

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Inkwanca Municipality which comprise the balance sheet as at 30 June 2009, income statement, and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes, and the accounting officer's report, as set out on pages [xx] to [xx].
2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the standards laid down by the Institute of Municipal Finance Officers (IMFO) in the Code of Practice (1997) and the Report of Financial Statements (2nd edition, January 1996) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA) 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), 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 about 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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for adverse opinion

Fixed assets

7. A prerequisite of the Code of Accounting Practice for Local Authorities in South Africa and the Standards laid down by IMFO in the Code of Practice (1997) is that net assets should equal external loans. Net assets in the analysis of fixed assets to the annual financial statements differed from external loans in external loans and internal advances by R3.2 million.
8. Fixed assets for *housing services* are reflected in the fixed asset register at R11 million. No detail is provided in this register. A breakdown of these assets was provided by the municipality. This breakdown reflected housing assets at a total value of R4.6 million. The difference of R6.4 million could not be explained by the municipality.
9. Numerous assets did not have a unique asset number. It was, in these circumstances not possible to verify all assets that were reflected on the fixed asset register. Certain assets of the municipality could also not be traced back to the asset register. Furthermore the municipality has included water service assets of the water authority, Chris Hanu District Municipality in the asset register and also disclosed these in the analysis of fixed assets. As loans redeemed and other capital receipts that are reflected in the analysis of fixed assets have not been linked to individual assets it was not possible to determine the carrying value, and thus the full financial impact of these errors could not be determined but is material.
10. Council approval for the disposal of assets amounting to R130 543 could not be provided by the municipality.

Long term liabilities

11. The nature, book values of securities and interest rate of long term liabilities totalling R2.3 million are not disclosed in note 4 to the annual financial statements as required by the *Code of Accounting Practice for Local Authorities in South Africa*.

Provisions

12. Included in note 10 to the annual financial statements are provisions of R539 858. No provision is made under this note for the rehabilitation of the two landfill sites of the municipality. This resulted in provisions being understated by R7.7 million.

Revenue

13. Service charges for rates, water and sanitation of R13.4 million has been disclosed in the income statement. This revenue and debtors of R43.5 million in note 8 to the annual financial statements is overstated by 10.7 million and the water services agency control account is understated by R1.7 million. These misstatements resulted from incorrect capturing of meter readings on the billing system, council approved tariffs not being correctly loaded onto the billing system and the inclusion of revenue and debtors of the water services authority

14. Source documentation could not be provided for revenue journals of R660 881 and garden service revenue of R1.4 million. It was thus not possible to confirm transactions of revenue amounting to R30.6 million, as disclosed in the income statement, took place and that they related to the business of the municipality.

Debtors

15. Consumer debtors of R43.5 million are included in note 8 to the annual financial statements. It was not possible, even through alternative procedures to, confirm that all debtors included in the disclosure existed as direct confirmation of these accounts was not possible, subsequent receipts did not provide adequate assurance as to the existence of these debtors and the municipality was not able to provide us with supporting documentation and original invoices for transactions in these accounts.
16. The municipality does not have an approved accounting and credit control policy for doubtful debts. As a result it was not possible confirm that all *provisions for doubtful debts* of R39 million included in note 8 were recorded and that transactions took place and that they related to the business of the municipality.

Purchases and payables

17. The municipality did not provide payment vouchers and source documentation for purchases to the value of R414 893 that are included in expenditure of R11.1 million which is disclosed in the income statement. It was thus not possible to, even through alternative procedures, to confirm that these expenditure transactions took place or that all expenditure transactions were recorded in the income statement.

Contingent liabilities

18. The municipality has not disclosed any contingent liabilities in note 23 to the annual financial statements. The municipality was unable to provide confirmation from their legal representative that no contingent liabilities existed at financial year end. Alternative procedures did not provide the required level of audit assurance. Accordingly it was not possible to confirm that no contingent liabilities existed at year end and that the disclosure in note 23 was correct.

Opinion

Adverse opinion

19. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements of the Inkwanca Municipality have not been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 and in the manner required by the MFMA and DoRA.

Emphasis of matter

I draw attention to the following matters on which I do not express an adverse opinion:

Basis of accounting

20. The municipality's policy is to prepare financial statements in accordance with the standards laid down by the Institute of Municipal Finance Officers (IMFO) in the Code of Practice (1997) and the Report of Financial Statements (2nd edition, January 1996) as set out in accounting policy note 1.1.

Unauthorised, irregular and fruitless and wasteful expenditure

21. The unauthorised expenditure of R18.8 million that is disclosed in note 25 to the annual financial statements was incurred as expenditure exceeded approved budgets.

22. Irregular expenditure of R414 363 is disclosed in note 25 to the annual financial statements. This resulted from irregular travel allowances to employees and proper processes not being followed in the procurement of goods and services.

23. According to note 25 to the annual financial statements fruitless and wasteful expenditure of R411 666 was incurred. This fruitless and wasteful expenditure was penalty interest on a late payment to South African Revenue Services and payments to employees that were on extended leave.

Going concern

24. The dependence of the municipality on government assistance is disclosed in note 28 to the annual financial statements. These conditions, along with the matters as set forth in this report, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

Other matter(s)

I draw attention to the following matter that relates to my responsibilities in the audit of the financial statements:

25. 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 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.

Par. no.	Basis for adverse opinion	CE	RA	CA	IC	M
7	Fixed assets – fixed assets not agreeing to external loans	X				
8	Fixed assets – housing assets			X		
9	Fixed assets – verification			X		
10	Fixed assets – disposal of assets	X				
11	Long term liabilities – disclosure note	X				
12	Provisions – land fill sites	X				
13	Revenue - overstatement			X		

14	Revenue – documentation not submitted	X				
15	Debtors – existence of debtors	X				
16	Debtors – policy on provision for doubtful debts	X				
17	Purchases and payables – documentation not submitted		X			
18	Contingent liabilities – non submission of documentation					X

Control environment

26. The municipality has not developed, approved and implemented a number of policies and procedures. Furthermore the audit committee and internal audit department was not fully functional during the year. Despite having a finance department the municipality has employed external service providers to prepare their financial statements in the last two financial years. Subsequent to the external service provider compiling the annual financial statements they were not adequately reviewed by the chief financial officer as a means to ensure that the annual financial statements are free from material misstatements.

Risk assessment

27. The risk assessment performed by internal audit was not complete in that it did not identify the compliance aspects of the provision of water services as a high risk. A limited framework to guide the municipality in this matter would have prevented the error. Management has also not implemented a risk management strategy to mitigate the identified risks.

Control activities

28. The municipality has not implemented a certain manual and automated controls to ensure that the reporting activities are free from material misstatements.

Monitoring

29. Insufficient monitoring and financial control is exercised in the finance department.

Legend	
CE = Control environment	
The organisational 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 standard for financial reporting.	4
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 analyse 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 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
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

30. 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		

No	Matter	Y	N
	<ul style="list-style-type: none"> The 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"> The 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)/95(c)(i) of the MFMA.		✓
12.	Delegations of responsibility are in place, as set out in section 79/106 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		✓
14.	SCOPA/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 Inkwanca Municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68/87 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.		✓

Non-compliance with applicable legislation

31. Disclosed in note 3 to the annual financial statements are conditional grants of R2.5 million. Contrary to section 47(2) of DoRA these conditional grants have been use for operational purposes.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

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

The accounting officer's responsibility for the performance information

33. 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

34. 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.

35. 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.

36. 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 integrated development plan

37. The key performance indicators set by the municipality did not include key performance indicators applicable to the municipality, as prescribed by section 43(1) of the MSA.

No mid-year budget and performance assessments

38. The municipality did not assess its service delivery performance, service delivery targets and performance indicators set in the service delivery and budget implementation plan, by 25 January as required by section 72 of the MFMA.

Lack of adoption or implementation of a performance management system

39. A framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, was not adopted as was required in terms of

regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Existence and functioning of a performance audit committee

40. The municipality did not budget for or appoint a performance audit committee. It did also not make use of its audit committee to perform the function of the performance audit committee. Consequently it did not comply with the requirements of regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Usefulness and reliability of reported performance information

41. 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

48. Objectives reported in the annual report are not consistent with those listed in the integrated development plan for infrastructure and basic services programmes. The performance information for the local economic development programme did not include objectives, targets or indicators. No targets were included in the integrated development plan. Targets however were included for programmes in the annual report. This indicates that these targets were not predetermined.

APPRECIATION

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

East London

30 November 2009



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

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