

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Gariep Municipality, which comprise the statement of financial position as at 30 June 2010, 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 of these financial statements in accordance with South African Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act (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, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, 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 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 of qualified opinion

Property, plant and equipment

7. The asset register of the municipality did not contain sufficient information to confirm the valuation, existence and completeness of non-current assets acquired for the year under review disclosed at R7,9 million in the statement of financial position as at 30 June 2010. In addition, the municipality did not reconcile the difference between the amount disclosed as non-current assets in the statement of financial position of R7,9 million and the amount recorded as R6,7 million in the asset register. The municipality's records did not permit the application of alternative audit procedures regarding the disclosure and recording of property, plant and equipment. Consequently, I did not obtain all the information necessary to satisfy myself as to the valuation, existence and completeness of property, plant and equipment.

Value-added tax (VAT)

8. The municipality is registered for the payment of VAT on the invoice basis for the time of supply. However, in contravention with section 15 of the VAT Act, 1991 (Act No. 89 of 1991), the municipality recorded transactions on the cash basis and therefore VAT was accounted for, and claimed and paid on the same basis. In addition, the municipality was unable to reconcile the VAT payable of R3,1 million (2009: R9 million), as disclosed in the statement of financial position, with the last return submitted to the South African Revenue Services (SARS) amounting to R2,3 million, resulting in an unexplained difference of R859 690. Consequently, I was not able to verify the completeness, existence and valuation of VAT.
9. I could not confirm that journals that decreased VAT payable, as disclosed in note 12 to the financial statements, by R4,2 million should have been processed or were recorded in the correct accounts and at the correct amounts as they were not supported by appropriate supporting documentation. The municipality's records did not permit the application of alternative audit procedures.

Trade and other payables from exchange transactions

10. Included in trade and other payables from exchange transactions are debtors with credit balances of R1,8 million (2009: R312 781) as disclosed in note 11 to the financial statements. Included in the debtors with credit balances amount of R1.8 million, are balances amounting to R1,2 million, which could not be confirmed as journals processed are not supported by appropriate supporting documentation. As a result, the existence, accuracy and completeness of debtors with credit balances could not be confirmed. The municipality's records did not permit the application of alternative audit procedures.

Cash and cash equivalents

11. Management has corrected the overdraft bank balance of R194 439 (2009: R1,8 million - favourable) with the amount of R1,4 million as at 30 June 2010 and the corresponding entry has been processed to accumulated surplus. However, it was not possible to verify the existence and accuracy of this correction due to insufficient supporting documentation for the journal entry.

Employee benefits

12. The municipality did not disclose post-employment medical care benefits for the financial year under review in accordance with the South African Statement of Generally Accepted Accounting Practice, IAS 19, Employee benefits. Due to the non-disclosure, I was not able to perform alternative procedures. Consequently, the extent of the non-disclosure could not be determined.

Distribution losses

13. Section 125(2)(d)(i) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of any material losses. Electricity distribution losses amounting to R111 757 (2009: R3 million) were disclosed in note 39 to the financial statements. I was unable to obtain audit assurance that all distribution losses that should have been recorded, were recorded and that distribution losses were recorded at an appropriate amount. This was as a result of the municipality not being able to provide sufficient appropriate audit evidence to support these amounts. I was unable to perform alternative procedures due to a lack of controls with regard to the recording of these losses.

Qualified opinion

14. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Gariep Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with GRAP and in the manner required by the MFMA.

Emphasis of matters

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

Unauthorised expenditure

16. As disclosed in note 35 to the financial statements, unauthorised expenditure amounting to R49,2 million was incurred by the municipality during the year ended 30 June 2010. The unauthorised expenditure was incurred as a result of inadequate budget control.

Fruitless and wasteful expenditure

17. As disclosed in disclosure note 36 to the financial statements, fruitless and wasteful expenditure amounting to R41 752 was incurred by the municipality during the year ended 30 June 2010 due to interest incurred on late payments.

Irregular expenditure

18. As disclosed in disclosure note 37 to the financial statements, irregular expenditure amounting to R1,2 million was incurred by the municipality during the year ended 30 June 2010. This is a result of procurement processes not having been followed.

Going concern

19. Note 34 to the financial statements indicates that the Gariiep Municipality incurred a net loss of R41,2 million during the year ended 30 June 2010 and, as of that date, the entity's current liabilities exceeded its total assets by R44,4 million. These conditions, along with other matters as set forth in note 34, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to operate as a going concern.

Restatement of corresponding figures

20. The previously issued financial statements were restated where a change in accounting policy had been affected. This was as a result of the municipality changing its basis of accounting from an entity-specific basis (IMFO) to the GRAP reporting framework.

Members of council arrear rates and service charges

21. The rates and service charges of members of the council who have not paid their accounts for more than three months are disclosed in note 39.7 to the financial statements. Paragraph 12A of the code of conduct for members of the council issued in terms of section 54 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) prohibits members of the council from being in arrears with their rates and service charge accounts for more than three months.

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 and regulations (MFMA and Municipal Systems Act (Act 32 of 2000) (MSA), 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 requirements

No reporting against predetermined objectives, indicators and targets

24. I could not conduct the audit of performance against predetermined objectives as the municipality did not prepare the annual performance report as required in terms of section 46 of the MSA.

Internal auditing of performance measurements

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

Lack of adoption or implementation of a performance management system

26. 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 sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

27. The accounting officer of the 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(1)(a)(ii) of the MFMA.

Compliance with laws and regulations

Municipal Finance Management Act (Act 56 of 2003) (MFMA)

The audit committee was not properly functioning

28. The audit committee did not fulfil all of its responsibilities for the year, as set out in section 166 of the MFMA.

The internal audit unit was not properly established

29. The municipality did not have an internal audit unit for the year under review as required by section 165 of the MFMA.

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

30. The municipality did not make all payments to creditors within 30 days of receipt of the invoice, as required by section 65(2) (e) of the MFMA.

The financial statements were not prepared in accordance with applicable legislation

31. The financial statements submitted for auditing 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 qualified opinion paragraphs.

Expenditure was incurred otherwise than in accordance with sections 15 and 11(3) of the MFMA resulting in unauthorised expenditure

32. Expenditure was not incurred in accordance with the approved budget of the municipality and consequently overspent the total amount appropriated in the municipality's approved budget.

Expenditure was incurred otherwise than in accordance with applicable legislation resulting in irregular expenditure

33. Expenditure was not incurred in accordance with the requirements of section 3.13 of the supply chain management policy of the municipality.

Expenditure incurred could have been avoided resulting in fruitless and wasteful expenditure

34. Expenditure incurred was made in vain and could have been avoided based on the fact that reasonable care had been exercised, as set out in section 1 the definition of "fruitless and wasteful expenditure" of the MFMA.

INTERNAL CONTROL

35. 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.
36. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

• **Leadership**

In the year under review the position of chief financial officer was occupied by an acting chief financial officer for 10 months of the financial year. The lack of sustainability at chief financial officer level contributed towards a weak control environment. This resulted in material findings within the financial accounting records and reported predetermined objectives. In addition, instances of material non-compliance were identified which was a result of inadequate supervision and review of internal controls. The necessary mechanisms are not in place at the municipality to detect the deficiencies in the control environment and to detect non-compliance with laws and regulations.

• **Financial and performance management**

Significant misstatements in the financial statements were identified during the audit signifying weaknesses in accountability and reporting practices. This negatively affected the quality and reliability of the submitted financial statements and predetermined objectives reported. Management subsequently made the appropriate corrections. These issues may be attributable to the following:

- Sufficient ongoing monitoring and supervision of the financial statements and the report of predetermined objectives were not undertaken to enable the assessment of the effectiveness of internal control over financial and predetermined objective reporting.
- Internal control deficiencies and non-compliance were not identified and communicated in a timely manner to allow for corrective action to be taken.

- **Governance**

There was no internal audit division for the financial year under review. This contributed to the audit committee not adequately discharging all its duties during the financial year under review. Although a risk assessment was performed and a fraud prevention plan compiled during the financial year under review, both documents were in draft format and not approved by the council.

OTHER REPORTS

Investigations

37. An investigation was initiated by the municipality and conducted by an independent consulting firm for suspected irregularities in the cash management and cash handling activities in the finance and traffic departments at the municipality. The investigation was still ongoing at 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

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