

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

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Nkonkobe Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, the 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, 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 Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act (Act No. 56 of 2003) (MFMA) and the 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 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**

#### **Comparatives**

4. In my previous audit report dated 22 February 2010, I was unable to express an audit opinion on the financial statements of the municipality for the year ended 30 June 2009. The disclaimer matters have not been adequately resolved and my audit report is modified regarding the corresponding figures.
5. In addition, these uncorrected disclaimer matters are of a pervasive and material nature and the impact on the current year balances could not be determined. As a result my opinion on the current period financial statements is also modified.

#### **Cash and cash equivalents**

6. The municipality could not provide sufficient appropriate audit evidence to support a reconciliation between the cash and cash equivalents stated in the statement of financial position at R34,879,910 and the amount of R3,624,976 confirmed by the

financial institution. Therefore I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation of cash and cash equivalents. As a result of this limitation of scope the impact on the accuracy and completeness of revenue, expenditure and fixed assets cannot be determined.

7. Due to the above limitation of scope and ineffective internal controls the possibility of fraud cannot be eliminated.

#### **Trade and other receivables from exchange transactions**

8. As stated in note 4 to the financial statements other receivables from exchange transactions includes Sundry Debtors of R35,691,292, Other Debtors of R10,727,097 and Bank suspense accounts of R1,235,502. These balances emanate from previous financial periods and I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation and allocation of these receivables.
9. During the audit work performed on trade debtors it was identified that in certain instances the billing integration did not occur on a monthly basis for all debtors. Consequently sufficient appropriate audit evidence could not be obtained to verify the completeness of revenue and receivables.
10. Trade debtors as disclosed in note 4 of the financial statements of R17,315,289 represents the net amount of gross trade debtors of R95,702,178 and a debt impairment of R78,385,099. No supporting documentation was available for the calculation or basis of this debt impairment. In addition, included in the trade debtor balance are amounts which have been outstanding for a long period of time and for which no payments have been received subsequent to year end. Consequently there is significant uncertainty regarding the recoverability of R12,732,317 of this balance.
11. The debt impairment applicable to the current year charge of R13,012,530 was not included in the statement of financial performance and therefore expenditure is understated by the said amount.
12. The comparative amount for trade debtors in note 4 of the financial statements is overstated by R98,917 as compared to the prior year audited financial statements. Although this amount is not individually significant the classification differences between trade and sundry debtors could not be substantiated. As disclosed in note 4 to the financial statements the comparative amount for trade debtors reflects a credit balance of R26,932,567 as compared to the prior year audited financial statements debit balance of R8,347,105. The corresponding amount for sundry debtors is disclosed as R48,487,269 in note 4 of the financial statements as compared to the prior year audited financial statements of R13,108,680.
13. Trade and other receivables were not disclosed and measured at fair value taking into account imputed interest as required by the International Financial Reporting Standards, IFRS 7, Financial Instruments: Disclosure and International Accounting Standards, IAS 39, Financial Instruments: Recognition and Measurement respectively. Consequently revenue is overstated by approximately R329,906 and interest income understated by approximately R307,079.

#### **VAT receivable**

14. A reconciliation of the net VAT receivable of R4,124,711 reflected in the financial statements to the balance per a confirmation received from the South African Revenue

Service of R4,454,523 could not be obtained. It was therefore not possible to determine the reason for the difference of R329,812. Although this difference is not material the impact of the errors in VAT calculations on expenditure and VAT adjustments in revenue, discussed in paragraphs 31 and 24 of this report, the net VAT receivable is uncertain.

#### **Other receivables**

15. There was no supporting documentation to corroborate an amount of R5,173,149 disclosed as other receivables on the Statement of Financial Position, and as a result I could not obtain reasonable assurance to the existence, rights, completeness, valuation and allocation of such other receivables.

#### **Trade and other payables**

16. Included in trade payables in note 7 to the financial statements is an amount of R1,831,683 which represents a reclassification of debtors with credit balances. Upon further investigation this amount constitutes unallocated deposits and due to the lack of internal control and no reconciliation performed by management sufficient appropriate audit evidence could not be obtained to verify the existence, rights and valuation of this balance. In addition the impact on trade debtors and revenue cannot be determined.
17. As per note 7 in the financial statements trade payables includes an amount of R2,394,158 and other payables of R10,633,259 disclosed as due by the municipality. The amount was recognised in a prior financial reporting period and the municipality was unable to provide an explanation or supporting documentation to support the amounts disclosed. As a result I am not able to confirm the valuation, rights and obligations and existence of this amount disclosed as trade and other payables.
18. A difference of R802,544 was identified between the amount disclosed in note 7 to the financial statements for trade payables and the general ledger. No supporting documentation was available for this overstatement. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, valuation and allocation of the trade payables balance.
19. Included in other payables is an amount of R40,415,007 for unidentified deposits. These amounts should either have been allocated to the appropriate debtors account or recognised as revenue depending on the source of the deposit. The municipality's records did not permit the application of alternative audit procedures and consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the allocation of monies received. As a result revenue and trade receivables are understated and overstated respectively by an unknown allocation of the above amount.
20. Trade and other payables were not disclosed and measured at fair value taking into account imputed interest as required by the International Financial Reporting Standards, IFRS 7, Financial Instruments: Disclosure and International Accounting Standards, IAS 39, Financial Instruments: Recognition and Measurement respectively. Consequently interest expenditure is understated by approximately R929,089 and payables understated by approximately R447,853.
21. Included in trade and other payables from exchange transactions in note 7 to the financial statement is an amount of R1,737,732 for accrued bonuses. This amount represents a thirteenth cheque paid to employees in their birthday month. However the liability at year end was not calculated on a pro-rata basis and is therefore overstated by approximately R595,348.

22. Included in trade and other payables from exchange transactions in note 7 to the financial statement is an amount for deposits received of R941,808. The municipality does not maintain a register of these consumer deposits and therefore I could not confirm the completeness and accuracy of this balance.

#### **Property, plant and equipment**

23. Included in property plant and equipment on the Statement of Financial Position is an amount of R705,000 relating to an asset which was paid for during the year under review but only delivered after year end. In terms of the Standards of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial statements*, an asset is a resource controlled by the entity from which future economic benefits or service potential are expected to flow to the entity. Therefore property, plant and equipment is overstated and receivables understated by the said amount.
24. Included in infrastructure assets as disclosed in note 4 of the financial statements is an amount of R4,843,355 for expenditure incurred on projects in progress. However general ledger transactions amounting to R5,621,744 were identified as relating to these projects and the difference of R778,389 could not be explained. Based on the error rate identified in my sample property, plant and equipment is understated by approximately R2,606,810. In addition due to the difference identified in cash and cash equivalents in paragraph 6 of this report unallocated transactions exist which may relate to fixed assets. Therefore I could not satisfy myself to the completeness of fixed assets.

#### **Unspent conditional grants and receipts**

25. The amount of unspent conditional grants and receipts of R4,207,955 disclosed on the Statement of financial position does not correspond with the closing balances of the MIG call accounts of R2,769,810. The difference of R1,438,145 was not substantiated and therefore I could not satisfy myself as to the valuation, obligation and existence of this account balance.

#### **Other loans**

26. The balance of other loans on the Statement of financial position includes an amount of R4,357,789 owing to the Development Bank of South Africa (DBSA). However a difference of R823,747 was identified between this disclosure and a confirmation received directly from the financial institution. Therefore I could not confirm the completeness, obligations, valuation and allocation of other loans.

#### **Suspense accounts**

27. There was no supporting documentation to corroborate an amount of R429,305 disclosed as suspense accounts on the Statement of Financial Position. Although this amount may not appear individually material it constitutes significant debit and credit entries which have a net effect on the balance. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, valuation and allocation of the current liabilities suspense account balance.

#### **Government grants and subsidies**

28. Government grants and subsidies as stated on the Statement of Financial Performance includes an amount of R56,652,108 relating to equitable share. However the amount granted in terms of the Division of Revenue Act (DORA) gazette was R 59,612,000 and a reconciliation or explanation could not be obtained for the difference of R2,959,891. Therefore I did not obtain sufficient appropriate audit evidence to satisfy myself to the

completeness of grant revenue.

29. In addition Government grants and subsidies as stated on the Statement of Financial Performance includes an amount of R250,000 received and no supporting documentation could be provided to substantiate the validity of this receipt. Consequently I could not satisfy myself as to the completeness of grant revenue.
30. In terms of Section 43(c) of GAMAP 9, *Revenue*, government grants are recognised as revenue to the extent that there has been compliance with any restrictions associated with the grant. The amount of R79,860,972 reflected as government grants and subsidies on the Statement of Financial Performance includes an amount of R20,810,000 which has been recognised in the financial period in which the monies were received. However conditional grants should only be recognised to the extent expenditure has been incurred in relation to such grants. Due to the misstatements identified in expenditure and the limitation of scope on cash and cash equivalents, sufficient appropriate audit evidence could not be obtained to satisfy myself to the accuracy of government grants and subsidies.

#### **Revenue**

31. Included in sundry income on the Statement of Financial Performance is an amount of R4,919,317 relating to VAT adjustments. However sufficient appropriate audit evidence could not be obtained to satisfy myself to the occurrence, completeness, accuracy, cut-off and classification of such revenue.

#### **Interest received (trading)**

32. The interest rate applied to overdue debtors was not affected in line with changes in the prime rate during the year under review. The municipality's credit control policy states that any amount which remains due and payable after a period of 30 (thirty) days shall attract interest at prime plus 1%. Therefore interest received is overstated by an estimated R730,069 and the corresponding trade debtors is understated by the same amount.
33. Furthermore as a result of the misstatement of trade debtors (refer to paragraph 8) sufficient appropriate audit evidence could not be obtained to verify completeness of interest received.

#### **General expenditure**

34. Expense transactions were identified for which the VAT was duplicated and the extent of the expenditure overstatement could not be determined. Furthermore the entity could not provide sufficient appropriate audit evidence to support journal entries of R16,179,919 relating to VAT adjustments. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of general expenditure.

#### **Commitments**

35. Commitments to the amount of R1,750,419 as disclosed in note 23 of the financial statements did not correspond with a schedule of project commitments for R17,437,049. The entity could not provide an explanation for not disclosing the difference and therefore commitments is understated by R15,686,630.

### **Contingencies**

36. The municipality omitted a note on contingent liabilities in the financial statements and therefore contingent liabilities as a result of litigation and claims pending is understated by R10,337,247. In addition contingent assets of R764,421 relating to litigation in progress has not been disclosed in the financial statements.

### **Post retirement benefits**

37. The municipality did not consider or recognise a defined benefit obligation in the financial statements as required by IAS 19, *Employee Benefits*. An actuarial valuation was not obtained by the municipality and therefore I could not obtain sufficient appropriate audit evidence to confirm the omission of a value relating to the current obligation for post retirement benefits.

### **Related parties**

38. International Public Sector Accounting Standard, IPSAS 20, *Related party disclosures* requires disclosure of the remuneration of key management personnel and the number of individuals. The remuneration of four members of key management personnel was not included in disclosure note 15 to the financial statements, resulting in the disclosed key management personnel remuneration amount being understated by R1,520,668.
39. Furthermore IAS 24, *Related Parties*, read with IPSAS 20 states that relationships between the municipality and any related party shall be disclosed irrespective of whether there have been transactions between those related parties. However the financial statements of the municipality do not include a note on related parties.

### **Irregular expenditure**

40. Section 38(1)(a)(iii) of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) requires the entity to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Irregular expenditure amounting to R2,082,615 as a result of various minor breaches to the Supply Chain Management Policy was identified during the audit which has not been disclosed in the financial statements.

### **Unauthorised expenditure**

41. The prior year financial statements note 28 reflects a balance of unauthorised expenditure of R5,766,037. However this has not been disclosed in the current period annual financial statements. In addition an amount of unauthorised expenditure of R558,184 was identified per Annexure E(1) of the financial statements for which actual expenditure exceeded the budget.

### **Cash flow statement**

42. Presentation of a cash flow statement, summarising the entity's operating, investing and financing activities is required by Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash flow statements*. The cash and cash equivalents at 30 June 2010 of R3,748,063, presented in the cash flow statement does not agree to the cash and cash equivalents of R34,879,910 included in the statement of financial position.
43. The cash flow statement includes an undefined difference of R5,022,027 compared to the cash generated from operations note. In addition the net cash flows from investing activities of R20,217,732 was not reconciled to the additions of property, plant and equipment of R21,326,643 and no explanation was provided for the difference of

R1,108,902. Therefore I could not satisfy myself to the accuracy of the cash flow statement.

#### **Accumulated surplus**

44. In terms of Directive 4 Transitional Provisions all balances in reserves and trust fund accounts that are not represented by cash on the date of transition should be transferred to the opening balance of the accumulated surplus/(deficit) account in the statement of changes in net assets. The sum of the closing balances of the Accumulated deficit, Statutory Funds, Trust Funds and Reserves account per the prior year audited financial statements amounts to R5,271,622. However the opening balance of the Accumulated Surplus account as disclosed in the Statement of changes in net assets at 1 July 2009 is R21,021,689. No reconciliation was available for the difference of R15,750,067. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation and allocation of the Accumulated surplus balance.
45. In addition the Change in accounting policy note 26 to the financial statements is not complete as it does not detail the balances as previously reported and the adjustments as a result of the implementation of GRAP.

#### **Subsequent events**

46. The municipality did not provide any information as requested regarding subsequent events. Therefore I could not obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that may require adjustment are appropriately reflected in the financial statements.

#### **Employee costs**

47. Included in personnel expenditure on the statement of financial position is an amount of R556,607 which could not be verified. The employee file was not available at the time of the audit and therefore I could not satisfy myself as to the existence, completeness and accuracy of this amount.
48. Instances of manual payments relating to employee costs were identified which were not processed via the payroll system. Concern is expressed that such payments may not be taxed appropriately. The extent of such payments could not be determined and therefore the financial impact could not be quantified.

#### **Going concern**

49. Management did not perform a formal assessment of the municipality's ability to continue as a going concern. A detailed review of the municipality's financial position, results of its operations and the related cash flows indicates that there is significant uncertainty regarding the financial sustainability of the municipality. This matter was not adequately disclosed in the municipality's annual financial statements. The following are highlighted:
  - The Auditor-General has withheld an opinion or issued a disclaimer due to inadequacies in the financial statements or records of the municipality since inception.
  - There is a weak system of internal control at the municipality evidenced by the breakdown in controls identified during the audit.

- A difference of R31,254,934 between the cash and cash equivalents disclosed in the Annual Financial Statements and the bank confirmation/statements(s) cannot be reconciled.
- Due to the audit findings relating to receivables and payables the net asset position of the municipality is undetermined.

#### **Disclaimer of opinion**

50. 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 matters**

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

#### **Restatement of corresponding figures**

52. As disclosed in note 26 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of the change in accounting standards from IMFO to GRAP.

#### **Matters important to the users of the financial statements:**

##### **Impairments**

53. As disclosed in note 4 to the financial statements, material losses to the amount of R 13 million were incurred as a result of debt impairment of debtors due to poor collection practices.

##### **Material underspending of the budget**

54. As disclosed in appendix E to the financial statements, the municipality has materially underspent its budget for expenditure to the amount of R20,363,692 and capital expenditure to the amount of R16,461,077.

##### **Additional matters**

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

##### **Material inconsistencies in other information included in the annual report**

56. The report on predetermined objectives as included in the annual report contains material inconsistencies as compared to the Integrated Development Plan. Refer to the report on predetermined objectives below for further details.

##### **Unaudited supplementary schedules**

57. The supplementary annexures set out on pages xx - xx 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**

58. 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 Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and financial management (internal control).

### **Predetermined objectives**

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

### **Non-compliance with regulatory and reporting requirements**

60. The reported performance information to be included in the annual report is not presented in a simple, accessible format, relevant and useful to the intended user, and/or in accordance with the requirements of MFMA circular 11 and the relevant guidance applicable to reporting for the financial year-end. No disclosure of the previous financial years achievements were made in the Annual Performance Report.
61. Adequate explanations for major variances between the planned and the actual reported targets for the following objectives were not reported as required in terms of the relevant reporting guidance. In total 58% of the reported targets with variances had no explanations for those variances.
62. The Annual Performance Report was not perceived to be simple, in that the objectives and what was achieved were not disclosed. Additionally, it was not considered to be accessible or useful because the indicator was not reported on within the report. No measure to improve performance was reported in the Annual Performance Report.
63. No reporting on performance information occurred for the following:
- 16 developmental areas.
  - 19 objectives
  - 61 indicators
64. The Nkonkobe Municipality did not enter into a service delivery agreement with the NEDA for the provision of a municipal service, as required in terms of section 76 of the MSA and regulation 9(2) of the Municipal Planning and Performance Management Regulations, 2001.
65. The Nkonkobe 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.
66. The Nkonkobe 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.
67. The Nkonkobe 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 sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal

Planning and Performance Management Regulations, 2001.

68. The accounting officer of the Nkonkobe Municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

### **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:

69. The integrated development plan of the Nkonkobe municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001. Objectives, indicators and targets reported in the Annual Performance Report were not pre-determined as per the IDP. The key performance indicators set by the Nkonkobe Municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.
70. The Municipality has not reported on all the predetermined objectives, as required by section 121 (3)(f) of the MFMA. No reporting occurred on 16 priority areas, 19 objectives and 61 indicators as per the IDP.
71. The actual achievements with regard to 92.31% of all planned indicators and targets specified in the integrated development plan for the year under review, for the selected objectives were not reported in the annual performance report submitted for audit purposes.
72. The Nkonkobe Municipality has not reported on all the predetermined objectives, as required by Section 46(1)(b) of the Municipal Systems Act No 32 of 2000 and Section 121(3)(a) of the Municipal Finance Management Act No 56 of 2003.
73. The indicator and targets as per the integrated development plan for the year under review did not relate directly in more than 100% of instances to the institution's strategic goals and objectives as per the three year integrated development plan. For the selected programs, 100% of the planned and reported indicators were not clearly linked to the objectives and mandate of the municipality as the IDP only addresses a 2-year strategic plan and not a 5-year plan as set out in legislation.

74. Planned and reported indicators not well defined
75. For the selected objectives, 46.15% of the planned and reported indicators were not clear, with an unambiguous definition to allow for data to be collected consistently.
76. For the selected objectives, 92.31% of the planned and reported indicators/measures were not verifiable, as it was not possible to validate/adequately validate the processes and systems that produce the indicator.
77. For the selected objectives, 89.74%% of the planned and reported targets were not:

#### **Reliability of reported performance information**

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.

The following audit findings relate to the above criteria:

78. For the selected objectives, 20.51% of the reported indicators and targets were not valid, accurate and complete when compared to source information
79. For the selected objectives the validity, accuracy and completeness, 85% of the reported indicators and targets could not be established as sufficient appropriate audit evidence could not be provided for audit purposes. Reported indicators and targets were not valid, accurate or complete as no or inadequate supporting source information was provided.
80. Sufficient appropriate audit evidence in relation to all the selected objectives could not be obtained. There were also no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information. All documentation was not submitted to the auditors and therefore the audit procedures could not be performed.

#### **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)**

##### **The audit committee was not in operation for a majority of 2009/10**

81. Contrary to the requirements of section 166(1) of the MFMA the municipality did not have an audit committee for the entire period of the 2009-2010 financial year.

##### **Internal audit was not in operation for a majority of 2009/10**

82. Contrary to the requirements of section 165(1) of the MFMA the municipality did not have an internal auditor for the entire period of the 2009-2010 financial year.

#### **Non-submission of quarterly reporting**

83. Contrary to the requirements set out in section 11(4)(b) of the MFMA no evidence was obtained to confirm that the accounting officer, within 30 days after the end of each quarter, submitted a copy of a consolidated report of all withdrawals of money from any of the municipality's bank accounts to the provincial treasury and the Auditor-General.

#### **Non-submission of monthly reporting**

84. Contrary to the requirements set out in section 71(1) of the MFMA the accounting officer did not submit to the mayor and the provincial treasury a statement on the state of the municipality's budget, in the prescribed format by no later than 10 working days after the end of each month.

#### **Accounting officer did not adhere to the reporting requirements with regard to conditional grant spending**

85. The municipality did not submit all information, returns, documents, explanations and motivations a may be prescribed or may be required to the National Treasury, as required by section 74(1) of the Municipal Finance Management Act.

#### **Municipal website not updated**

86. The municipality did not place all documentation as required by section 75 of the Municipal Finance Management Act on its official website.

#### **Distribution losses were not monitored**

87. The municipality did not calculate distribution losses of electricity and thus the financial statements do not contain the associated disclosure contrary to section 125(2)(d) of the MFMA which states inter alia that the notes to the annual financial statements of a municipality must disclose particulars of any material losses.

#### **The financial statements were not fairly presented**

88. The municipality did not prepare financial statements that fairly present the state of affairs of the municipality as required by section 122(1)(a) of the Municipal Finance Management Act. Furthermore, disclosure information as required in terms of sections 123 - 125 of the MFMA has not been fully disclosed in the annual financial statements.

#### **Non-disclosure irregular and authorised expenditure**

89. Irregular and unauthorised expenditure incurred was not disclosed as required by section 125(2)(d) of the Municipal Finance Management Act.

#### **No documented system of delegation**

90. The municipality does not have a documented system of delegations as required in terms of section 79 of the MFMA.

#### **Lack of internal control system**

91. Contrary to section 62 of the MFMA in conjunction with section 78 the municipality did not maintain effective, efficient and transparent systems of internal control legislation for:

- Debtors and revenue
- Creditors and payments
- Assets and liabilities
- Guarding against fraud, theft and financial mismanagement

## **Income Tax Act of South Africa, No 58 of 1962**

### **Employee tax not deducted for fringe benefit**

92. Contrary to the requirements of par 2(d) of schedule 7 of the Income Tax Act, employees did not pay tax on the fringe benefit received on rentals paid for municipal houses.

### **INTERNAL CONTROL**

93. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.

94. 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**

It is evident from the findings during the audit process that the accounting officer and in turn management, did not exercise effective oversight over reporting, compliance with laws and regulations and internal control, in all instances. A key indicator at this level is the fact that not all the external audit findings of the prior year have been addressed, resulting in repetitive findings and unattended weaknesses in the control environment. This is further evident from the lack of a constructive risk assessment process culminating in a strategy.

An appropriate attitude towards reporting against predetermined objectives was not demonstrated by the implementation of controls over the development of performance targets and processes and controls to ensure that reporting of actual performance against targets is valid and complete.

- **Financial and performance management**

The financial and performance management control objective relates mainly to the preparation of quality financial statements and performance reports which are supported by appropriate record keeping and information systems. With this in mind it was evident during the audit process that pertinent information was not identified and captured in a form and time frame to support financial and performance reporting. The shortcomings are further indicative that the financial statements were not reviewed for completeness and accuracy prior to the submission for audit. Additionally, delays to provide requested information in a timely manner were experienced in certain instances.

Municipalities rely heavily on computerised information systems to perform their statutory, financial management, reporting and administrative functions. The fact that manual and automated controls were not in all instances adequately implemented to ensure that the transactions have occurred, are authorised and are completely and accurately processed is reason for concern. In addition it should be noted that systems are not appropriate in all instances to facilitate the preparation of financial statements and performance reports.

- **Governance**

The governance control objective relates mainly to involvement of the audit committee and internal audit in the identification and management of risk (including information technology) and fraud prevention. Although cognisance is taken of appointment of an audit committee and internal audit unit, these appointments came very late in the financial year. As a result of the late appointment and the fact that they are under capacitated, these governance role players had no effect on the audit outcome.

## **OTHER REPORTS**

### **Investigations in progress**

95. Special investigations were conducted into alleged financial irregularities at the municipality. However the reports have not been released to date.

*Auditor-General.*

East London

30 November 2010



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*