

Sakhisizwe Municipality

Audit Report

For the year ended 30 June 2010

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS OF SAKHISIZWE MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Sakhisizwe 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, 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 South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the 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) and 126(3) of the Municipal Finance Management Act of South Africa, 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

Investment properties and inventory

7. The municipality has not disclosed the fair value of investment properties and inventory under the cost model, in accordance with the Statement of Generally Recognised Accounting Practice, GRAP 16, *Investment property* and GRAP 12, *Inventory*. The independent valuation does not distinguish between investment properties and expenditure on reconstruction and development programme (RDP) housing projects. The subsequent measurement on these properties could not be determined. Under these circumstances the exemptions in Directive 4, *transitional provisions* could not be applied. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of investment properties and inventory.

Property, plant and equipment

8. Property, plant and equipment with of R74.5 million (2009: R59.4 million) is disclosed in the statement of financial position and in note 4 to the financial statements. Municipal properties of R800 000 for which the municipality does not have title have been included in this balance. In addition, property, plant and equipment expenditure of R653 000 has been incorrectly classified as general expenditure. GRAP 17 requires assets to be recognised at cost less accumulated depreciation and impairment. The depreciable amount should be allocated over the useful life of the asset. Also included in property, plant and equipment is a landfill site with a carrying value of R4.1 million. Management has estimated the useful life of this landfill site asset to be between 5 and 15 years. On 30 June 2009, management declared their intention to close the landfill site by 30 June 2010. The landfill site has not been closed and management has now indicated that the landfill site will be closed by 30 June 2012. The landfill site should have been depreciated during the 2009-10 financial year by an amount of R1.3 million. This asset is thus overstated by R1.3 million.

Consequently, as a result of the above, property, plant and equipment and accumulated surplus is overstated by R1.4 million.

9. The municipality could not provide sufficient supporting documentation to reconcile infrastructure additions of R14.3 million (2009: R0). Sufficient supporting documentation could also not be provided to confirm the value of roads infrastructure assets of R6.9 million at year-end. A property of the municipality was also not included in property, plant and equipment. Documentation or any other information regarding the value of this municipal property could not be provided.

Consequently I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence and valuation of property, plant and equipment.

Consumer debtors

10. The municipality did not account for interest on overdue consumer debtors' accounts. The billing module on the financial system did either not charge interest to debtors for certain months, or charged the incorrect amount. Consequently, consumer debtors and the accumulated surplus are understated by R1.1 million.

Consumer deposits

11. Consumer deposits of R307 000 (2009: 287 000) are disclosed in the statement of financial position. Approximately half of the municipality's consumers were not charged deposits, before services were provided to them. The municipality also did not maintain an adequate register of consumer deposits. As a result, I could not satisfy myself that consumer deposits were complete.

Value Added Tax (VAT) Receivable

12. VAT receivable disclosed in note 10 to the financial statements is R2.5 million (2009: R3.3 million). The reconciliation between the VAT returns and the general ledger reflected reconciling items amounting to R500 000. Supporting documentation for these reconciling items could not be provided. VAT refunds have also not been received since the February 2010 tax period and there is a material uncertainty as to the recoverability of these refunds. Consequently I could not obtain sufficient appropriate evidence to satisfy myself as to the existence, valuation and completeness of this balance.

Accruals, provisions and contingent liabilities

13. Trade payables of R3.5 million (2009: R300 000), as disclosed in note 16 to the financial statements, differs from the underlying records. There were no satisfactory alternative audit procedures that I could perform to confirm the existence of trade payables.

Revenue

14. Service charges of R 5.5 million (2009: R5.7 million) and assessment rates of R2.8 million (2009: R1.1 million) are included in note 18 to the financial statements.
15. A reconciliation of rateable properties was not performed and errors occurred in readings and the processing of meter readings. As a result service charges and rates revenue were understated by R732 000 and R130 000 respectively. Consequently consumer debtors and the accumulated surplus were both understated by R770 000.
16. Supporting documentation for an assessment rates journal of R106 000 and electricity charges of R450 000 could not be provided. The entity's records did not permit the application of alternative procedures to verify these transactions. Consequently I could not obtain sufficient appropriate evidence as to the completeness, accuracy and occurrence of revenue.

General expenditure

17. General expenditure of R7.5 million is included in note 24 and in operating expenditure on the statement of financial performance. Supporting documentation could not be provided for R672 000 of this expenditure. The accounting records did not permit the use of alternative procedures and consequently I could not satisfy myself as to the occurrence and accuracy of operating expenditure.

Government grants

18. Disclosed in the statement of financial performance and note 21 of the financial statements is grant revenue of R41.7 million (2009: R29.1 million). The financial statements disclosed that equitable share revenue of R561 000 had not been received. The financial statements also disclosed that the municipality had an excess of R1.3 million on their infrastructure grant. I could not, even through alternative procedures, obtain sufficient appropriate evidence to satisfy myself as to the completeness, occurrence and classification of government grant revenue.

Employee related costs

19. Employee costs of R12.8 million (2009: R12.2 million) are disclosed in note 25 to the financial statements. The municipality could not provide sufficient appropriate audit evidence that employee costs of R352 000, included in this disclosure, were incurred at the correct salary grade. The municipality's accounting records did not permit the application of alternative procedures. Casual wages of R861 000 was classified as general expenditure. The municipality could also not provide supporting documentation, in the form of timesheets or wages registers, for casual wage expenditure of R159 000. Consequently I was unable to obtain sufficient appropriate audit evidence procedures over the occurrence and accuracy of employee costs.

Commitments

20. The municipality did not disclose commitments at year-end. The municipality entered into contracts for the upgrading and construction of roads for which expenditure had not been incurred at year-end. Consequently commitments are understated by R4.2 million.

Irregular expenditure

21. Irregular expenditure of R5.2 million (2009: R0) is disclosed in note 39 to the financial statements. Further irregular payments of R7.1 million were identified but not disclosed in note 39. Irregular expenditure is consequently understated by R7.1 million.

Opinion

Adverse Opinion

22. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Sakhisizwe Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with South African Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act of South Africa (MFMA).

Emphasis of matters

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

Amendments to the applicable basis of accounting

23. The municipality adopted the Statements of Generally Recognised Accounting Practice in the current financial year as in the prior year the municipality was on the GAMAP framework. No further amendments to the basis of accounting have been made.

Restatement of corresponding figures

24. As disclosed in note 34 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during 2010 in the financial statements of the Sakhisizwe Local Municipality at, and for the year ended, 30 June 2010. Scope limitations in the prior year audit prevented these errors from being detected.

Matters important to the users of the financial statements

Fruitless and wasteful expenditure

25. As disclosed in note 29 to the financial statements fruitless and wasteful expenditure of R136 000 was incurred.

Material losses

26. Material losses of R180 000 are disclosed in note 41 to the financial statements. These material losses incurred as a result of cash receipts not being banked.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

27. 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 MFMA and DORA, and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

29. Contrary to regulation 14(2) of the Municipal Planning and Performance Management Regulations 2001, the municipality did not budget for or appoint a performance audit committee. It did also not utilise the audit committee as the performance audit committee.

Usefulness of information

30. For the selected objectives, all of the planned and reported indicators were not :

- Specific in clearly identifying the nature and the required level of performance;
- Measurable in identifying the required performance, and
- Time bound in specifying the time period or deadline for delivery.

31. The municipality has not reported throughout on its performance against pre-determined objectives, indicators and targets which is consistent with the approved integrated development plan.

Reliability of information

32. For the selected objectives the validity, accuracy and completeness of ninety percent of the reported indicators and targets could not be established as sufficient appropriate audit evidence and supporting documentation could not be provided for audit purposes.

Lack of adoption or implementation of a performance management system

33. 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 regulation 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Compliance with laws and regulations

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

34. The municipality did not make all payments due to creditors within 30 days as required by section 65(2)(e) of the Municipal Finance Management Act.
35. The municipality's supply chain management policy is in conflict with the Municipal Supply Chain Management Regulations as it requires two rather than three quotes.
36. The audit committee did not carry out all its duties as required by section 166(1) and (2)(a) of the MFMA.

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

37. Contrary to the requirements set out in section 11(5) of DoRA, the municipal manager did not annually evaluate its performance in respect of programs funded or partially funded by a schedule 4 allocation, and did not submit this evaluation to the transferring national office within two months after the municipal financial year.

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 and DoRA but not for the purpose of expressing an opinion on the effectiveness of internal control.

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

- **Leadership**

Management's philosophy and operating style does not promote effective control over reporting. This was apparent by the nature and extent of errors that exist in accounting records, the quality of the financial statements that were provided for auditing, the non-compliance with laws and regulations and the non-adherence to supply chain management regulations which resulted in irregular expenditure of R5.2 million. Limited oversight responsibilities by management have also resulted in non compliance with laws and regulation and deficiencies in performance reporting.

- **Financial and performance management**

Pertinent information is not always provided in a timely and complete form to support financial reporting and performance management processes. Vacancies in the finance department have resulted in limitations in inherent controls and risk assessment processes. The financial statements and the report on performance information were not properly reviewed for completeness and accuracy prior to submission for audit.

- **Governance**

The audit committee and internal audit did also not fulfil their functions in the prescribed manner for the year under review. Oversight functions also had a limited impact in assessing and responding to risk.

Auditor - General.

East London

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

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