

REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND COUNCIL ON IKWEZI MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Ikwezi Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and statement of cash flows 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 XX to XX.

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 Statements of Generally Recognised Accounting Practice (GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007)(DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic 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 *1111 of 2010* issued in Government Gazette *33872 of 15 December 2010*. 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 qualified audit opinion.

Basis for qualified opinion

VAT receivable

7. Value Added Taxation (VAT) amounts were incorrectly processed in the general ledger of the municipality as input and output VAT was not always claimed on expenses incurred and revenue recognised, resulting in expenditure being overstated by R739 456, revenue being overstated by R617 630 and the VAT receivable being understated by R121 826. I could not apply alternative procedures to satisfy myself on the completeness and valuation of VAT receivable.
8. In addition, the municipality was unable to reconcile the VAT receivable of R1,4 million, as disclosed in the statement of financial position and note 4 to the financial statements, to the returns submitted to the South African Revenue Services (SARS). The municipality's records did not permit the application of alternative audit procedures. As a result, I was unable to obtain sufficient appropriate evidence relating to the existence, completeness and valuation of the VAT receivable as disclosed in the statement of financial position.

General expenses

9. In terms of paragraph 101 of GRAP 1: *Presentation of financial statements*, an entity shall present an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant. Expenditure to the amount of R3,2 million included in other expenses within general expenditure was incorrectly classified. Furthermore, the classification, occurrence and completeness of R1,1 million of general expenditure included in R17,5 million as disclosed in note 21 to the financial statements could not be confirmed as sufficient appropriate evidence was not provided.

Opinion

10. 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 Ikwezi Municipality as at 30 June 2011 and its financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

11. As disclosed in notes 35 to the financial statements, the corresponding amounts included in the financial statements for the financial year ended 30 June 2011 have been restated for the purposes of corrections of errors in the prior year. These corrections were mainly due as a result of Directive 4 principles not being applied correctly in the prior period.

Unauthorised, fruitless and wasteful and irregular expenditure

12. As disclosed in note 31, the Municipality incurred unauthorised expenditure of R5,6 million as a result of exceeding the total amount of the vote and incurring expenditure not in accordance with the purpose of the conditional grants.
13. As disclosed in note 33, the municipality incurred expenditure to the amount of R31,1 million without following supply chain management requirements which has resulted in it being classified as irregular expenditure.
14. As disclosed in note 32, the municipality incurred fruitless and wasteful expenditure to the value of R69 120.

Material losses and impairments

15. Contrary to section 64(2) (a) and (g) of the MFMA the municipality did not implement an effective revenue collection system and as a result not all revenue due was collected. This led to the impairment of debtors (provision for doubtful debt) by R9,1 million (2010: R6,5 million) which is disclosed in note 2 and 3 to the financial statements. Furthermore, the municipality had not taken the necessary action in terms of the Council's credit control policy to disconnect services for long outstanding consumer debtors.
16. As reported in note 34 of the annual financial statements, the municipality suffered a significant electricity loss of 1,6 million kilowatts with a value of R341 834 during the year under review.

Additional matters

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

Unaudited supplementary schedules

18. The supplementary information set out on pages xx to xx does not form part of the financial statements and is 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

19. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the Municipality.

Predetermined objectives

Presentation of information

20. The following criterion is relevant to the finding below:

- Performance against predetermined objectives is reported using the National Treasury guidelines.

Audit finding:

Measures taken to improve performance were not provided in the performance report

21. Measures taken to improve performance were not provided in the performance report, as required in section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total, all of the indicators had no details of the measures taken to improve performance.

Usefulness of information

The following criteria are relevant to the findings below:

- Consistency: Objectives, indicators and targets are consistent between planning and reporting documents
- Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets
- Measurability: Indicators are well-defined and verifiable, and targets are specific, measurable and time-bound

Audit findings:

Reported objectives, indicators and targets are not consistent when compared with the planned objectives, indicators and targets

22. Reported performance against predetermined objectives, indicators and targets is not consistent with the approved integrated development plan. In total 80% of the reported objectives, indicators and targets were not consistent when compared to the planned objectives, indicators and targets.

Reported objectives, measures and targets are not relevant to the planned objectives of the municipality

23. The measures and targets as per the integrated development plan did not relate directly in 100% of instances to the annual performance reports objectives.

Reported objectives, indicators and targets are not consistent when compared with the planned objectives, indicators and targets

24. Fifty per cent of reported performance against predetermined objectives and 77% of reported performance against predetermined indicators and targets are not consistent with the approved IDP.

Planned and reported targets are not specific and time bound

25. For both the planned and reported targets:

- Twenty seven per cent were not specific in clearly identifying the nature and the required level of performance;
- Forty one per cent were not time-bound in specifying the time period or deadline for delivery.

Compliance with laws and regulations

Strategic planning and performance management

26. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury, and the Provincial Treasury as required by section 72(1)(b) of the MFMA.

Budgets

27. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

28. The mayor did not submit all quarterly reports to council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

Annual financial statements, performance and annual reports

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of capital assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

30. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of Supply Chain Management (SCM) regulation 17(a) & (c).

31. Quotations were accepted from prospective providers who are not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).

32. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).

33. Final awards and/or recommendation of awards to the accounting officer were not always made by an adjudication committee which was constituted of four senior managers as per the requirements of SCM regulation 29(2).
34. Awards were made to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state as per the requirements of Municipal SCM regulation 13(c).
35. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act (PPPFA) and SCM regulation 28(1)(a).
36. The performance of contractors or providers was not monitored on a monthly basis as required by section 116(2)(b) of the MFMA.
37. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA.
38. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered and qualified for the contract in accordance with the prescripts of the Construction Industry Development Board.
39. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

Expenditure management

40. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
41. The accounting officer did not take reasonable steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.
42. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised expenditure when it was incurred and accounted for creditors of the municipality, as required by section 65(2)(b) of the MFMA.

Transfer and conditional grant

43. The municipality did not always submit quarterly reports to the transferring national officer on non-financial performance in respect of the allocation received for Grants as required by section 11(2)(c) of DoRA.

Revenue Management

44. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.

45. A credit control and debt collection policy was not implemented as required by section 96(b) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
46. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned, as required by section 64(2)(e) of the MFMA.

Asset Management

47. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.
48. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

Internal audit

49. The internal audit processes and procedures did not include assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the Municipal Systems Act as required by Municipal Planning and Performance Management Regulation 14.
50. The internal audit processes and procedures did not include assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators as required by Municipal Planning and Performance Management Regulation 14.
51. The internal auditors of the municipality did not audit the performance measurements on a continuous basis as required by Municipal Planning and Performance Management Regulation 14.
52. 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 by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14.

Audit committee

53. The audit committee did not perform the following as required by Municipal Planning and Performance Management Regulation 14:
 - review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality
 - review the municipality's performance management system and make recommendations in this regard to the council of the municipality
 - submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

INTERNAL CONTROL

54. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

55. There is a lack of oversight and accountability of senior management as sufficient monitoring controls are not in place to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting and adherence to internal policies and procedures at department level and for the purpose of taking corrective action. Although the audit action plan was formulated and implemented, it was not effective and properly monitored as audit findings on revenue, expenditure, assets and unspent conditional grant were identified in the current financial year that led to a qualification.
56. The municipality does not have adequate processes in place to identify and record irregular expenditure. There is a lack of monitoring by senior management which resulted in irregular expenditure identified in the year under review which was subsequently disclosed in the financial statements.
57. The municipality does not have adequate assignment of responsibility and processes in place to monitor compliance with the approved budget and ensure compliance all applicable laws and regulations. The municipality has thus incurred unauthorised expenditure and not fully complied with all requirements of the MFMA.

Financial and performance management

58. The municipality's manual and automated controls are not designed and implemented to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. Management does not adequately manage transactions upon recording which resulted in the findings under the Basis for qualification opinion paragraphs, predetermined objectives and compliance with laws and regulations.
59. The municipality did not prepare quarterly financial performance reports. Furthermore, the municipality did not prepare monthly reconciliations relating to revenue, conditional grant expenditure, the VAT control account and creditors. This has resulted in a lack of supporting documentation to explain material differences found during the audit.
60. The municipality place a large amount of reliance on consultants appointed for the preparation of financial statements. However, due to the lack of systems and controls in place at the municipality, material misstatements were identified during the audit for which inadequate documentation and explanations by management could not be obtained in order to adjust the financial statements.

61. The municipality did not have processes in place to ensure compliance with laws and regulations and thus, the municipality has not complied with all requirements of MFMA, MSA and Local Government Municipal Planning and Performance Management Regulations, SCM regulations and DoRA.

Governance

62. The audit committee reviewed the annual financial statements and noted their concerns about the quality thereof. However, management did not correct these concerns before submitting the annual financial statements for audit purposes.

63. Despite an adequate risk assessment process, the municipality did not respond to and adequately monitor the risks identified. As a result, there were numerous instances of non-compliance with the MFMA, MSA, SCM and DoRA.

Auditor-General

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence