

Inkwanca Municipality

Audit Report

For the year ended 30 June 2010

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements, which comprise of financial position as 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, and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the standards of Generally Accepted Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), Division of Revenue Act, 2007 (Act No. 1 of 2007) (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.

Basis for Adverse opinion

Corresponding figures

7. In the prior year my audit report contained a modification on a number of account balances and classes of transactions. Journal entries that were processed to correct prior year errors of R372 000 disclosed in note 28 did not contain sufficient supporting documentation. Consequently I am unable to satisfy myself that comparative figures are fairly stated.

Trade and other receivables

8. Consumer receivables of R55.6 million (2009: R40.7 million) and doubtful debts provision of R53.8 million (2009: R39 million) are included in note 4 to the financial statements. The municipality has not provided for doubtful debts as required by the International Accounting Standards (IAS), IAS 39, *financial instruments*. The loan account with the district municipality of R2.3 million (2009: R1.7 million) could also not be confirmed even through alternative procedures. Consequently I was unable to satisfy myself that trade and other receivables exist and are fairly valued.

Revenue

9. Service charges and assessment rates income of R8.6 million (2009: R19.7 million) has been included in the statement of financial performance. Incorrect meter readings and processing resulted in billing errors of R1.6 million. Consequently trade and other receivables and the accumulated surplus is understated by R1.6 million.
10. Supporting documentation could not be provided for service charges revenue of R864 000. The accounting records did not permit the application of alternative procedures. Consequently, I could not satisfy myself as to the accuracy and occurrence of service charges revenue.

Employee costs

11. Salaries and wages expenditure of R8.2 million (R7.6 million) is disclosed in note 18 to the financial statements. Documentation could not be provided to support wage expenditure of R170 000 included in this disclosure. Consequently I could not satisfy myself as to the accuracy and occurrence of salaries and wages expenditure.

Accruals, provisions and contingent liabilities

11. Trade and other payables of R7.1 million (2009: R6.9 million) is included in the statement of financial position and note 11 to the financial statements. The municipality did not accrue expenditure of R508 000 incurred before year-end. As a result trade and other payables is understated and the accumulated surplus overstated by R508 000.

12. The provision for leave pay of R637 000 (2009: R540 000) is disclosed in note 11.1 to the financial statements. Errors in the current accrual of leave resulted in the understatement of the leave pay provision and employee costs expenditure by R111 000.

Financial instruments

12. The municipality did not comply with the provisions of the International Accounting Standards (IAS) 32 and 39 in respect of the recognition and measurement of financial instruments. Consequently trade and other receivables and trade and other payables are overstated by R46 000 (2009: R173 000) and R309 000 (2009: R101 000) respectively. The application of this standard has also resulted in the reclassification of R104 000 of revenue to interest income and R791 000 of expenditure to interest cost. Consequently the accumulated surplus at year end was understated by R263 000 (R2009: overstatement of R72 000).

Employee benefits

13. The municipality did not account for the present value of post retirement benefits required by IAS 19, *Employee benefits*. Consequently the post retirement benefits is understated and the accumulated surplus overstated by R1.1 million.

Expenditure

14. Operating, conditional grant and indigent subsidy expenditure of R17.2 million (2009: R14.8 million) has been disclosed in the statement of financial performance. The municipality could not provide documentation for R1.4 million to support these transactions. Consequently I could not satisfy myself that these transactions occurred and were accurate.

Irregular, fruitless & wasteful, and unauthorised expenditure

15. Irregular payments of R414 000 were disclosed in note 19 to the financial statements. Further irregular expenditure of R1.7 million was identified but not disclosed in note 19. Irregular expenditure is consequently understated by R1.7 million.
16. Disclosed in note 19.2 to financial statements is fruitless and wasteful expenditure of R509 433. Further fruitless and wasteful expenditure on interest and penalties of R19 000 and housing development expenditure of R185 000 on projects was identified but not disclosed. Consequently fruitless and wasteful expenditure is understated by R204 000.

Commitments

17. Commitments have not been disclosed in note 24 to the financial statements. No contract management system is in place for the identification and recognition of contracts at the municipality. Consequently, I was unable to satisfy myself as to the completeness of this disclosure.

Adverse opinion

In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, these financial statements do not present fairly the financial position of the

Inkwanca Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended have not been prepared, in all material respects, in accordance with Generally Accepted Accounting Practice (GRAP) described in note xx to the financial statements and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA).

Emphasis of matter

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

Amendments to the applicable basis of accounting

19. The municipality implemented the Generally Recognised Accounting Practices (GRAP) financial reporting framework for the year under review. Implementation of this framework requires a change in accounting policy (GRAP3) and the municipality should have retrospectively restated the figures disclosed under the previous reporting framework, IMFO.

Going concern

20. A material uncertainty as to the ability of the municipality to continue as a going concern has been identified in note 37 to the financial statements. The accounting officer has listed the reasons for this assessment in this note.

Additional matter

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

21. The municipality provided supplementary information in the financial statements with respect to resources that were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 Presentation of Financial Statements. The supplementary budget information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. 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, Municipal Finance Management Act, No 56 of 2003 (MFMA), Municipal Regulations (Regulations - GNR/GN), Division of Revenue Act, No 12 of 2009 (DoRA), Municipal Systems Act, No 32 of 2000 (MSA), Municipal Structures Act, No 117 of 1998 and regulations and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirement

24. The integrated development plan of the municipality did not include the key performance indicators and performance targets that were determined in terms of its performance management systems and did thus not meet the requirements of section 26(1) and 41(1) (b) of the Municipal Systems Act, 2000 (No 32 of 2000) (MSA) and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.
25. The audit committee also performed the functions of the performance audit committee. In its capacity as performance audit committee it did not:
 - meet at least twice during the financial year;
 - review the quarterly reports of the internal auditors in respect of their audits of the performance measurements;
 - review the municipality's performance management system and make recommendations in this regard to the council, and
 - submit a report to the municipality regarding the performance management system at least twice during the financial year.
26. The municipality did not implement a framework that describes and represents how its 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 Regulation 2001.
27. The internal audit processes and procedures did not include assessments of the extent to which the municipality performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators (section 45 of MSA).

Usefulness of information

28. 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:

29. The municipality has not reported on its performance against predetermined targets that are consistent with the approved integrated development plan or service delivery budget and implementation plan.

30. The municipality reported on objectives, indicators and targets that were not in the approved five year integrated development plan/service delivery budget and implementation plan.

Reliability of reported performance information

31. 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 municipality 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 finding relates to the above criteria:

32. For the selected objectives, 85 percent of the reported targets were not reliable on the basis of the source information or evidence provided to support the reported indicators/targets.

Compliance with laws and regulations

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

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

Responsibilities of the audit committee

33. Contrary to section 166 the audit committee did not fulfill its responsibilities for the year.

Responsibilities of internal audit

34. Contrary to section 165(2) the internal audit function did not fulfill its responsibilities for the year

Payment of expenditure within 30 days

35. Contrary to sections 65 and 99 the municipality did not make payments in respect of expenditure within 30 days of the date of the receipt of the invoice and, in the case of civil claims, from the date of settlement as prescribed.

Supply chain management

36. Contrary to section 62(1)(d) the accounting officer failed to take all reasonable steps to ensure that unauthorised, irregular or fruitless and wasteful and other losses are prevented.

37. Contrary to section 116(2)(b) the municipality failed to establish capacity to ensure that contracts are procured and managed in terms of the requirements.

Expenditure management

38. Contrary to section 65(2)(i) the accounting officer failed to take all reasonable steps to ensure that that the municipality's supply chain management policy referred to in section 111 is implemented in a way that is fair, equitable, transparent, competitive and cost-effective.

Submission of the Annual Report to the Auditor-General

39. Contrary to section 127(5) the municipality failed to submit the annual report to the Auditor-General.

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

40. The integrated development plan did not satisfy the requirements of section 26(h) of the MSA.

INTERNAL CONTROL

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.

41. The matters reported below are limited to the significant deficiencies regarding the basis for adverse opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• Leadership

Management did not exercise oversight responsibility over reporting and compliance with laws and regulations and internal control. Consequently proper tender processes were not always followed resulting in irregular expenditure of R1.7 million.

• Financial and performance management

Finance personnel do not have adequate knowledge of the accounting standards applicable to the presentation and disclosure of the financial statements. This necessitated the appointment of consultants to prepare the financial statements for the financial year under review. These financial statements and the report on performance information were not properly reviewed for completeness and accuracy prior to submission for audit. Financial staff did not always provide documents and information requested during the audit timeously resulting in significant delays.

- **Governance**

A risk assessment was not conducted and an approved fraud prevention plan does not exist. Furthermore the segregation of duties to prevent fraudulent data and asset misappropriation is not adequate. The audit committee and internal audit did not also fulfil their functions in the prescribed manner for the year under review.

Auditor - General

East London

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

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