subject to any deadline dates for completion.

APPRECIATION

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

East London

30 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence