

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ngqushwa 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, and a summary of significant accounting policies and other explanatory information, 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 South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa, (DoRA). 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, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with 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.

Bases for qualified opinion

Trade and other payables from exchange transactions

7. Included in trade and other payables is an amount for staff leave accrual, but due to inadequate leave records and discrepancies in such records, I was unable to determine the accuracy and valuation of the leave accrual amount of R441,217 (2008-09: R568,259) as disclosed in note 15 to the financial statements. The municipality's records also did not permit the application of adequate alternative audit procedures.

Revenue

8. Included in fines, licences and permits as disclosed in the statement of financial performance is an amount of R1,1 million which relates to traffic income. I was unable to verify the completeness of such revenue as there were missing receipt numbers that could not be explained.

Restatement of corresponding figures

9. As disclosed in note 30 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors identified from the prior year audit.
10. No supporting documentation was available for a journal entry of a credit of R725,626, affecting revenue and a debit of R2,7 million affecting salaries. Furthermore, the municipality could not provide sufficient appropriate audit evidence to support journal entries of R640,944 restating trade and other payables, R591,221 restating VAT receivables and R149,382 restating Housing Development Fund. I was therefore unable to establish if the correcting entry had been captured in the correct accounting period and if it was accurately disclosed. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all restatement of corresponding figures was properly recorded.

Opinion

11. In my opinion, except for the 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 Ngqushwa Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practice and in the manner required by the Municipal Finance Management Act of South Africa

Emphasis of matter

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

Fruitless and wasteful expenditure

13. Fruitless and wasteful expenditure to the amount of R19,912 was incurred, for interest and penalties related to late payments made to the South African Revenue Services, as disclosed in note 35 to the financial statements.
14. The municipality also incurred fruitless and wasteful expenditure of R417,134, as disclosed in note 35 with respect to the removal of Councillors and the non-compliance with paragraph 1.1(c) and (d) of the municipality's Code of Conduct, which resulted in a defamation claim being brought against the Municipality in which a settlement agreement was reached.

Irregular expenditure

15. As disclosed in note 36 to the financial statements, irregular expenditure to the amount of R3,5 million was incurred, as proper supply chain management processes had not been followed.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. 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), Municipal Regulations, Division of Revenue Act, No 12 of 2009 (DoRA), Municipal Systems Act, No 32 of 2000 (MSA), and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

Included below are findings related to material non-compliance with the regulatory and reporting requirements.

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

Annual report not submitted to the relevant authorities

17. Contrary to the requirements of section 127(5)(b) of the MFMA, the municipality did not submit the annual report to the relevant provincial treasury and the provincial department responsible for local government in the province, immediately after it was tabled in the council.

Annual report not submitted within legislated timeframe

18. As required by section 132 of the MFMA, the municipality did not submit the annual report and oversight reports to the provincial legislature within seven days after the municipal council had adopted the relevant oversight report.

Municipal Planning and Performance Management Regulations, 2001

Performance audit committee not appointed

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

Municipal Systems Act of South Africa, No 32 of 2000 (MSA)

Performance measurements not audited by internal audit

20. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

Performance management framework not adopted

21. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of section 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Integrated Development Plan did not include financial plan

22. The integrated development plan of the municipality did not include a financial plan, as required by section 26(h) of the MSA.

Comparisons between current year targets and previous years not included in reported pre-determined objectives

23. The reported predetermined objectives to be included in the annual report does not include comparisons between performance in the current year with targets set for the current and previous financial years, as required by section 46 of the MSA.

Usefulness of information

24. 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?

Included below are findings related to the usefulness of information.

25. Fifty-five percent (55%) of the planned and reported targets were not:
- Specific in clearly identifying the nature and the required level of performance;
 - Measurable in identifying the required performance;
 - Time bound in specifying the time period or deadline for delivery.
26. Twenty-four percent (24%) of the planned and reported indicators were not clear, with an unambiguous definition to allow for data to be collected consistently.
27. Thirty percent (30%) of the planned and reported indicators were not verifiable, as it was not possible to validate the processes and systems that produce the indicator.
28. Inspection of the municipality's annual performance report revealed the format/content of the report was not clearly presented.

Reliability of information

29. The following criteria were used to assess the reliability of the planned and reported performance:
- Validity: Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
 - Accuracy: Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
 - Completeness: All actual results and events that should have been recorded have been included in the reported performance information.

Included below are findings related to the reliability of information.

30. The validity accuracy and completeness of 28,8% of the reported targets could not be established as sufficient appropriate audit evidence could not be provided for audit purposes.
31. Inspection of the municipality's quarterly reports revealed the format/content of the quarterly reports was not consistent with the performance objectives as per the integrated development plan and these reports were not clearly presented.
32. The municipality has not reported on its performance against predetermined objectives, indicators and targets which is consistent with the approved integrated development plan.
33. The municipality reported on objectives, indicators and targets in addition to those as per the approved integrated development plan. Furthermore, these additional objectives, indicators and targets were not approved subsequent to the strategic planning process and were not explained in the annual performance report.

Compliance with laws and regulations

Included below are findings related to material non-compliance with the acts as indicated.

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

Material misstatements corrected in the financial statements

34. In order for the financial statements to meet the requirements of section 122(1) of the MFMA, material misstatements identified during the audit were corrected by management.

Annual budget not tabled and approved within legislated timeframes

35. As required by section 16 of the MFMA, the mayor of the municipality did not table the annual budget at a council meeting at least 90 days before the start of the budget year. Contrary to section 24, the municipal council did not approve the annual budget at least 30 days before the start of the budget year.

National Treasury not informed immediately of payments due by other organs of state

36. Non-compliance with the requirements of section 64 of the MFMA was identified, in that the accounting officer did not immediately inform the National Treasury of any payments due by an organ of state to the municipality in respect of municipal tax or for municipal services, where such payments are regularly in arrears for periods of more than 30 days.

Expenditure was not paid within the parameters set by the applicable legislation

37. Contrary to the requirements of section 65(2)(e) of the MFMA, the municipality's expenditure was not paid within the required 30 days from the receipt of an invoice, or such a period as prescribed for certain categories of expenditure.

Non-timeous tabling and adoption of the oversight report

38. The requirements of section 129 of the MFMA were not met, in that the oversight report to the 2008-09 annual report, as prepared by the oversight committee, was not submitted to council timeously (by 31 March 2010). As a result of the non-timeous tabling and adoption of the oversight report, the accounting officer was also unable to make public such oversight report in April 2010, as required.

Annual report not publicised adequately

39. As required by section 127(5) of the MFMA, the municipality did not adequately publicise the 2008-09 annual report.

Internal audit unit not fully functional during the year

40. Contrary to the requirements of section 62(1)(c) and 165 of the MFMA, the municipality did not have a fully functional internal audit unit during the year and did not perform an annual risk assessment.

Audit committee non-existent for the financial year

41. The municipality did not have an audit committee for the financial year and therefore did not comply with section 166 of the MFMA.

Value-Added Tax Act, No 89 of 1991

Vat erroneously claimed on accrual basis instead of payment basis

42. The municipality did not comply with section 16(1) of the Value Added Tax Act No 89 of 1991, in that the municipality erroneously claimed input tax on an accrual basis instead of a payment basis.

INTERNAL CONTROL

43. 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), Municipal Regulations, Division of Revenue Act, No 12 of 2009 (DoRA), Municipal Systems Act, No 32 of 2000 (MSA), but not for the purpose of expressing an opinion on the effectiveness of internal control.
44. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

Oversight responsibility over the preparation of financial statements, reporting on predetermined objectives, compliance with the laws and regulations and internal control was not adequately exercised by the accounting officer.

- **Financial and performance management**

The municipality has not selected and developed internal controls to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives, signifying weaknesses in accountability and reporting practices. As a result, significant misstatements in the financial statements were not identified by management, which negatively affected the quality and reliability of the report on pre-determined objectives and the financial statements initially submitted for audit. As a result, material adjustments had to be made to the financial statements submitted for audit.

- **Governance**

Risk identification and management processes are not designed to identify changes in processes or risks and verify that the design of underlying controls remain effective.

There was no audit committee during the financial year. Accordingly, the audit committee did not meet prior to the submission of the financial statements and the report on pre-determined objectives for auditing on 31 August 2010, to review the adequacy, reliability and accuracy of thereof.

Internal audit has not been effective during the financial year due to a lack of direction and instability within the internal audit unit.

There was no risk assessments conducted during the financial year. Furthermore, the fraud prevention plan was rolled out to councillors and municipal employees in March 2010. As a result the fraud prevention plan was not effective for the majority of the year.

Auditor-General

East London

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

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