

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Intsika Yethu Municipality which comprise the balance sheet as at 30 June 2009, 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 xxx to xxx.

Responsibility of the accounting officer 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 set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), *Auditor-General audit circular 1 of 2007* 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.

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) and section 126(3)(d) of the MFMA, 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 and *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 judgment, 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 qualified opinion

Debtors

7. The debtors balance of R18 million disclosed in the balance sheet and note 7 includes sundry debtors to the value of R3,5 million that are not substantiated by supporting documentation. As a result, I was not able to confirm that this balance was due to the municipality, was recorded at the correct amount, in the correct account, in the correct period or was capable of being recovered. There were no alternative procedures that could be performed to verify this balance.
8. The provision for doubtful debts of R1,1 million disclosed in note 7 to the financial statements was not based on the credit control policy of the municipality which requires the calculation of this provision to be based on the credit profiles of individual consumers. As a result, the provision for doubtful debts disclosed in note 4 and expenses disclosed in the face of the income statement are understated by R700 000 while the debtors balance of R18 million disclosed in the balance sheet and note 4 is overstated by this amount.
9. The audit report for the year ended 30 June 2008 included a qualification on debtors. No adjustments were effected to the corresponding consumer debtors figure disclosed in note 7 to correct the matters reported. As a result the corresponding figure for consumer debtors is still misstated.

General Expenses

10. A journal of R1.9 million was processed to expenses in order to agree the balance on the consumer debtors control account to the debtors' age analysis. This journal was not supported by adequate documentation or explanations. As a result I could not confirm that this journal should have been processed or that it was processed to the correct accounts, at the correct amount and in the correct period. There were no alternative procedures that could be performed to verify this journal

Provisions

11. 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. A provision for the rehabilitation of landfill sites has not been raised in the financial statements. The costs of rehabilitating landfill sites that are similar in size to those operated by the municipality is estimated at R3,5 million. As a result the provisions and expenses disclosed in the financial statements are overstated by this amount.

Qualified opinion

12. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Intsika Yethu Municipality have 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.

OTHER MATTERS

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

Non-compliance with applicable legislation

Environmental Conservation Act (No.73 of 1989)

13. Public access to the landfill site operated by the municipality was not restricted as required by Section 19 (1) of the Environmental Conservation Act.

Governance framework

14. 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 key governance responsibilities addressed below:

Internal control deficiencies

15. 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 |
|----------|-----------------------------|----|----|-----|----|---|
| 7-8 | Debtors | | | 2,3 | | 1 |
| 9 | General expenses | | | 2,3 | | 1 |
| 10-11 | Provisions | | 1 | | | 1 |

16. The qualifications relating to debtors and general expenses resulted from the implementation of a new information technology system without providing the necessary training and support to the finance personnel responsible for its use.
17. A lack of monitoring and supervision of the monthly accounting disciplines such as the reconciliation of key control accounts to supporting schedules and documentation also contributed to these qualifications.
18. The lack of a permanent chief financial officer for most of the year under review also contributed to all of the qualifications as risks to financial reporting that should have been identified and addressed by the chief financial officer were not identified.

| Legend | |
|--|---|
| 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 |
| 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

19. 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"> The Municipality had an audit committee in operation throughout the financial year. | ✓ | |
| 6 | The audit committee operates in accordance with approved, written terms of reference. | | ✓ |
| 7 | 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 | ✓ | |

| No. | Matter | Y | N |
|--|--|---|-----|
| | 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. | | ✓ |
| 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. | | n/a |
| 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 Intsika Yethu against its mandate, predetermined objectives, outputs, indicators and targets 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. | ✓ | |

20. The control environment in the municipality is not conducive to sound governance and accountability as the leadership has not ensured that the control environment has received the appropriate attention. The following key governance responsibilities have not been effectively addressed:

- Difficulties were experienced obtaining supporting documentation for other debtors and adjustments to the consumer debtors control account and general expenses. These difficulties were the result of implementing a new computerised financial system without providing the relevant finance personnel adequate training and support.
- Material amendments were made to the financial statements submitted for audit. These amendments were due to a lack of monitoring of the monthly accounting disciplines such as the reconciliation of key control accounts to supporting schedules and supporting documentation, the lack of a permanent chief financial officer for most of the year under review and the

non –submission of the financial statements to the audit committee for review prior to their delivery to my office.

- The municipality makes use of a shared audit committee and shared internal shared internal audit service provided by the Chris Hani District Municipality. One of the members of the shared audit committee resigned and was not replaced resulting in audit committee meetings being held without a quorum. The shared internal audit service is under –resourced and capacitated and did not conduct all its planned audits during the year under review. The effectiveness of the audit committee was thus also hampered by the ineffective shared internal audit service.
- Management did not complete a risk assessment or prepare and implement a risk management strategy that incorporates a fraud prevention plan.
- The significant deficiencies in the design and implementation of internal control in respect of the financial, risk assessment and compliance with applicable laws and regulations areas were attributed to inadequate implemented controls and a lack of monitoring and supervision by management.
- As is evident from the findings in this report the accounting record system of the municipality was not in all respects adequate to allow for the preparation of the annual financial statements.
- Management has not taken sufficient action to clear all prior year audit findings. There was no audit intervention plan and certain matters in the management report as well as this report were also raised in prior financial years.
- No systems are in place to ensure that non-financial performance is measured and reported on.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

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

Responsibility of the accounting officer for municipalities

22. 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 Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

23. 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*.
24. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
25. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

Non-compliance with regulatory requirements

Internal auditing of performance information

26. The municipality's internal audit did not perform any work on performance management processes as required by section 45 of the MSA.

Existence and functioning of a performance audit committee

27. The municipality did not appoint or budget for a performance audit committee, nor was another audit committee used as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Adoption and submission of the integrated development plan (IDP)

28. Management did not give 14 days notice of a public meeting for the adoption of Integrated Development Plan (IDP) as required by section 25(4)(a) of the MSA.
29. Management did not provide evidence that IDP was submitted to member of the executive committee for Local Government within 10 days of adoption by council as required by section 32(1) (a) of the MSA.
30. Intsika Yethu's Service Delivery Improvement Plan was not approved within 28 days after budget approval as required by section 53(1)(c) of the MFMA.
31. Management did not submit municipal evaluation performance report to National Treasury as required by section 72 of the MFMA.

APPRECIATION

32. The assistance rendered by the Mayor and officials of Intsika Yethu Municipality during the audit is sincerely appreciated.

East London

Date: 14 February 2010



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence