AUDITOR-GENERAL
SOUTH AFRICA

The accounting officer
Great Kei Municipality
Private Bag X2
Komga
4950

30 November 2010

Reference: 21298REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Great Kei 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, 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.

Auditing to build public confidence

Auditor-General of South Africa
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Kindly acknowledge receipt of this letter.

Yours sincerely

Signed

....
Rama Purushothaman (EL03)

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

Introduction

1. I have audited the accompanying financial statements of the Great Kei Local 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 the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with Standards of Generally Recognised Accounting Practice (GRAP) as set out in accounting policy notes 1 to 16 and in the manner required by the Municipal Finance Management Act of South Africa and the Division of Revenue Act of South Africa. 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.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act, 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 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 opinion

Corresponding figures

4. The accumulated surplus for the year ending 30 June 2010 is disclosed at R27 857 000 (2009: R4 312 000) on the face of the statement of financial position. Amounts disclosed for 2009 and the opening balances of 2010 that related to trade payables, trade receivables and accumulated surplus with a net effect of R6 110 000, R12 240 000 and R5 972 000 respectively, were not adjusted. Adjustments were required to correct and address misstatements and limitations that could not be quantified during my prior year audit. These misstatements resulted in me not to express an opinion on the financial statements for the year ended 30 June 2009.

Accumulated surplus

5. The municipality did not provide sufficient supporting documentation for journals amounting to R21 782 000. I was unable to confirm or verify by alternative means the nature of the general journals. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of the accumulated surplus balance disclosed in the financial statements.

6. The correction of prior year error, that relates to the implementation of Standards of Generally Recognised Accounting Practices, per the statement of changes in net assets amounting to R4 413 000 did not agree to the general ledger as at 30 June 2010 by an amount of R1 449 000. The financial statements furthermore did not include a note relating to the

correction of prior year errors and was not disclosed in line with GRAP 3, Accounting policies, Changes in accounting estimates and Errors, paragraph 49.

7. Detail to the change in accounting policy which decreased the accumulated deficit, previously reported, by R1 118 000 was included in the statement of changes in net assets and note 47 to the financial statements. The disclosure omitted the title of the standard affecting the change in accounting policy, the nature of the change, the impact on amounts disclosed in the current period and prior periods and reference to transitional provisions applied as required by GRAP 3, Accounting Policies, Changes in accounting Estimates and Errors, paragraph 28.

8. Standards of Generally Recognised Accounting Practice, GRAP 1, *Presentation of financial statements*, paragraph 48 and GRAP 3, *Accounting policies, Changes in accounting estimates and Errors*, paragraph 28 and 49, requires detailed disclosure of classification differences and correction of prior year errors. In the absence of adequate disclosure and reconciliations of comparative amounts to amounts disclosed in the audited prior year financial statements, I was unable to confirm or verify by alternative means the differences indentified in the comparative retained earnings that also increased the opening retained earnings by R6 633 000. Further, the prior year accumulated surplus balance in the statement of changes in assets exceeds the accumulated surplus balance in the statement of financial position by R7 235 000. In the absence of adequate disclosure and reconciliations of comparative amounts disclosed in the financial statements, I was unable to verify the accuracy of accumulated surplus balances.

9. Transactions that related to the year ended 30 June 2009 was included in the general ledger for the year ended 30 June 2010. Certain entries were passed to correct these transactions inappropriately recorded but the original entries processed were not fully eliminated. The entries not eliminated had a material impact on the valuation of cash and cash equivalents, current investments and VAT receivable of R388 000, R392 000 and R494 000 respectively.

Non-current borrowings

10. Non-current borrowings representing loans from DBSA amounting to R3 428 000 is disclosed in note 22 to the financial statements. The Komga Royal Hotel serving as security for the non-current borrowings and related detail are not disclosed in a note to the financial statements. Further, the current portion of DBSA loans amounting to R227 000 was not disclosed in the financial statements.

11. The municipality did not provide sufficient supporting documentation for debit journals amounting to R331 000 and credit journals amounting to R628 000 processed against non-current borrowings. I was unable to confirm or verify by alternative means the nature of the general journals. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself of the appropriate allocation of transactions processed to account for the movement in non-current borrowings.

Cash and cash equivalents

12. The municipality did not provide supporting documentation for the reconciling items in the year end bank reconciliation which increased the cashbook balance by R796 000. I was unable to confirm or verify these items by alternative means and could not confirm the valuation and completeness of cash and cash equivalents disclosed at R4 975 000 on the statement of financial position and note 1 to the financial statements.

Cash flow statement

13. Presentation of a cash flow statement, summarising the entity's operating, investing and financing activities is required by Standards of Generally Recognised Accounting Practice, GRAP 2, *Cash flow statements*. Cash flows from operating activities disclosed in the financial statements were

materially misstated as the surplus for the year disclosed in note 44 to the financial statements amounting to R15 359 000 (2009: R16 898 000) did not agree to the surplus disclosed in the statement of financial performance amounting to R16 310 000 (2009: 15 795 000). Cash flows from financing activities disclosed in the cash flow statements is materially misstated as the decrease in non-current borrowings amounting to R2 342 000 did not agree to the R202 000 repayments of borrowings disclosed in the cash flow statement. Further, differences amounting to R628 000 were noted between the loan amount per cash flow statement paid back during the year and the amount repaid during the year per the register.

Commitments

14. There was no contract management system in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of capital commitments amounting to R3 842 000 and lease commitments amounting to R414 000 disclosed in note 52 to the financial statements.

Contingent Liabilities

15. Documentation in support of contingent liabilities disclosed in note 54 to the financial statements that amounted to R2 121 000 could not be obtained. In the absence of explanations from management or further detail or confirmation of amounts applicable in documentation received from third parties, the valuation of the contingent liability could not be confirmed.

Employee Costs

16. The municipality could not provide sufficient appropriate payment documentation to support employee cost amounting to R4 782 000. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that employee costs were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, and classification of employee cost disclosed at R13 606 000 in the statement of financial performance.

17. The net pay of employees per the salary system amounting to R2 741 000 could not be linked to funds actually transferred to employees. Evidence in support of amounts actually transferred could not be obtained while Municipal records did not permit the application of alternative audit procedures to confirm whether the net pay amounts were correctly calculated. The net pay due to employees per the salary system furthermore exceeded funds transferred to the affected employees by an amount of R390 000.

18. Employee related cost and councillor remuneration disclosed in the statement of financial performance and totalling R16 156 000 could not be agreed to employee cost recorded in the payroll system that amounted to R15 720 000. No reconciliation or explanation could be obtained for the difference of R436 000 noted.

Irregular expenditure

19. Section 79 (1) (a) of the Municipal Finance Management Act 56 of 2003, states that the accounting officer of a Municipality must, for the proper application of this Act in the municipality's administration, develop an appropriate system of delegation that will both maximise administrative and operational efficiency and provide adequate checks and balances in the municipality's financial administration. The Municipality have operated for the year without a written financial delegation as required by the MFMA. Expenditure incurred amounting to R6 970 000 million was thus irregular as it was not authorised by the accounting officer of the Municipality.

20. Irregular expenditure amounting to R281 000 was incurred due to non-compliance to the municipal supply chain policy. The irregular expenditure was not identified by internal control systems at the municipality and was therefore not disclosed in the financial statements.

Unauthorised expenditure

21. Section 1 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003), defines unauthorised expenditure in relation to a municipality as "any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11 (3), and includes overspending of the total amount appropriated in the municipality's approved budget."The municipality's expenditure exceeded the approved budget by R6 245 000. This unauthorised expenditure were not disclosed in the financial statements of the municipality.

22. Section 15 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003), Appropriation of funds for expenditure states," municipality may, except where otherwise provided in this Act, incur expenditure only in terms of an approved budget; and within the limits of the amounts appropriated for the different votes in an approved budget. No provision was made in the approved budget for capital expenditure amounting to R834 000 incurred during the year. Furthermore, no review was performed on the impact in respect of expenditure on roads infrastructure for the current year referred to in paragraph 26 below.

Property, plant and equipment

23. The Municipal Infrastructure Grant expenditure of R7 176 000 as per the grants register exceeded additions to property plant and equipment amounting to R834 000 that was recognised for the year ended 30 June 2010. The Municipal Infrastructure Grant expenditure also did not agree to the "conditions met – transferred to revenue" amounting to R9 283 000 disclosed in note 31.2 to the financial statements. Property, plant and equipment carried at zero values for all years prior to 1 July 2009 and at cost for additions subsequent to this date were understated as expenditure on municipal infrastructure during the year were not capitalised and did not appear in the fixed asset register.

Unspent conditional grants

24. Revenue relating to Government grants and subsidies disclosed in the statement of financial performance amounted to R29 752 000 (2009:R26 134 000) and made reference to note 31 to the financial statements. MIG Grant revenue of R8 892 000 (2009: R4 762 000) and other government grant and subsidies of R1 119 000 (2009: R9 855 000) disclosed in note 31 did not agree with the R9 283 000 (2009: 5 719 000) for MIG grant disclosed in note 31.2 and the R916 000 (2009: R2 225 000) disclosed for other government grants and subsidies in note 31.3.

25. The municipality has incorrectly debited unspent conditional grant accounts with expenditure incurred thereby not accounting for unspent conditional grants in line with the standards of Generally Recognised Accounting Practice, GRAP 23, *Revenue from non-exchange transactions*, paragraph 42 which requires that an entity recognised as a liability the inflow of resources from a non-exchange transaction and that it reduce the carrying amount of the liability recognised and recognise an amount of revenue equal to that reduction. Payments amounting to R6 408 000 have not been recorded as either an expense or fixed asset and have not been recognised as revenue as per GRAP 23. The MIG grant furthermore disclose a debit balance of R664 000 in note 31.2 to the financial statements while the related investment account had a balance of R2 490 000. The unspent portion of the other remaining conditional grants amounted to R1 294 000 while the related investment accounts had a balance of R2 345 000.

Fruitless and wasteful expenditure

26. Section 125 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) states that particulars of any material losses and any material irregular or fruitless and wasteful

expenditures, including in the case of a municipality, any material unauthorised expenditure, that occurred during the financial year, and whether these are recoverable should be disclosed in the financial statements. The municipality did not disclose fruitless and wasteful expenditure amounting to R200 000 incurred as payment for damages for a controlled fire that was lit by municipal employees which burnt across various farmers' lands. The court came to the conclusion that the municipality was negligent and could have reasonably avoided the situation. Further fruitless and wasteful expenditure relating to penalties and interest expenditure incurred totalling R139 025 has not been disclosed in the financial statements.

Other financial liabilities

27. The municipality did not provide sufficient supporting documentation for amounts disclosed as 'other financial liabilities' amounting to R1 502 000. I was unable to confirm or verify by alternative means the nature of these amounts. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of other financial liabilities disclosed in the financial statements.

Fixed assets

28. The municipality did not provide sufficient supporting documentation for general journals amounting to R3 705 000. I was unable to confirm or verify by alternative means the nature of these general journals. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity of general journals and accuracy of fixed asset amounts disclosed in the financial statements. Further, a rateable valuation reconciliation was not provided.

29. Due to the deficiencies in the fixed asset register, I could not confirm that all assets were included in the financial statements at appropriate amounts, that the municipality owned the disclosed assets and that assets recorded in the finanical statements actually existed. The fixed asset register did not include sufficient information on assets relating to: the source of funding, disposals and withdrawals, identification numbers, detailed descriptions, acquisition dates, physical location details and department or vote details. In certain instances cost of the individual asset were not recorded. Further, no controls are in place to ensure that additions and disposals are updated correctly and timely.

30. The gross carrying value of fixed assets disclosed at R834 912 in note 11 to the financial statements does not agree to the fixed asset register which reflects a gross carrying value of R288 857. In the absence of reconciliations for the differences noted, I was unable to quantify assets not included in the annual financial statements and consequently I could not confirm by alternate means that all fixed assets that should have been included in the financial statements, have been included.

Investments

31. The investment account that supports investments amounting to R478 000 disclosed under non-current investments in the statement of finanical performance was closed on 30 June 2009. The cash on the closed account were transferred to a municipal bank account but the R478 000 loss was not recognised in the accounting records of the municipality.

32. GRAP 2, paragraph 07 states that cash comprises cash on hand and demand deposits which are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Investment balances as disclosed in note no. 2 of the annual financial statements amounting to R13 447 000 were not disclosed as cash and cash equivalents in the annual financial statements. These investments are redeemable within 90 days should be classified as cash and cash equivalents and disclosed in aggregate with positive bank account balances disclosed in note no. 1 of the financial statements.

33. Investments balances per the investment register exceeded the balances per the general ledger and the R13 447 000 investments disclosed under current assets in the statement of financial position by R2 924 000. The municipality furthermore did not provide sufficient supporting documentation for journals increasing investments by R16 610 000. Other account blances and transactions affected by the journals passed to account for the movement in the investments could not be identified As a result of inconsistencies and conflicting information, the impact on other account balances could not be assessed.

Expenses

34. The municipality could not provide sufficient appropriate audit evidence to support repairs and maintenance of R989 000. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all repairs and maintenance expenditure was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of repairs and maintance of R2 330 000 as disclosed on the face of the statement of financial performance.

35. General expenses was disclosed at R5 749 000 (2009: R8 774 000) in the statement of financial performance and note 40 to the financial statements. General expenses includes an amount of R598 000 that rerelating to services received in the prior year. Had the expense been accounted for in the correct accounting period, accounts payable in the corresponding figures would have increased by R598 000 and expenditure in the corresponding figures would have increased by the same amount. Expenditure for the year ended 30 June 2010 would have decreased while the opening accumulated surplus would have decreased by the mentioned amount.

36. Discrepancies were identified in general expenses disclosed in the annual financial statements in the claiming of input vat amounting and amounts paid to suppliers that did not agree to invoices amounting to R252 000. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that input vat was appropriately claimed on goods and services and that the correct amounts were paid to suppliers.

37. Sufficient appropriate audit evidence to support debit journal entries amounting to R818 000 and credit journal entries amounting to R417 000 processed against general expenses could not be provided. Documentation in support of expenditure amounting to R377 000 could furthermore not be obtained while accounting entries for payments amounting to R503 000 could not be identified in the accounting records of the municipality.

38. Sufficient appropriate audit evidence to support the receipt of goods and services amounting to R1 017 957 for which payments were made. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all goods and services procured from suppliers was received. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness and accuracy of general expenses disclosed on the face of the statement of financial performance. The limitations experienced prohibited the identification of symptoms of irregular expenditure and fraudulent activities.

39. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all operating expenses were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of general expenses disclosed. The limitations experienced prohibited the identification of irregular expenditure and fruitless and wasteful expenditure.

Trade and other payables

40. The municipality could not provide documentation in support of accounts payable that was disclosed at R6 392 000 (2009: R7 056 943) on the face of the statement of financial position and note 16 to the financial statements. A detailed accounts payable listing in support of the disclosed balance could not be obtained. Adequate supporting documentation to confrim the existence and valuation.

41. The municipality furthermore did not provide sufficient appropriate audit evidence to support project creditors amounting to R3 881 000 and accounts payable with a debit balance of R543 000. Accounts payable with debit balances should have been included under receivables if the existence and valuation of these accounts could be confirmed.

42. The municipality did not accrue for goods and services amounting to R186 000 received prior to 30 June 2010. Had these invoices been accrued expenditure and accounts payable for the year ended 30 June 2010 would have increased by R186 000.

43. International Accounting Standard 39 requires that the effect of the time value of money should be reflected in the purchase where this is material, i.e. an entity must record the purchases and the recognition of the payable at the present value of the future cash flows and accrue an interest expense until date of payment. The effect of discounting has to be considered for each and every purchase transaction made throughout the year, and the outstanding creditors at year-end. . The fair value of trade and other payables did not agree to the accounts receivable balances disclosed in the annual financial statements by an amount of R101 000.

44. I was unable to confirm or verify by alternative means the nature of amounts disclosed as creditors due to the limitations set out in the paragraph 38 and 39 above. I, furthermore, could not confirm the timing of receipt of goods and services to supporting documentation. I, consequently did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation, completeness and obligation relating to trade and other payables disclosed in the financial statements.

Provisions

45. The provision for leave of R974 199 disclosed under note 20, inappropriately took into account non-accumulative leave days. Had the non-accumulated leave days been appropriately excluded from the calculation of the leave provision the liability would have decreased by R917 000.

46. Standard of Generally Recognised Accounting Practice, GRAP 19, Provisions,contingent liabilities and contingent assets, paragraph 20 requires a provision to be recognised when an entity has a present obligation and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Performance bonuses of R578 000 are disclosed in note 20 to the financial statements. Evidence demonstrating that a liability exist or that an outflow of resources is probable to performance bonuses of R190 000 provided could not be obtained. The performance bonus reflected in note 20 furthermore inappropriately includes a provision for annual bonuses amounting to R387 000. The Standard of Generally Recognised Accounting Practice, GRAP 19, Provisions,contingent liabilities and contingent assets, states that a provision is a liability of uncertain timing or amount. As there is no uncertainty relating to the amount or timing of annual bonuses the amount should have been allocated to accounts payable and not provisions.

47. Section 28 of National Environmental Management Act No 107 of 1998, imposes an obligation on every person who causes damages to the environment to take remedial action to remedy

the damage caused. The legal obligation on the municipality for the restoration of the disposal sites was not recognised as provisions due to the application of Directive 4 issued by the Accounting Standards Board (ASB). Information relating to the nature of the obligation the timing of outflows and uncertainties relating to the provision were however not disclosed as required by the Standards of Generally Recognised Accounting Practice, GRAP 19, Provisions,contingent liabilities and contingent assets paragraph 105.

Trade and other receivables

48. R16 283 000 (2009: R16 515 000) on the face of the statement of financial position and note 2 to the financial statements. The gross balance of trade and other receivables disclsoed in note 2 amounting to R19 283 000 (2009: R14 937 000) did not agree to the service debtors ageing of R20 366 000 (2009: R14 942 000) disclosed in the same note. The accounts receivable balance of R19 411 000 in the general ledger did not agree to the balance of R20 738 000 disclosed in the debtors age analysis in the municipal accounting system and the difference of R1 326 000 was not reconciled. I could not determine the effect of the noted discrepensies on the other account balances.

49. The municipality could not provide sufficient appropriate audit evidence to support a suspense account with a balance of R368 000 included under trade and other receivables. The municipality's records did not permit the application of alternative audit procedures regarding the accounts receivable suspense account.

50. Provision for doubtful debts amounting to R4 055 000 (2009: R14 937 000) is disclosed in note 2 to the annual financial statements. Re-assessment of debtors indicate that the disclosed provision may be understated by R15 135 000. Doubtful debts could however not be estimated reliably due to the inconsistencies and errors noted in the debtors balances. Further, the reconciliation of the doubtful debt provision disclosed in note 2, did not reflect any movement in the provision. The balance at 30 June 2010 of R4 055 000 agreed to the balance of the provision as at 30 June 2009 per the audited prior year financial statements but did not agree to the R14 948 000 negatively reflected as corresponding figure to doubtful debt provisions in note 2.

51. Interest was not charged on overdue accounts as required by section 97(1)(e) of the Local Government Municipal System Act, Act No.32 of 2000. Due to limitations set out in the paragraphs above, I could not reliably estimate the impact that interest charges not levied had on income and debtors due to the inconsistencies and errors noted in the debtors balances.

52. International Accounting Standard 39 requires that the receivable be initially recognised at its fair value, and this would take into account the effect of the time value of money. The effect of discounting has to be considered for each and every non-cash sales transaction made throughout the year, and the outstanding debtors at year-end. The fair value of accounts receivable did not agree to the accounts receivable balances disclosed in the annual financial statements by an amount of R1 274 000. Furthermore, the debtors balances were not discounted as there was no interest charged on long outstanding balances.

53. The municipality did not provide sufficient supporting documentation for large debtors balances amounting to R1 016 000 included in the accounts receivable balances of R19 283 000 disclosed in note 2 of the annual financial statements. I was unable to confirm or verify by alternative means the nature of these amounts. Consequently, i did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence and valuation of trade and other receivables disclosed in the financial statements.

54. The municipality did not provide sufficient supporting documentation for journals amounting to R4 688 000. I was unable to confirm or verify by alternative means the nature of the general journals. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself

as to the valuation and completeness of the receivables balance disclosed in the financial statements

55. Management could not explain the differences noted in paragraph 47 to 50 above while amounts disclosed were not reconciled to the underlying accounting records. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation of the accounts receivable balance of R16 163 000.

Other financial assets

56. The municipality did not provide sufficient supporting documentation for amounts disclosed as other current financial assets amounting to R434 000. I was unable to confirm or verify by alternative means the nature of these amounts. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of other financial liabilities disclosed in the financial statements.

Revenue

57. Discrepancies were noted in the disclosure of grants in the annual financial statements in note 21 and note 31.2 and 31.3. Further discrepancies were noted between government grants and subsidies disclosed in the statement of financial performance and these notes to the annual financial statements.
58. Electricity income amounting to R2 500 000 million forms part of total income disclosed in the statement of financial performance. A recalculation of the estimated electricity income based on electricity purchases that took into account maximum electricity losses allowed by the National Electricity Regulator (NER) indicated a loss of electricity income in excess of R3 000 000 due to unbilled usage.

59. Registers for direct and other income were not maintained. Originating source - and supporting documentation to direct and other income, amounting to R7 040 000, could furthermore not be obtained. In the absence of alternative audit procedures it could not be confirmed that all direct and other income were accurately and appropriately accounted for. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of direct and other income included in revenue.

60. I could not satisfy myself as to the accuracy and completeness of rates and refuse removal as disclosed at an amount of R9 787 000 in note 26 and 27 respectively due to assessment rates undercharged by R 1 989 000 and refuse removal undercharged at R1 063 000. Further properties were identified that were not recorded on the valuation roll amounting to R 1 114 000.

Leases

61. Lease agreements could not be obtained for operating lease expenditure amounting to R414 394, disclosed in note 52.2 to the financial statements. I was unable to confirm or verify by alternative means the nature of these amounts. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of lease commitments disclosed in the financial statements. Consequently, operating lease expenditure is overstated and general expenses is understated by R414 394.

VAT

62. Net VAT receivable included in the financial statements amounted to R2 872 000 at year end. VAT receivable per the accounting records was not assessed to be reasonable. The amounts disclosed were less than the SARS confirmed balance by R769 000. Furthermore, the VAT receivable disclosed in note 18 of the annual financial statements does not include the effect of VAT due on amounts receivable from debtors. VAT due on debtors could not be estimated due to the fact that the accounting system of the municipality cannot differentiate between the

different types of service revenue incorporated debtor balances. VAT receivable included in the annual financial statements is misstated by R330 000.

63. VAT due to the municipality as at 30 June 2010, according to a confirmation received from the South African Revenue Services totalled R1 906 000 and VAT calculated as per municipal accounting records totalled R3 216 000. In the absence of reconciliations for the differences noted, Due to limitations placed on the scope of my work and municipal records not permitting the application of alternative audit procedures, I was unable to quantify the impact on VAT included under debtors, creditors, expenditure and revenue.

Disclosure and other matters

64. The Standards of Generally Recognised Accounting Practice, GRAP 1, *Presentation of financial statements*, paragraph 20, require that a fair presentation, in virtually all circumstances, is achieved by compliance in all material respects with applicable Standards of GRAP and requires an entity to present information, including accounting policies, in a manner which provides relevant, reliable, comparable and understandable information. Material deficiencies and omissions including inadequate descriptions of the impact of the application of transitional provisions were identified in the disclosure of information in the financial statements.

65. The Standards of Generally Recognised Accounting Practice GRAP 1, *Presentation of financial statements*, Para 12 requires a comparison with the budgeted amounts for a reporting period to be included in the financial statements where the financial statements and the budget are on the same basis of accounting. The municipality did not include a summary of variances between the budget and actual amount as an appendix to the financial statements.

Disclaimer of opinion paragraph

66. 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 these financial statements.

Emphasis of matter

I draw attention to the matters below. My opinion is not modified in respect of these matters:

67. The annual financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practice (GRAP), issued by the Accounting Standards Board in accordance with Section 122(3) of the Municipal Finance Management Act, (Act No. 56 of 2003). In accordance with section 122(3) of the Municipal Finance Management Act, (Act No. 56 of 2003), the Municipality has adopted Standards of GRAP issued by the Accounting Standards Board during the financial year, which are fundamentally different to the funds accounting policies adopted in previous financial years. Comparative amounts have been restated retrospectively to the extent possible.

68. Misstatements in the corresponding figures were corrected in the financial statements of the current year. Management corrected the misstatement identified in the prior year audit by restating the corresponding figures as set out below. The differences included in the table below were not appropriately disclosed in the annual financial statements:

Account Description	Corresponding figures excluding changes in accounting policy & prior year errors	Audited 2009 trial balance per prior year file	Difference
Accumulated (surplus)/deficit	11 482 308.06	4 849 287.48	6 633 020.58
Cash and cash equivalents	4 963 596.05	10 767 798.05	(5 804 202.00)
Consumer deposits	(93 049.20)	(93 827.09)	777.89
Current provisions	(963 078.00)	(963 078.00)	-
Employee related cost	7 728 007.28	11 414 906.26	(3 686 898.98)
Expenditure	10 020 300.06	12 546 696.32	(2 526 396.26)
Inventory		223 165.00	(223 165.00)
Investments	6 136 857.34	(4 461 807.34)	10 598 664.68
Non-current receivables	11 593.71	11 593.71	-
Payables	(17 200 101.18)	(23 960 361.68)	6 760 260.50
Receivables	21 135 073.18	23 916 971.63	(2 781 898.45)
Revenue	(39 303 916.88)	(34 251 344.34)	(5 052 572.54)
Unspent Conditional Grants	(3 917 590.58)		(3 917 590.58)
Grand Total	**(0.16)**	-	**(0.16)**

Funding of operations/ financial sustainability/ Going concern

69. The municipality is largely dependent on the financial support received from government. In the absence of grants and subsidies, the municipality will not generate sufficient internal revenue to fund expenditure. This material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern was disclosed in accounting policy 1.3 to the financial statements.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

70. 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 key laws and regulations compliance with the following key laws and regulations, the Municipal Finance Management Act, No 56 of 2003 (MFMA) ,the Municipal Regulations (Regulations - GNR/GN), the Division of Revenue Act, No 12 of 2009 (DoRA) and the Municipal Systems Act, No 32 of 2000 (MSA), noted in paragraph 74 to paragraph 80 below, and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

Inadequate content of integrated development plan

72. The Integrated Development Plan does not reflect general Key Performance Indicator's as prescribed in terms of section 43 of the Municipal Systems Act (Act No. 32 of 2000).
73. The key performance indicators set by the municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.
74. The Integrated Development Plan (IDP) of the municipality did not include a financial plan.
75. Development objectives reflected in IDP do have a budget allocation.

76. Adequate policies and procedures are not in place for the drafting, adoption and implementation of the IDP.

77. The performance targets disclosed in the IDP for the municipality are inconsistent with the Annual Performance report. Further, the annual performance report was not included in the prior year annual report.

Usefulness of information

Inadequate presentation of reported information

78. Objectives reflected in the IDP have been reworded on the Annual Performance Report.

79. The annual report does not comply with prescripts of Section 46, par 1 and 2 of the Municipal Systems Act.

80. The service delivery and budget implementation plan does not reflect the requirements of Circular 13 of the MFMA. Further, the service delivery budget and implementation plan does not reflect service delivery targets and performance indicators for each quarter as required by Chapter 1 of the Municipal Finance Management Act No 56 of 2003.

Reliability of information

Reported information not consistent with planned objectives, indicators and targets

81. Key performance indicators do not include input indicators, outcome indicators and output indicators.

82. No controls in place to ensure achievement of performance objectives. Further, achievement of performance reflected in the annual performance report is vague.

83. No information could be provided to support activities performed for performance measurement.

84. The community was not invited to make presentations on the annual report.

85. Evidence of mayoral review of section 71 and 72 reports was not provided for review.

Compliance with laws and regulations

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

86. The municipality does not have one or more committees necessary for the effective and efficient performance of any of its functions or the exercise of any of its powers

87. Section 131 (1) of the Municipal Finance Management Act states that: "A municipality must address any issues raised by the Auditor-General in an audit report. Evidence that issues raised by the Auditor-General were properly addressed was not obtained.

88. Section 62(1)(c)(i) of the MFMA states that: the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. No evidence could be obtained that there was a formal risk assessment process in place.

89. Certain independence declarations were not maintained by the municipality for supply chain management.

90. The municipality did not have an audit committee as required by section 166(1) and (2) of the MFMA.

91. The municipality no longer has an internal audit function as required by section 165(1) and (2) of the MFMA after resignation of the Head of Internal audit.

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

92. The municipality did not comply with Section 27 and 28 of the DoRA. The municipality under spent grant funds and was not in compliance with Section 27(1)(c) of the DoRA. MIG withheld funds were later released to the municipality at 3 March June 2010, subsequent to further correspondence with the Department of Cooperative Governance and Traditional Affairs.

93. The tariff structure applied in current financial year does not agree with the tariff structure approved by the National Electricity Regulator of South Africa. The municipality could not provide evidence of approval of deviations from the approved tariff structure. Further, no documentation could be provided as evidence that the municipality is licensed by the National Electricity Regulator of South Africa to supply electricity.

INTERNAL CONTROL

94. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the the Municipal Finance Management Act, No 56 of 2003 (MFMA), the Municipal Regulations (Regulations - GNR/GN), the Division of Revenue Act, No 12 of 2009 (DoRA) and the Municipal Systems Act, No 32 of 2000 (MSA), but not for the purpose of expressing an opinion on the effectiveness of internal control.

95. 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

96. The municipality does not follow up on council minutes and resolutions and implement resolutions taken in a timely manner.

Financial and performance management

97. The municipality's payroll and financial system are not integrated and no monthly reconciliations are performed between the general ledger and the payroll records to identify any unreconciled items.

98. The GRAP framework for the preparation and presentation of financial statements required the municipality to prepare financial statements on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent are received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. The recording of creditors does not always occur on receipt of goods as the municipality does record transactions on an accrual basis. The impact thereof cannot be determined.

Governance

99. Difficulties were experienced during the audit on submission to the Auditor-General of such information, returns, documents, explanations and motivations as may be prescribed or as may be required by section 74 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

OTHER REPORTS

Investigations

100. Investigations are being conducted by external investigators on cheque fraud and an unauthorised attempt to misappropriate funds from the main bank account amounting to R600 000. The municipality did not suffer any financial losses as all funds were recovered. The investigation was still ongoing at the reporting date.

Auditor General

East London

30 November 2010

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence