

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE SUNDAYS RIVER VALLEY MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Sundays River Valley Municipality, which comprise the statement of financial position as at 30 June 2010, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages xx to xx.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury: Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). 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; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa and section 4 of the Public Audit Act of South Africa, 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 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009. Because of the matters described 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 for disclaimer of opinion

Cash and cash equivalents

4. The entity could not provide sufficient appropriate audit evidence to support the write off of R39 716 against the petty cash float and accumulated surplus during the year. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy or occurrence of petty cash expenditure of R39 716.

Receivables

5. Included in trade receivables is a credit balance of R3 065 992. This is as a result of a system error that occurred in March 2010 specific to one debtor account and resulted in a credit of R3 099 549 being erroneously charged to the account. Had the error been corrected, gross trade receivables and the provision for doubtful debts included in note 2 to the financial statements, would have increased by R3 099 549, and the service charges per note 18 and the doubtful debt impairment per the annual financial statements would have increased by the same.
6. The entity could not provide sufficient appropriate audit evidence to prove the recoverability of other debtors totalling R543 482. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of other debtor's totalling R543 482 per note 3 to the financial statements.
7. The entity could not provide sufficient appropriate audit evidence to support the R14 350 550 owed by the Department of Housing per note 3 to the financial statements. This is as a result of an ongoing verification process regarding the expenditure incurred. Consequently, I was

unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence and valuation of this balance.

8. The prior year provisions of R41 764 821 against trade debtors and R2 645 517 against traffic fines per notes 2 and 3 to the financial statements were not audited in the prior year due to political interference. Consequently, I was unable to confirm or verify by alternative means the cut-off, classification, completeness and accuracy of the bad debts impairment of R16 101 200 per the statement of financial performance, which comprised the movement in these provisions from prior year to current year.
9. The entity could not provide sufficient appropriate audit evidence to support the traffic fines provision of R3 759 512, due to the reports detailing the payment history for the last three years not being provided in order to re-perform the average payment history. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of the net debtor of R287 380 included in note 3 to the financial statements.

VAT receivable/payable

10. VAT input was incorrectly claimed on various additions to property, plant and equipment during the year due to the invoices received not being valid VAT invoices in terms of section 20(4) of the VAT Act, No 81 of 1991. Had the correct input VAT been claimed, the VAT receivable per note 11 to the financial statements would have decreased by R538 140 (projected error: R578 047) and the additions to property, plant and equipment per note 7 to the financial statements would have increased by this amount.
11. VAT input was incorrectly claimed on various expenditure incurred during the year due to the invoices received not being valid VAT invoices in terms of section 20(4) of the VAT Act, No 81 of 1991. Had the correct input VAT been claimed, the VAT receivable per note 11 to the financial statements would have decreased by R886 533 (projected error: R1 526 554) and the surplus for the period and the accumulated surpluses would have decreased by R886 533 (projected error: R1 526 554).
12. The municipality has not apportioned any input tax where goods or services are acquired partly for consumption, use or supply in the course of making taxable supplies. Output tax has also not been apportioned for goods or services which are supplied partly as a taxable supply as required by section 17(1) of the VAT act, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all input VAT and output VAT was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness and valuation of the VAT recorded per notes 10 and 11 to the financial statements.
13. The entity could not provide sufficient appropriate audit evidence to support the reconciling items offsetting to R883 390 between the input and output VAT recorded per the general ledger and the input and output VAT recorded on the VAT 201 forms. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and allocation of VAT recorded per notes 10 and 11 to the financial statements.

Property, plant and equipment

14. The rights to land could not be confirmed as a result of the land not being registered in the municipality's name. The municipality could not provide a list of possible names that all the land could have been registered in and thus alternative audit procedures could not be applied. Consequently, I was unable to confirm or verify by alternative means the municipality's rights to land reflected at a total cost of R0 (due to the application of directive 4) per note 7 to the financial statements.
15. As stated in note 7 to the financial statements, an amount of R4 140 448 was acquired via a donation in 2009 but was only capitalised during the current financial year. Had the error been corrected, opening cost of property, plant and equipment per note 7 would have increased by R4 140 448 and current year additions would have decreased by R4 140 448.
16. The entity could not provide tender documentation relating to various projects totalling

R19 291 592 for audit purposes. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself that this expenditure was not irregular.

Accruals, provisions and contingent liabilities

17. Unspent conditional grants are R15 523 371 per note 13 to the financial statements and investments are only R1 615 321 per note 5 to the financial statements, thus there is a shortfall of R13 908 050. This indicates that funds have not been used for their intended purposes in accordance with the grant agreements.
18. As a result of the inadequate record keeping in relation to the restatement of the prior year balances and the close out of funds during the current year, I was unable to perform the audit procedures deemed necessary to determine the existence and valuation of certain liabilities to the value of R15 492 348 as per note 13 to the financial statements
19. The Environment Conservation Act (Act 73 of 1989) states that “any person who fails to comply with a condition of a permit permission, authorization or direction issued or granted under the said provisions shall be guilty of an offence and liable on conviction to a fine not exceeding R5 million or to imprisonment for a period not exceeding five years”. It was evident that permit conditions and the minimum requirements for waste disposal by landfill (for the Sunland, Langbos and Paterson landfill sites) is not being adhered to, and as a result contingent liabilities per note 39 to the financial statements have been understated by R5 million. In addition section 21(2)(1) of the Act refer to waste and sewage disposal which will probably have detrimental effect on the environment. It was evident that minimum requirements are not being met per the site visits and as a result contingent liabilities per note 39 to the financial statements have been understated by a further R5 million.
20. The scope of our audit was restricted as leave forms were not completed for days employees did not work, various attendance registers were missing and certain approved leave forms were not deducted from employees leave balances. Consequently, I was unable to confirm or verify by alternative means the value and completeness of the leave pay accrual of R2 491 657 per note 12 to the financial statements.
21. In terms of the loan agreement with the Development Bank of South Africa (DBSA), an investment of at least R600 000 should be maintained. At year end however only R1 318 was held in a separate investment account. Consequently, the long term portion of the loan of R1 695 329 per note 14 to the financial statements should be reflected as a current liability.
22. International Accounting Standards, IAS 39 Financial Instruments – Recognition and Measurement requires an entity to measure all financial liabilities at amortised cost using the effective interest method. The Municipality has not discounted its creditors. Had the adjustment been made; trade creditors reflected per note 8 to the financial statements would decrease by R693 943 and finance income would have increased by the same amount.
23. The scope of my audit was restricted as I was unable to obtain the supporting documentation for certain trade creditors totalling R3 373 968 (projected error: R3 697 589) per note 8 to the financial statements. This is as a result of the creditor not providing creditors statements for the purposes of reconciling the amounts to the general ledger. Consequently, I was unable to confirm or verify by alternative means the existence, completeness and valuation and allocation of trade creditors of R3 373 968 (projected error: R3 697 589) included in note 8 to the financial statements.
24. The scope of my audit was restricted as I was unable to obtain sufficient appropriate audit evidence regarding a claim against the Municipality of R1 033 626. This is as a result of the attorneys not being able to give an indication as to the likelihood of the claim succeeding. Consequently, I was unable to confirm or verify by alternative means the existence and valuation of trade creditors of R1 033 626 included in note 8 to the financial statements.

25. Standards of Generally Recognised Accounting Practice, GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets* require a provision to be recognised when an entity has a present obligation (legal or constructive) as a result of a past event. No provision has been made for the thirteenth cheque that will be paid in November and December 2010. Had the adjustment been made; other creditors reflected per note 8 to the financial statements would have increased and the surplus for the period and the accumulated surpluses would have decreased by R959 291.
26. The scope of my audit was restricted as I was unable to obtain sufficient appropriate audit evidence regarding claims against the Municipality of R17 619 278. This is as a result of the attorneys not being able to give an indication as to the likelihood of the claim succeeding due to procurement issues still being investigated. Consequently, I was unable to confirm or verify by alternative means the existence and valuation of provisions of R17 619 278 included in note 12 to the financial statements.
27. International Accounting Standards, IAS 19 *Employee benefits* state that an amount should be recognised for defined benefit liabilities. The municipality has a post retirement medical aid liability which has not been provided for in the financial records of the municipality. This was as a result of an exemption that was taken in prior years in Gazette no. 30013, dated 29 June 2007, however this exemption has now expired. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of this liability and the entity's records did not permit the application of alternative audit procedures.

Accumulated surplus/deficit

28. As disclosed in note 46.3 to the financial statements, accumulated surplus has been restated by R3 906 400. The entry was passed in the current year trial balance and prior year comparatives were therefore not restated which is not in compliance with GRAP 3 *accounting policies, changes in Accounting estimates and errors*. In addition investments were restated by R63 169 as reflected in note 46.3, however our prior year audit report indicated that the amounts did not reconcile by R414 059. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and allocation of the adjustment of R63 169 to accumulated surplus.
29. The scope of my audit was restricted as I was unable to obtain sufficient appropriate audit evidence regarding the restatement of R101 849 to other payables and the restatement of R811 432 per note 46.3 to the financial statements. Consequently, I was unable to confirm or verify by alternative means the existence, completeness and valuation and allocation of these two restatements to accumulated surplus for the year.
30. The scope of my audit was restricted as I was unable to obtain sufficient appropriate audit evidence regarding the restatement of R5 462 685 per note 46.3 to the financial statements. Consequently, I was unable to confirm or verify by alternative means the existence, completeness and valuation and allocation of this restatement to accumulated surplus for the year.
31. Included in general expenditure for the current year is an amount of R750 000 which related to claim instituted by the Municipal Manager in 08/09. Had the error been corrected general expenditure and the surplus for the period would have increased by R750 000 and the opening accumulated surpluses would have decreased by the same amount.

Revenue

32. A reconciliation between the valuation roles and rates charged in support of the property rates revenue of R8 801 215 per the statement of financial performance was not performed. Municipal employees were also not available to provide evidence that interim valuations were adequately and timeously effected in the accounting system. Consequently, I was unable to confirm or verify by alternative means the completeness, occurrence, cut-off, classification and accuracy assertions for the property rates revenue of R8 801 215 per the statement of financial performance.
33. There was no system of control over the building plans for the purposes of determining sewerage and sanitation points and refuse removal sites, and there were no satisfactory audit

procedures that I could perform to obtain reasonable assurance that all sewerage and refuse removal income was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of sewerage and sanitation charges income of R1 484 226 and refuse removal income of R3 254 289 per note 18 to the financial statements.

34. The entity could not provide sufficient appropriate audit evidence to support the reconciling items of R918 212 between the amounts deposited into the motor registration bank account for the year and the amount collected per the e-Natis reports. Consequently, I was unable to confirm or verify by alternative means the completeness and accuracy of agency fee income of R1 066 274 grouped to licenses and permits income per the financial statements.

Employee costs

35. Employee costs and councillor remuneration per the statement of financial performance of R26 424 219 could not be reconciled to the salary reports of R24 284 512 for the year. Consequently, I was unable to confirm or verify by alternative means the occurrence, cut-off, classification and accuracy assertions for employee costs and councillor remuneration for the difference of R2 139 707.

Other expenses

36. The scope of our audit was restricted as I was unable to obtain applications for registered indigent debtors to determine whether the indigents qualified for the subsidies received against rates, water, refuse and sewerage accounts of R1 162 173. Consequently, I was unable to confirm or verify by alternative means the occurrence and accuracy of grants and subsidies paid of R1 162 173 per note 30 to the financial statements.
37. The scope of our audit was restricted as I was unable to obtain adequate source documentation for general expenditure of R1 923 795 and R149 059 (projected error: R3 647 407 and R282 631 respectively) per note 31 and grant expenditure of R63 270 and R1 836 894 (projected error: R111 796 and R3 098 977) per note 30 to the financial statements. Consequently, I was unable to confirm or verify by alternative means the occurrence of the above expenditures.
38. General Expenses of R387 268 (projected error: R1 081 336) were incorrectly classified as repairs and maintenance in the general ledger accounts. If the correct entry had been passed, the effect would have been to reduce repairs and maintenance expenditure by R387 268 (projected error: R1 081 336) and to increase the general expenditure by an equal amount.

Related parties

39. Councillors and department employees were members/directors of various housing project creditors of the Municipality. The scope of our audit was restricted as I was unable to obtain supporting documentation for payments made to these entities totalling R878 397 during the year. Consequently, I was unable to confirm or verify by alternative means that these expenses did not constitute irregular expenditure.

Irregular, fruitless & wasteful, and unauthorised expenditure

40. Payments totalling R226 997 during the year were made to a supplier (Newington Management Projects 9 CC) that does not appear to exist on the SARS website or on the CIPRO database. Consequently, I was unable to confirm or verify by alternative means that these expenses did not constitute irregular expenditure.
41. The municipality entered into a contract whereby a supplier (Jongisizwe) would rent a camera and vehicle to the traffic department in return for 50% of the fines revenue. The traffic revenue recognised for the year was R1 794 204 however the amount invoiced for the year were reconciled to R819 447. A portion of these payments would therefore appear to constitute fruitless and wasteful expenditure.
42. Actual expenditure per the statement of financial performance exceeded the budget by R14 548 777 which is therefore considered unauthorised expenditure. Furthermore, actual

revenues received were under budget by R6 526 733 for the year.

43. Insufficient authorisation was received through the approval of purchase orders for general expenditure totalling R3 720 127, repairs and maintenance expenditure totalling R452 691 and grant expenditure totalling R310 361 which therefore constitutes irregular expenditure.
44. Supply Chain Management Regulations 12, 16 and 17 were not complied with for expenditure of R429 335 as a result of not obtaining the minimum number of quotes due for transaction values between R10 000 and R200 000.
45. Supply Chain Management Regulations 14 and 18 were not complied with as the supplier database has not been updated quarterly and the listing criteria for prospective providers are not specified.

Cash flow statement

46. GRAP 2, *Cash Flow Statements*, requires that items that do not require the use of cash or cash equivalents shall be excluded from the cash flow statement. The cash flow statement in the financial statements however have not removed the effects of non-cash items such as accrued interest income and prior year errors corrected through the accumulated surplus (refer to note 46.3).

Consolidations

47. GRAP 6 *Consolidated and Separate Financial Statements*, states that a controlling entity shall present consolidated financial statements in which it consolidates its investments. Minutes of a meetings held on 29th September 2010 indicated that there was a relationship with entities Rapicorp (Pty) and Addo Cold Store Trust however I was unable to determine whether this relationship constituted "control" as defined in GRAP 6, as the Municipality has not been able to supply us with any contracts or records of these entities. Consequently, I was unable to confirm or verify by alternative means whether the results of these entities should have been consolidated in the financial statements of the Municipality in accordance with GRAP 6.

Prior year

48. Expenditure of R266 613 was posted to the wrong expense accounts in the general ledger. Consequently, I was unable to confirm or verify by alternative means the classification assertions for the total expenditure disclosed of R192.32 million per the statement of financial performance.
49. The 08/09 opening accumulated surplus per the statement of changes in net assets and prior year general expenditure has been overstated by R542 036 as a result of incorrect cut-off errors in the prior year.
50. Agency fees received by the municipality for assisting the Department of Roads and Transport with the collection of licence fees are not shown on a net basis in the prior year. Had the error been corrected, the prior year revenue and expenditure would have decreased by R2.7 million.
51. The scope of our audit was restricted as I was unable to obtain source documentation for general expenditure incurred of R4.23 million. Consequently, I did not verify by alternative means the occurrence, accuracy and classification of general expenses of R15.25 million per the statement of financial performance.
52. The scope of our audit was restricted as I was unable to obtain source documentation or grant agreements for expenditure charged against conditional grants of R116.16 million and financial management grants of R3.95 million per note 19 to the prior year financial statements. Consequently, I was unable to confirm or verify by alternative means the occurrence, accuracy and classification of the above expenditures and the associated conditional grant revenue recognised of R117.95 million (R3.95 million and R114 million) per note 13 to the prior year financial statements.
53. As a result of the high error rates identified during the execution of the 08/09 audit procedures, the occurrence, accuracy, completeness, and classification of total expenditure incurred on repairs and maintenance, bulk purchases, contracted services, grants and subsidies paid and

general expenditure of R146.61 million per the statement of financial performance could not be verified.

54. Based on the scope limitation on the various other components audited I do not express an opinion on the cash flow statement.
55. The scope of our audit was restricted as I was unable to obtain supporting journal vouchers or explanations for any of the journals selected for fraud tests and the journal sample did not balance by a net credit of R349 032. Consequently, I was unable to confirm or verify by alternative means the occurrence, valuation, existence, cut-off classification and accuracy of all the affected components in the financial statements. The journal download did balance for the current year.
56. Opening accumulated surplus per the statement of changes in net assets and prior year general expenditure has been overstated by R542 036 as a result of incorrect cut-off errors in the 07/08 year.

Opinion

Disclaimer of opinion

57. 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 matters

I draw attention to the matters below:

Going concern

58. The municipality has total creditors of R19 746 522 per note 8 and housing project provisions of R17 619 278 per note 12 to the financial statements however the overdraft facility is only R1 million. Note 1.3 further indicates that the Municipality has been placed under administration in terms of Section 139 of the MFMA and that the Municipality has applied for a financial bailout during the year. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

Unauthorised, fruitless and wasteful expenditure

59. As disclosed in note 36.1 to the financial statements, unauthorised expenditure to the amount of R14 548 777 was incurred.
60. As disclosed in note 36.2 to the financial statements, fruitless and wasteful expenditure to the amount of R1 597 762 was incurred.

Related parties

61. As disclosed in note 42 to the financial statements, transactions with a value of R897 722 occurred with entities that certain councillors had an interest in.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the PAA and in terms of General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations: Municipal Finance Management Act, No 56 of 2003 (MFMA), Division of Revenue Act, No 12 of 2009 (DoRA), Municipal Systems Act, No 32 of 2000 (MSA); Municipal Structures Act, No 117 of 1998; and financial management (internal control).

Predetermined objectives

Material findings on the report on predetermined objectives are reported below:

62. I could not conduct the audit of performance against pre-determined objectives as the Sunday's River Valley Municipality did not prepare the annual performance report as required

in terms of section 46 of the Municipal Structures Act (No. 117 of 1998)

63. The integrated business development plan did not contain key performance indicators or performance targets nor did it contain a financial plan; this is in contravention of section 26.
64. There is no performance management systems present at the Municipality; this is in contravention of section 38.
65. The municipality has not set any key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the Municipality's development priorities and objectives as set out in its IDP; this is in contravention of section 41.
66. There was no consultation with the community relating to the performance information system, nor was the performance audit committee fully operational in the 09/10 year; this is in contravention of section 14.
67. There was no reporting made to the community, councillors or state relating to the performance information system; this is in contravention of section 41.

Usefulness of reported performance information

68. The following criteria were used to assess the usefulness of the planned and reported performance:
 - Consistency: Has the Municipality reported on its performance with regard to its objectives, indicators and targets in its integrated development plan i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
 - Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
 - Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?
69. The usefulness of the performance information could not be assessed due to the Municipality not setting key performance indicators, refer to paragraph 65.

Reliability of reported performance information

70. The reliability of the performance information could not be assessed due to the Municipality not setting key performance indicators, refer to paragraph 65.

Compliance with laws and regulations

Municipal Finance Management Act of South Africa, No 56 of 2003 (MFMA)

71. Loans amounting to R515 511 have been made to councillors as well as an amount of R229 386 in respect of PAYE paid on their behalf; this is in contravention of section 164(1)(c);
72. The system of financial management and internal control established for the municipality was not carried out diligently; this is in contravention of section 78;
73. Bank and investment reconciliations were not performed throughout the year, nor was the valuation roll reconciled to the general ledger; this is in contravention of section 64(2)(e);
74. The fixed asset register reconciliation to the general ledger was not performed throughout the year, this is in contravention of section 63;
75. Payroll deductions (e.g. PAYE, UIF, SDL) are not being paid over within 7 days after month end; this is in contravention of section 65;
76. Employee files are not maintained (e.g. salary increase forms, appointment letters and authorisation for deductions); this is in contravention of section 62(1);
77. There was no fraud prevention plan in place; this is in contravention of section 115;
78. The municipality was paying for the councillors cell phone accounts and then deducting the

amount from their salaries; this is in contravention of section 167;

79. There are pending allegations against the previous municipal manager for financial mismanagement and misconduct and there are insufficient controls around the authorisation of journal entries; this is in contravention of section 62(1);
80. The accounting officer does not take all reasonable steps to ensure that amounts owed by the Municipality are paid within 30 days of receiving the statement or invoice; this is in contravention of section 65(2)(e);
81. No debtors were handed over to attorneys in an attempt to recover outstanding monies despite the fact that there are significant debtors over 90 days old nor were any of their services disconnected; this is in contravention of section 64;
82. For certain section 57 employees the Municipality does not have performance agreements in place; this is in contravention of section 57;
83. There have been no internal audit plans, no audit charter and no risk assessments during the current year; this is in contravention of section 165(2);
84. The audit committee did not review the management letter and adequacy of management's responses to the issues raised in the management letter; this is in contravention of section 165(2)(a); and
85. The municipality failed to produce a SDBIP report and the mid-year budget was only submitted to council after 31 January 2010; this is in contravention of section 54.

Division of Revenue Act of South Africa, No 12 of 2009 (DoRA)

86. The Municipality did not submit the monthly Municipal Infrastructure Grant reports (except for June 2010) within 10 days of month end; this is in contravention of section 11(2)(b).

Municipal Supply Chain Regulations of South Africa (GNR.868 of 20 May 2008)

87. Expenditure was not incurred in accordance with the requirements of the supply chain management policy of the Municipality, resulting in irregular expenditure; this is in contravention of MPPR 12, 16 and 17.

INTERNAL CONTROL

88. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the Municipal Finance Management Act, No 56 of 2003 (MFMA), Division of Revenue Act, No 12 of 2009 (DoRA), Municipal Systems Act, No 32 of 2000 (MSA) and Municipal Structures Act, No 117 of 1998, but not for the purpose of expressing an opinion on the effectiveness of internal control.
89. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

LEADERSHIP

Oversight responsibility over reporting

90. The accounting officer did not perform an adequate review of the financial statements prior to its submission for audit thus there were numerous corrections that needed to be adjusted for in the financial statements.
91. There was inadequate oversight over financial reporting and compliance with laws and regulations as a number of non-compliances were identified.

Availability of key personnel

92. Key staff members were not always available during the course of the audit which caused delays in the submission of requested information.

Adequacy and competence of personnel responsible for reporting

93. The significant number of findings identified during the current financial year is due to inadequate training and capacity of personnel within the finance department and other departments of the municipality.

Integrity and ethical behaviour

94. No matters to report.

Implementation of appropriate key controls (policies and procedures)

95. The municipality did not have documented and approved internal policies and procedures to address planning, implementation, monitoring and reporting processes and events pertaining to performance management and reporting.

FINANCIAL AND PERFORMANCE MANAGEMENT

Adequacy of systems preparation of the financial statements and the report on predetermined objectives

96. The systems, processes and controls in place to identify pertinent information for the inclusion in the annual financial statements were not sufficient. The audit process identified material misstatements in reported amounts per the annual financial statements, as well as omissions. These matters which were corrected in the financial statements have been indicated in paragraphs 14 and 15 above.

97. Sufficient appropriate evidence with regard to performance information could not be obtained as there is no information and communications system in place to generate the relevant performance information or to facilitate the preparation of accurate and complete actual performance information.

Accounting discipline

98. The following reconciliations were not prepared either in part or throughout the financial year:

- Payroll reconciliations of the salary run to the general ledger.
- Supplier statements to the relevant supplier control accounts.
- Bank control account to the bank statements.
- Unknown receipts register to the unknown deposits account.
- Valuations roll to the valuations inputted into the system.
- Fixed asset register to the fixed asset general ledger accounts.
- Investments statements to the investment control account.
- Approved tariff rates to the rates inputted into the system.

99. Journals passed onto the system are not appropriately authorised and reviewed by independent persons.

100. There is a lack of master file amendment controls in reviewing amendments made to the various master files and comparing back to authorised file amendment forms.

Accounting policies, estimates and disclosures

101. The annual financial statements were submitted with accounting policies that were not complete or accounting policies that were inadequate.

102. The municipality has elected to apply the transitional provisions as contained in Directive 4 regarding property, plant and equipment.

Budget process as well as measurement and achievement

103. The municipality has materially overspent its budget. At the date of this report, the overspending amounted to R14 548 777. In addition, the actual revenues received were under budgeted by R6 526 733.

104. The impact of the overspending is that the municipality is facing financial difficulties in meeting obligations to creditors and cannot release payments to creditors until funds are received into the bank account. The delays in paying creditors are impacting service delivery.

Availability of expected information (both financial and performance)

105. As indicated in our engagement letter, it was agreed that all information requested for purposes of the audit would be submitted within 2 days of the request by the auditors. Despite this agreement, management did not supply the documentation requested timeously which resulted in qualifications inserted in the audit report.

Late submission of financial statements and report on predetermined objectives

106. Not applicable as the financial statements were submitted on the 31st of August 2010.

Related party transactions

107. The municipality has not implemented controls to identify, account for and disclose related party relationships and transactions. They also do not have appropriate policies to authorise and approve significant transactions and arrangements with related parties.

Use of consultants in the preparation of the financial statements

108. Charteris and Barnes were consulted to prepare the annual financial statements as the municipality is lacking the capacity and technical expertise.

109. A reduction of the number of material misstatements relating to the preparation of the annual financial statements was noted.

GOVERNANCE

Risk and fraud identification and management

110. The municipality has not undertaken a risk assessment process to assess any risks of fraud. Neither have they developed or implemented a fraud prevention plan, as required by Section 62(c)(i)/95(c)(i) of the MFMA.

Internal audit

111. The Municipality's internal audit division was outsourced to KPMG for the 09/10 year.

Audit committee

112. The municipality did not establish a performance audit committee as required by Section 14(2)(a) of the Local Government Municipal Planning and Performance Management Regulations of 2001. A performance audit committee was in the process of being established during the 08/09 year, however this performance audit committee has not yet become fully operational during the current financial year and therefore did not submit the required reports in 09/10 relating to the 08/09 performance assessment.

OTHER REPORTS

Investigations

113. The South African Revenue Service is in the process of conducting a Value Added Tax audit.

114. In the prior year, quotes were obtained for expenses of R514 330 which appeared invalid as the letterhead formats for the same suppliers had been interchanged, the addresses differed, the signatures were not consistent and the quotes from the various suppliers appeared to have been printed from the same greyscale printer. These same instances were identified in the current year audit. There is therefore a possibility that the requirements of the supply chain management policy have been deliberately circumvented (due to fraud). There is therefore a possibility that the staff were receiving kickbacks from suppliers. Based on these findings I recommend that a forensic investigation be undertaken.

115. In the prior year, irregularities have been reported regarding tender procedures that were not followed on various housing projects. In addition it appeared that supply chain management procedures with regard to payments on these projects were also not followed. A forensic investigation has been undertaken by KPMG, however at the time of our audit, this report has not been finalised. Payments were made during the prior year of R81 million on various housing projects.

Auditor General,

Port Elizabeth

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence