

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying financial statements of the Mbizana Local 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, 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 Generally Recognised Accounting Practice (GRAP), issued by the Accounting Standards Board in accordance with Section 122(3) of the Municipal Finance Management Act, (Act No 56 of 2003). 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 the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (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 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. 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 a disclaimer of opinion

### Other receivables from non exchange transactions

4. The municipality could not provide sufficient and appropriate audit evidence to support debit journal entries processed after year end to other receivables from non exchange transactions amounting to R1,2 million. Management has indicated that these journal entries relate to clearing of reconciling items on the bank reconciliation that could not be traced to supporting document, due to bank reconciliation not prepared on a monthly basis. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the journal entries were properly recorded.

5. Consequently I was unable to satisfy myself on existence, valuation and rights to the debtor of R1,2 million disclosed as other receivables from non exchange transactions in the statement of financial position and in note 3 to the financial statements.

## Trade and other payables

6. The municipality could not provide sufficient and appropriate audit evidence to support debit the journal entries processed to trade and other payables amounting to R7,5 million. Management has indicated that these journal entries relate to bank reconciling items that could not be traced to supporting documents. The above discrepancy resulted from not preparing bank reconciliations on a monthly basis. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the journal entries were properly recorded.

7. The municipality has processed a journal entry to adjust prior year trade and other payables balance, however the municipality could not provide sufficient appropriate audit evidence to support the adjusting journal entry processed amounting to R2,7 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the journal entry was properly recorded.

8. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, obligations, completeness, valuation and allocation of the trade and other payables balance of R8,7 million as disclosed in the statement of financial position and in note 13 to the financial statements.

## Property, plant and equipment

9. The asset register of the municipality does not contain sufficient and appropriate information to be able to uniquely identify each asset, identify the location of the asset and determine the value of each asset. There were no alternative audit procedures that I could perform to obtain reasonable assurance that opening balances as disclosed in note 9 of the financial statements for infrastructure assets amounting to R51,2 million, community assets R23,7 million and land R6 million respectively do exist.

10. I was furthermore unable to verify the existence and correct valuation of other assets disclosed in note 9 of the financial statements amounting to R3,6 million, this is due to the asset register not having recognisable details and identification numbers of individual assets recorded. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that these assets exist and are recorded at correct values.

11. I was unable to trace assets identified as being property, plant and equipment of the municipality to the fixed asset register maintained by the municipality, the estimated value of these assets is R24,4 million. Consequently the property, plant and equipment disclosed in the statement of financial position and note 9 to the financial statements are understated with the same amount.

12. As disclosed in note 9 to the financial statements carrying values at the end of the 2009 year have been restated by an amount of R6,9 million (Adjustment to cost of R18,1 million and adjustment to accumulated depreciation of R11,2 million), management has indicated that the adjustment was processed in order to agree the value of the assets per the financial system to the fixed asset register. The municipality could not provide sufficient and appropriate audit evidence to support the journal processed. There were no satisfactory

alternative audit procedures that I could perform to obtain reasonable assurance that the adjustments were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation and allocation of the adjustments.

13. The municipality could not provide sufficient appropriate audit evidence to support work in progress amounting to R3,5 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the aforementioned amount was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, and valuation and allocation of the work in progress.

14. The municipality could not provide sufficient appropriate audit evidence to support the intangible assets amount of R0,5 million disclosed in note 10 to the financial statements due to the fact that the municipality did not have an intangible assets register. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance to the existence, rights, completeness, valuation and allocation of intangible assets.

15. The municipality did not review the useful lives of assets at each reporting date in accordance with paragraph 61 of the Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*. Had this review been done, in line with Treasury guidelines for municipalities "Municipal Finance Management Act – Local Government Capital Asset Management Guideline – October 2008" the amount for depreciation as disclosed in note 9 to the financial statements would have increased with an estimated amount of R5,7 million. This is due to the fact that gravel access roads are depreciated over a 30 year period instead of the recommended 5 to 15 years, there is no evidence to support the period selected by management. Consequently the depreciation and amortisation expense of R8,1 million disclosed in the statement of financial performance and note 31 to the financial statements is understated with an amount of R5,7 million.

16. Due to the limitations placed on the scope of my work and the municipal records not permitting the application of alternative procedures, I could not obtain sufficient appropriate evidence to confirm that the property, plant and equipment amounting to R98,5 million disclosed in the statement of financial position and note 10 to the financial statements is reflected at the correct amount.

### Value added tax

17. The municipality could not provide sufficient appropriate audit evidence to support the difference of R1,7 million noted between the VAT returns completed and submitted for the year and the amount disclosed in the statement of financial position and note 18 to the financial statements of R9,2 million. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, rights, completeness, valuation and allocation of the VAT receivable amounting to R9,2 million disclosed in the statement of financial position.

18. The municipality has paid VAT to suppliers that are not VAT vendors as required by the VAT act. We estimate that these payments amount to R0,2 million and they constitute fruitless and wasteful expenditure. The municipality has not made the required disclosure in the financial statements.

## **Investment property**

19. The Standard of Generally Recognised Accounting Practice, GRAP 16, *Investment Property*, paragraph 41 states that after initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value. The municipality has not complied with the above as the municipality did not disclose the fair value of its investment property.

## **Accumulated surplus**

20. The municipality could not provide sufficient appropriate audit evidence to support the debit journal entries processed to accumulated surplus after year end amounting to R11,6 million. Management has indicated that these journal entries relate to bank reconciling items that could not be traced to supporting documents in prior years due to bank reconciliations not being on a monthly basis. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the journal entries processed into accumulated surplus disclosed in the statement of financial position and the statement of changes in net assets were properly recorded.

## **Corresponding Figures**

21. In my previous report, I provided disclaimer of opinion on the municipality's financial statements for the year ended 30 June 2009. Through inspection of the corresponding figures for the current year it was noted that the municipality did not process all the correcting entries required to correct prior year balances and as such my audit report is modified regarding the corresponding figures.

## **Disclaimer of opinion**

22. 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:

## **Irregular expenditure**

23. As disclosed in note 45.3 to the financial statements, irregular expenditure to the amount of R3,8 million was incurred, as a total of 3 suppliers appointed by means of a competitive bidding process have not complied with the supply chain management policy for appointments. The non-compliance includes not making use of the preferential points system formula when evaluating a tender, winning providers not declaring interest in their bidding documents and not recording points awarded for price and equity ownership by historically disadvantaged individuals. Furthermore, sufficient quotations were not obtained in support of expenditure as required by the supply chain management policy.

## Unaudited supplementary schedules

24. The supplementary annexes set out on pages xx to 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

25. 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 the Municipal Finance Management Act, No 56 of 2003, Municipal Regulations, Division of Revenue Act, No 12 of 2009, Municipal Systems Act, No 32 of 2000 and financial management.

## Predetermined objectives

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

## Non-compliance with regulatory and reporting requirements

27. The integrated development plan of the Mbizana Local 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.

## Usefulness of reported performance 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. During the audit of predetermined objectives it was noted that the municipality's Key performance indicators differ from the Municipal Systems Act requirement of "input indicator" that measures the costs, resources and time used to produce an output "output indicator" measures the results of activities, processes and strategies of a program; "outcome indicator" measures the quality and or impact of an output on achieving a particular objective.

30. The actual achievements with regard to 100% of all planned indicators and targets specified in the integrated development plan for the year under review, for the selected programmes were not reported in the annual performance report submitted for audit purposes.

### **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 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:

32. Changes to the indicators from the approved annual performance plan for the year under review, were not disclosed and explained as required in terms of the relevant National Treasury preparation guide.

33. Actual achievements to targets are not documented, this includes targets not met with reasons for non-performance. There is no evidence that progress on performance is reviewed annually.

### **Compliance with laws and regulations**

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

#### **The municipality did not disclose all the required information in its website**

34. The municipality did not have all the required information disclosed on its website as required by section 75(2) of the MFMA. This includes the following information not disclosed:

- The annual and adjustments budgets and all budget-related documents.
- All budget-related policies.
- The annual report.
- All service delivery agreements.
- All supply chain management contracts above a prescribed value.
- All quarterly reports tabled in the council in terms of section 52(d)

**The municipality did not timeously submit its section 71 reports**

35. For the first 6 months of the period being audited the municipality did not submit within 10 working days after month end, budget statements to the mayor and relevant Provincial Treasury as required by section 71 of the MFMA.

**The accounting officer did not adhere to his statutory responsibility**

36. Monies received by the municipality are not promptly deposited into the Municipality's primary bank account as required by section 64 (2) (d) of the MFMA.

37. Interest earned on investments is not transferred from the investment account to the municipality's primary bank account as required by section 8 (4) of the MFMA. All interest earned is kept in the investment account.

38. The municipality did not submit bank account details to the Office of the Auditor-General and Provincial Treasury as required by section 9 of the MFMA.

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

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

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

**The code of conduct was not distributed to all employees**

40. A copy of the code of conduct was not distributed by the Municipal Manager to all members of staff in terms of section 70(a) of the MSA.

**The municipal by-laws were not maintained as required by legislation**

41. During the year under review no evidence could be obtained that all by-laws applicable to the municipality are maintained, updated and centrally filed as required by section 15 of the MSA.

**Environment Conservation Act, 1989 (Act No. 73 of 1989)**

**The municipality does not have a permit to operate a landfill site as required by legislation**

42. Section 20(1)(a) of the Act states that "No person shall establish, provide or operate any disposal site without a permit issued by the Minister of Water Affairs and that the Minister may issue a permit subject to such conditions as he may deem fit." The municipality's landfill site is illegal as the municipality failed to obtain a permit for the site.

## **Value Added Tax Act, 1991 (Act No. 89 of 1991) (VAT)**

### **The accounting officer did not adhere to his statutory responsibilities**

43. The municipality did not keep and maintain the required records and documents as required by section 55 of the VAT Act and there was inadequate monitoring of VAT to ensure compliance with the VAT Act.

### **The municipality has paid VAT to non VAT vendors**

44. The municipality has made VAT payments on invoices for suppliers that are not registered VAT vendors.

### **The municipality did not submit its VAT returns within the legislated timeframes**

45. VAT returns are not submitted on or before the 25<sup>th</sup> of every month as required by section 28 of the VAT Act.

### **Municipal Property Rates Act, Act No.6 of 2004**

### **The municipality did not have an updated property register for the year under review**

46. The municipality does not maintain an updated register in respect of properties situated within that municipality, as stipulated in MPRA section 6 of 2004 (last performed a general valuation of properties in 1998). Subsequently the municipality has performed a general valuation on properties.

### **Unemployment Insurance Contributions Act, Act No. 4 of 2002**

### **The municipality did not deduct and pay UIF for councillors**

47. The Unemployment Insurance Contributions Act determines under section 5 that:

(1) Every employer and every employee to whom this Act applies must, on a monthly basis, contribute to the Unemployment Insurance Fund.  
(2) The contributions must be paid by the employer either to the commissioner in terms of section 8 or to the Unemployment Insurance Commissioner in terms of section 9, whichever is applicable to the employer.

The municipality has not complied with the above as no Unemployment Insurance Contributions were paid to the Unemployment Insurance Fund in respect of the councillors.



## **Basic Conditions of Employment Act (Act No. 75 of 1997)**

**The employees of the municipality have worked overtime in excess of the allowed number of hours in terms of legislation**

48. According to the Basic Conditions of Employment Act, 1997 (Act No 75 of 1997), employees can only work a maximum of 3 hours overtime a day or 10 hours a week, except with accordance to an agreement. The agreement cannot extend more than 12 hours a day or 15 hours per week and the agreement must not last for more than 2 months. Employees are working more overtime hours than the amount allowed as stipulated in the above Act.

## **INTERNAL CONTROL**

49. 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, 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), but not for the purpose of expressing an opinion on the effectiveness of internal control.

50. 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**

51. Oversight responsibility over the preparation of financial statements, report on predetermined objectives, compliance with the laws and regulations and internal control was not exercised by the accounting officer. Leadership has not ensured that there is a process in place to ensure that reviews take place before submission. This was also evidenced by the numerous instances of non-compliance with laws and regulations, the internal control deficiencies and material misstatements in the financial statements that were noted throughout the audit process.

52. Instances have been identified where there is a lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non performance.

## **Financial and performance management**

53. Instances have been identified where quality, reliable monthly financial statements and management information is not prepared by the municipality. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting. Numerous errors have been noted on the annual financial statements submitted which is an indication that the financial statements were not adequately reviewed by management before submitting the final version for audit.



30 November 2010

East London

*Auditor-General*

59. An internal audit department has been established within the municipality, this department has however not conducted any internal audits during the period being reviewed.
58. Although an audit committee has been established there has only been three meetings held since inception (first meeting held 07/04/2010), this newly formed committee has not been established long enough to have discharge their duties within the period being reviewed.
57. A fraud prevention strategy has been adopted after year end, however, there is no evidence that management has taken action during the period being reviewed to address fraud risk (Fraud prevention strategy).
56. Risk identification and management processes are not designed to identify changes in processes or risks and verify that the design of underlying controls remain effective. The municipality has not selected and developed internal controls to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

#### **Governance**

55. The municipality does not have adequate financial management systems in place. Numerous instances have been identified where the municipality did not have manual or automated controls designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
54. The municipality does not have proper record keeping and record management processes in place to ensure that the documentation supporting the amounts and disclosures in the financial statements are properly filed and easily retrievable. Information requested for audit purposes was not readily available. In some cases, the documentation was not received at all which resulted in a limitation of scope being placed on the audit.