

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Intsika Yethu 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 the Standards of Generally Recognised Accounting Practice (Standards of GRAP) and in the manner required by the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa (Act No. 25 of 2004) (PAA), and section 126(3) of the MFMA, my responsibility is to express an opinion on the 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

Property, plant and equipment

4. The municipality could not provide sufficient appropriate evidence to support journal entries of R958 231 and R1,9 million, being debit and credit amounts respectively relating to property, plant and equipment. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
5. Further, there are inadequate controls over the processing, authorising and capturing of journal entries at the municipality as journals were not always accompanied by adequate supporting documentation, certain journal entries were duplicated in the accounting records of the municipality, as well as the journal amount processed not always agreeing to the journal voucher. These weaknesses are pervasive and are applicable to all journals reported in the paragraphs hereunder.
6. Accounting policy note 3.5 to the annual financial statements refers to relief relating to the subsequent measurement of property, plant and equipment in terms of Directive 4 issued by the Accounting Standards Board. This directive, however, requires that the municipality identify and correctly classify all their assets between different types of assets, and to recognise the assets using the principles in the Standards of Generally Recognised Accounting Practice (GRAP) or at provisional amounts using the relief allowed in Directive 4. These requirements were not fully adhered to by the municipality, and as a result, Directive 4 was not correctly applied.

7. Insufficient disclosure was made regarding the progress made by the municipality in respect of measuring property, plant and equipment, investment properties and intangible assets as well as recognising major classes of assets that have not been recognised in full, as required by the Standard of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements*.
8. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the amount recorded in the Statement of Financial Position.

Receivables

9. The balance of trade receivables from exchange transactions of R930,988 as disclosed in the Statement of Financial Position was determined after making provision for doubtful debts of R3,9 million. The municipality did not estimate doubtful debts based on a review of all outstanding amounts at year end as per the accounting policy, and the judgements made and key assumptions used by management to estimate the amount was not disclosed in accordance with the Standard of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements*.
10. Included in the balance of other receivables from exchange transactions of R9,9 million (2008/09: R5,3 million), as disclosed in the Statement of Financial Position, are salary control accounts and sundry debtors amounting to R3,4 million (2008/09: R3,5 million) for which no supporting documentation could be submitted for audit purposes.
11. Further, included in the balance of other receivables from exchange transactions of R9,9 million (2008/09: R5,3 million) is an amount of R663 470 (2008/09: R585 391) which relates to staff debts in respect of cellphones, medical aid and pension fund. The monthly deductions from the employees' salaries were not allocated to the relevant debtor accounts. Furthermore, contracts entered into for the cellphone contracts could not be provided for audit purposes.
12. The municipality could not provide sufficient appropriate evidence to support credit journal entries of R385 000. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
13. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the amount recorded in the Statement of Financial Position.

Payables

14. The municipality could not provide sufficient appropriate evidence to support credit journal entries of R2,7 million for payables. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
15. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of these transactions.

Value added tax

16. The municipality could not provide sufficient appropriate evidence to support journal entries of R5,2 million and R5,8 million, being debit and credit amounts respectively relating to VAT transactions. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.

17. The Value Added Tax (VAT) receivable amount of R1,8 million as disclosed in the statement of financial position did not agree with the recalculated refund amount of R1,6 million. The municipality could not provide an explanation or supporting documentation for the difference of R268 112 between the financial statements and the underlying accounting records. It was found that monthly reconciliations were not performed by the municipality to confirm the accuracy of the VAT account.
18. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the amount recorded in the Statement of Financial Position.

Cash and cash equivalents

19. Cash and cash equivalents amounting R24,9 million are disclosed in the Statement of Financial Position. This amount did not agree with the general ledger balance of R23 million, resulting in an unexplained difference of R1,9 million. Further, the municipality did not perform bank reconciliations on a monthly basis to confirm the accuracy and completeness of cash and cash equivalents.
20. Further, the municipality could not provide sufficient appropriate evidence to support journal entries of R162 116 and R690 774, being debit and credit amounts respectively. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
21. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the amount recorded in the Statement of Financial Position as well as the related revenue and expenditure for the year recorded in the Statement of Financial Performance.

Revenue

22. There was an inadequate system of control over service charges revenue and interest levied on long outstanding debtors on which I could rely for the purpose of my audit, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all service charges revenue and interest on long outstanding debtors was properly recorded. I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of service charges revenue of R273,498 (2008/09: R292,861) and interest revenue of R90,896 (2008/09: R126,608).

Expenditure

23. The municipality could not provide sufficient appropriate evidence to support journal entries of R1,8 million and R1,7 million, being debit and credit amounts respectively for expenditure. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
24. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, accuracy, completeness and classification of these transactions.
25. Expenditure was not disclosed and measured at fair value taking into account imputed interest as required by International Financial Reporting Standards, IFRS 7, *Financial Instruments: Disclosure* and International Accounting Standards, IAS 39, *Financial Instruments: Recognition and Measurement* respectively. As a result, expenditure net of employee related costs and bad debts disclosed on the statement of financial performance at R28 million is overstated by R839,292 and finance costs which are also disclosed on the statement of financial performance at nil is understated by the same amount.

Employee costs

26. The municipality could not provide sufficient appropriate evidence to support journal entries of R674 000 and R2,2 million, being debit and credit amounts respectively for salaries and wages. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
27. Consequently, I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, accuracy, completeness and classification of these transactions.

Cash flow statement

28. Standard of Generally Recognised Accounting Practice, GRAP 2, *Cash Flow Statements*, requires that the financial statements present fairly the financial position, financial performance and cash flows of an entity. Internal controls were not put in place to ensure that the cash flow statement is accurate. I was not able to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the comparative amounts recorded in the Cash Flow Statement.

Change in accounting policy

29. The Standard of Generally Recognised Accounting Practice, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors* requires the actual effect of the change in accounting policy to be disclosed in the annual financial statements. As disclosed in the Statement of Changes in Net Assets and note 31 to the financial statements, the effect of the change of accounting policy on the accumulated surplus is disclosed as restating the balance at 30 June 2008 and does not disclose the effect in respect of the prior ended 30 June 2009 as required.

Related parties

30. International Public Sector Accounting Standard, IPSAS 20, *Related party disclosures* requires disclosure of employees related to councillors, section 57 employees and key management personnel as well as information in respect of entities under the control of key management personnel. The disclosures included in note 41 to the financial statements do not meet the onerous disclosure requirements of standard.

Disclaimer of opinion

31. 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 the financial statements.

Emphasis of matter

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

Amendment to the applicable basis of accounting

32. During the year under review the municipality adopted the South African Standards of Generally Recognised Accounting Practices (SA Standards of GRAP). The corresponding figures for the year ended 30 June 2009 have been restated as a result of the change in accounting policy. Details of the restatements and re-classifications of certain amounts are disclosed in note 31 and 33 to the financial statements.

Restatement of corresponding figures

33. As disclosed in note 32 to the financial statements, the corresponding figures relating to the prior financial year have been restated in the financial statements for the year under review. This is due to prior year errors discovered during the year under review.

Irregular expenditure

34. As disclosed in note 34 to the financial statements, irregular expenditure to the amount of R15,6 million (2008/09: R187,710) was incurred during the year under review due to non adherence to tender processes, bid specifications and supply chain management policies.

Going concern

35. The statement of financial performance for the year ended 30 June 2010 indicated that the Intsika Yethu Municipality recognised government grants and subsidies amounting to R81,1 million. Revenue from other sources amounted to R7,6 million and may be inadequate to fund the annual expenditure which amounted to R71,7 million for the year ended 30 June 2010. These conditions, along with other matters indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matter

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

Unaudited supplementary schedules

36. The supplementary information set out in Appendix A and B does not form part of the financial statements and is presented as additional information, therefore no opinion will be expressed thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

37. In terms of the PAA of South Africa and *General notice 1570 of 2009*, issued in *Government Gazette No. 32758 of 27 November 2009* I include below my findings on the report on predetermined objectives, compliance with section 45 of the Municipal Systems Act and financial management (internal control).

Predetermined objectives

Non-compliance with regulatory and reporting requirements

Municipal Systems Act, Act No. 32 of 2000 (MSA)

Review of performance information

38. The review of performance information was not included in the internal audit process as prescribed in terms of section 45(a) of the MSA.

Submission of integrated development plan (IDP)

39. There was no evidence that the municipality's IDP was submitted to the MEC for local government prescribed in terms of section 32 of the MSA.

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

No evidence of community representation

40. Contrary to section 127(5) of the MFMA, proof that the municipality invited the community to submit representation in connection with the annual report could not be presented.

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:

Reported performance information not measurable, specific and time-bound

41. The Intsika Yethu Municipality has not reported throughout on its performance with regard to its targets as per the approved integrated development plan. Eleven targets contained in the IDP were not reported in the annual performance report.
42. For 100% of the selected indicators, planned and reported indicators/measures were not specific in clearly identifying the nature and the required level of performance, were not measurable in identifying the required performance, nor time bound in specifying the time period or deadline for delivery.

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:

Inadequate supporting source documentation

43. Supporting evidence for the achievement of 45% of the targets as reflected in the annual performance report could not be provided for audit purposes.

Compliance with laws and regulations

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

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

44. All suppliers were not paid within 30 days of receiving the relevant invoice or statement as prescribed in terms of section 65(2)(e) of the MFMA.

Annual budget and mid-year budget assessment not submitted within prescribed timelines

45. There was no evidence that the municipality submitted its annual budget and mid-year budget assessment to the mayor and provincial treasury as prescribed in terms of sections 16 and 72(1) of the MFMA.

Returns on conditional grant spent not submitted

46. Contrary to Section 74(1) of the MFMA, the municipality did not submit signed returns on their Conditional Grant spending for the year under review.

The financial statements were not prepared in accordance with applicable legislation

47. The financial statements submitted for audit did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit, certain of these were corrected by management and those that were not are included in the basis for disclaimer opinion paragraphs.

Government Gazette Regulations

Councillor travel allowances

48. Contrary to item 6(a)(i) of the *Government Gazette* 32833, councillors' travel allowances were in excess of the stipulated percentage of the annual total remuneration package.
49. The mayor received a salary increase in the current year which was in excess of the upper limit as stipulated in item 5 of the *Government Gazette* 32833.

Unemployment Insurance Fund Act, Act No.63 of 2001 (UIF Act)

Councillors' contributions to UIF

50. Contrary to section 4 of the UIF Act, the municipality has not deducted UIF contributions from councillors' salaries, nor has it paid the required employer's contribution to the fund.

INTERNAL CONTROL

51. 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, Municipal Regulations, Division of Revenue Act, and Municipal Systems Act, but not for the purpose of expressing an opinion on the effectiveness of internal control.
52. The matters reported below are limited to the significant deficiencies regarding the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

Management's oversight responsibilities over reporting, compliance with laws and regulations and internal control are not exercised and the accounting officer does not evaluate whether management has implemented effective internal controls. Municipal officials do not monitor tasks delegated to other staff members. The Chief Financial Officer also resigned subsequent to year end which placed additional pressures on the leadership of the municipality.

- **Financial and performance management**

The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit. Pertinent information is not identified in a form and time frame to support financial and performance reporting. Weaknesses were identified in the record keeping of the municipality in that recorded transactions do not always have adequate supporting documentation.

- **Governance**

The internal audit division was not effective in performing its duties and responsibilities in that the annual plan did not cover important risk areas to the municipality's operations such as procurement and predetermined objectives. This contributed to ineffective oversight which resulted in the findings included in the preceding paragraphs. Further, the internal auditor does not have the relevant qualification and the appointment was not recommended by the audit committee.

OTHER REPORTS

Investigations

53. An investigation was initiated by the municipality and conducted by the South African Police Service for suspected irregularities in the cash management and cash handling activities in the traffic department at the municipality. The investigation has concluded subsequent to year end but the outcome is still pending at the reporting date and the extent of the irregularities could not be determined at year end.

Auditor-General

East London

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence