



AUDITOR - GENERAL
SOUTH AFRICA

The accounting officer
PO Box 36
Butterworth
4960

30 November 2010

Reference: 21297REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mquma Municipality for the year ended 30 June 2010

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
3. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
4. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
5. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.

6. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

A handwritten signature in cursive script that reads "Pillay".

Delene Pillay
Senior Manager: ECPA

Enquiries: Dharmini Fakir
Telephone: (012) 345 6789
Fax: (012) 345 6789

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Mquma Municipality, which comprise the statement of financial position as at 30 June 2010, and 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 ... to

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 Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the Municipal Finance Management Act of South Africa, 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, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) 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 International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. 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 qualified opinion

Value-added tax (VAT) receivable

7. The municipality could not provide a reconciliation of the net VAT receivable of R2,7 million (2009: R4,6 million) as disclosed on the face of the statement of financial position. Queries noted by the South African Revenue Service indicated that input VAT of R1,2 million (2009: R0,7 million) did not meet the requirements of section 20(4) of the Value-Added Tax Act of South Africa, 1991 (Act No. 89 of 1991) and should not have been claimed. This was as a result of a lack of management control and oversight over the calculation of VAT. As the municipality's records did not permit the application of alternative procedures relating to the VAT receivable, I was unable to obtain sufficient appropriate audit evidence relating to the completeness, accuracy and valuation of the VAT receivable balance as disclosed in the statement of financial position.

Bank overdraft

8. The municipality could not provide a reconciliation of the bank overdraft of R2,7 million (2009: R5,7 million) as disclosed on the face of the statement of financial position. The municipality could not provide documentation, information or explanations to support transactions in the current and prior year to the amount of R2,5 million, as a result of incorrect processing that resulted in the general ledger balance not agreeing with the cash book by this amount. As the municipality's records did not permit the application of alternative procedures, I was unable to obtain sufficient appropriate audit evidence relating to the occurrence, accuracy and valuation of the bank overdraft balance as disclosed in the statement of financial position.

Corresponding figures

9. In the prior year my audit report contained a modification on a number of account balances and classes of transactions. Management processed entries and supplied evidence in order to correct these corresponding figures however no evidence could be obtained that the corresponding figures for revenue (R628 428), trade receivables (R148 725) and trade payables (R574 071) were corrected. As a result my opinion is again modified due to the comparability of these corresponding figures.

Qualified opinion

10. 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 the Mquma Municipality for the year ended 30 June 2010 and its financial performance and its cash flows for the year then ended, are prepared in accordance with the statements of GRAP and in the manner required by the MFMA.

Emphasis of matter

11. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Fruitless and wasteful expenditure

12. Fruitless and wasteful expenditure of R162 597 was identified by the municipality and adequately disclosed in the financial statements.

Additional matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

15. In terms of the PAA and *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 section 45 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), and financial management (internal control).

Predetermined objectives

16. Material findings on the report on predetermined objectives, as set out on pages to, are reported below:

Non-compliance with regulatory and reporting requirements**Content of the integrated development plan**

17. The integrated development plan of the municipality did not include the disaster management plans, as required by section 26(g) of the MSA.

Prior year comparisons

18. The annual performance plan did not include a comparison with the prior year's performance and measures to improve performance, as required by section 46(1)(a) and (b) of the MSA.

Approval of the service delivery and budget implementation plan (SDBIP)

19. In terms of section 53(1)(c)(ii) of the MFMA, the municipality's SDBIP needs to be approved by the mayor within 28 days after the approval of the budget. No evidence could be obtained that this was done.

Usefulness of reported performance information

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 approved 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?

The following audit findings relate to the above criteria:

20. The municipality did not report throughout on its performance with regard to its targets as per the approved integrated development plan. Thirty-one objectives contained in the integrated development plan were not reported in the annual performance report.
21. For the infrastructure planning and development and the socio-economic and environmental programmes, 13 objectives were not specific in clearly identifying the nature and the required level of performance.
22. The reported performance information included in the annual report was not presented in a simple, accessible format, relevant and useful to the intended user, or in accordance with the requirements of Treasury Regulation 18 or 28.2, MFMA Circular 11 and the relevant guidance applicable to reporting for the financial year-end.
23. The availability of storm water backlogs planned performance indicator or measure was not clear, with an unambiguous definition to allow for data to be collected consistently.

Compliance with laws and regulations

Municipal Finance Management Act

Expenditure was not paid within the parameters set by applicable legislation

24. The municipality did not pay creditors within 30 days as required by section 65(2)(e) of the MFMA.

The internal audit unit was not properly established or not functioning properly

25. The municipality's internal audit division did not fulfil all of its responsibilities as required by section 165(2) of the MFMA.

The audit committee was not properly established or not functioning properly

26. The audit committee did not dispense with all its duties as required by section 166(1) and (2)(a) of the MFMA.

The financial statements were not prepared in accordance with applicable legislation

27. The financial statements submitted for auditing did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit, of which some were corrected by management. Those that were not corrected were included in the basis for qualified opinion paragraphs.

The accounting officer did not adhere to his statutory responsibilities

28. The accounting officer did not take all reasonable steps to ensure that the fruitless and wasteful expenditure incurred was prevented as required by section 62(1)(d) of the MFMA.

Compliance with other enabling legislation

Environment Conservation Act of South Africa, 1989 (Act No. 73 of 1989)

29. Section 20(1)(a) of the act states that "No person shall establish, provide or operate any disposal site without a permit issued by the Minister of Water Affairs and that the Minister may issue a permit subject to such conditions as he may deem fit." Permits were not issued for the municipality's landfill sites located in Butterworth.

INTERNAL CONTROL

30. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA), but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• **Leadership**

Management's philosophy was positive, but oversight responsibilities over reporting, compliance with laws and regulations and internal control were not exercised and the accounting officer did not evaluate whether management had implemented effective internal controls with regard to the preparation of the financial statements. Management created a positive and effective environment to ensure that the municipality was adequately staffed to enable the finance department to function effectively.

• **Financial and performance management**

The financial statements and other information to be included in the annual report were not reviewed for completeness and accuracy prior to submission for auditing. Pertinent information was not identified in a form and time frame to support financial and performance reporting. An adequate working paper file was not prepared to support the financial statements in order for management to determine whether amounts and disclosures included in the financial statements were complete and accurate.

- **Governance**

The internal audit division was not effective in performing its duties and responsibilities as it was understaffed. The annual internal audit plan did not cover important risks to the municipality's operations, such as procurement and predetermined objectives. The plan was also not completed during the year, as five planned audits were not conducted. These limitations affected the adequate discharge of the audit committee's duties during the year under review. Review of the minutes of audit committee meetings revealed limited interaction between the municipality and the audit committee on such matters.

The audit committee did not exercise sufficient oversight over the implementation of the internal audit function, as the internal audit plan was approved late in the financial year and all planned audits were not completed. Furthermore, the internal audit division did not devote sufficient attention to high-risk areas of the municipality's operations. This contributed to the findings mentioned in the preceding paragraphs.

Auditor - General

East London

30 November 2010



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence