

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Inkwanca Local 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 cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages x to x and 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 South African Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (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 (PAA) my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Because of the matters described in the Basis for Disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for audit opinion.

Basis for Disclaimer

Revenue

4. Included in revenue is an amount of R 8 829 420 (2010: R 864 000) for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, occurrence, accuracy, cut-off and classification of revenue.

5. As per GAMAP 9, Revenue, revenue shall be measured at the fair value of the consideration received or receivable. Not all rateable properties were captured onto the system and errors were made in basic service charges billings, resulting from incomplete assessment rates charged of R 1 968 599. Consequently, revenue and other receivables from exchange transactions are understated by R 1 968 599.
6. In terms of paragraph 15 of GRAP 9, Revenue from Exchange Transactions, revenue shall be recognised at the fair value of the consideration received or receivable. In contravention of this requirement, included in trade and other receivables is an amount of R 2 059 956 (2010: R 1 672 263) resulting from incorrect basic service charges charged, differences found in assessment rate charges, interest charged and VAT errors. Consequently, revenue and trade and other receivables are overstated by R 2 059 956.
7. Inter-departmental charges of R 1 182 773 (2010: R 415 815) have not been recorded in terms of paragraph 12 of GRAP 9 as the municipality charged itself service charges when there were no inflows of economic benefits. Consequently, revenue and trade and other receivables are overstated by R 1 182 773.

Trade and other receivables

8. Included in the gross balance of trade and other receivables included in note 2 is an amount of R 23 113 289 (2010: R 4 726 242) relating to trade and other receivables for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation, rights, existence and completeness of trade and other receivables.
9. An amount of R 442 973 relating to credit balances for unallocated receipts were incorrectly processed to trade and other receivables. Consequently trade and other payables and trade and other receivables are understated by R 442 973.
10. IFRS 7 – Financial Instruments: Disclosure requires a disclosure of an analysis of the age of financial assets that are past due but not impaired as at the end of the reporting period. Contrary to this requirement, incorrect ageing of trade and other receivables was disclosed in note 2 to the annual financial statements.

Employee related costs

11. Included in employee related costs is an amount of R 3 128 782 (2010: R 170 000) for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, occurrence, accuracy, cut-off and classification of employee related costs.
12. Furthermore, an amount of R 173 328 relating to stand by allowances was calculated using the incorrect rate of the daily tariff. Consequently, employee related costs and trade and other payables are understated by R 173 328.

Accumulated deficit

13. Included in note 42 relating to the corrections of prior year errors is an amount of R 484 324 (2010: R 372 173) for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence as to the completeness, valuation, existence, and rights and obligations of accumulated deficit.
14. Reclassifications, correction of prior year errors and directive 4 amendments are included in note 42 to the annual financial statements. Amounts of R 364 524, R 362 014 and R 771 542 relating to grant revenue, other income and grant expenditure respectively were not recorded in the prior year and have not been disclosed as prior year errors. Consequently, the disclosure of prior period errors is incomplete by R 1 498 080.

Provisions

15. IAS 19: Employee Benefits, requires the entity to recognise a present obligation for leave days and bonus accrued at year end. Contrary to this requirement, the following material misstatements were identified during my audit:
 16. An amount of R 237 929 (2010: R 168 370) relating to provision for leave pay was incorrectly calculated. The number of leave days taken per the system does not agree to the leave forms in the leave form file. Consequently, employee related costs and the leave pay provision are overstated by R 237 929 (2010: R168 370).
 17. An amount of R 313 653 (2010: R 241 419) relating to bonus provision was incorrectly calculated. The provision included employees with June birth months however the employees with birthdays in June had been paid their bonus before year end. Consequently, employee related costs and the bonus provision are overstated by R 313 653 (2010: R 241 419).
 18. The municipality is required by IAS 19: Employee Benefits to disclose in the financial statements, the amount of long service awards provision at financial year end. The municipality does not have a system in place for the identification and recognition of this provision and consequently did not disclose any provision for long service awards. I was unable to confirm or verify by alternative means the long service awards provision and as a result, I was unable to determine the long services awards provisions to be disclosed in the financial statements.

Irregular expenditure

19. Section 125(2) of the MFMA requires the notes to the annual financial statements to include any material irregular expenditure incurred during the financial year.
20. Irregular expenditure amounting to R 2 562 685 (2010: R 1 695 304) was not included as part of note 31 to the annual financial statements. This relates to contravention of section 12(4) of the MFMA. Consequently, irregular expenditure is understated by R 2 562 685.

Property, plant and equipment

21. In terms of s63(2)(c) of the Municipal Finance Management Act, the accounting officer must maintain a system of internal control of assets, including an asset register.
22. GRAP 16: Investment property and GRAP 17: Property, plant and equipment (PPE), read with Directive 4: Transitional Provisions for Medium and Low Capacity Municipalities requires the municipality to have recognised all Investment Property and PPE. Even though the opening balance of Investment Property and PPE at 1 July 2009 as disclosed in note 7.2 and note 6.2 respectively in the financial statements is reflected at zero (provisional values), the municipality is still required to maintain a complete listing of all Investment Property and PPE assets. The process to compile such a listing has not taken place and consequently the municipality has not recognised all Investment Property and PPE assets belonging to the municipality in its financial records.
23. In addition, the Municipality has included in its listing of Investment Property and PPE assets whose physical existence could not be verified or verified against a title deeds search.

Trade and other payables

24. Included in trade and other payables from exchange transactions is an amount of R 4 900 644, relating to Chris Hani District Municipality – Water Services Authority Control Account, for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence, valuation, obligation and classification of trade and other payables.
25. Paragraph 83 of Framework for the Preparation and Presentation of Financial Statements states the requirements for when a liability should be recognised. In contravention of this, the municipality did not accrue for invoices relating to payments made subsequent to year end amounting to R 125 928 (2010: R 508 000). The payments were made for general expenses and VAT incurred in the current financial year. Consequently, trade and other payables from exchange transactions and expenditure are understated by R 125 928 (2010: R 508 000).
26. IAS 39, Financial Instruments – Recognition and Measurement, requires financial liabilities to be initially recognised at fair value. Included in trade and other payables is an amount of R 252 196 resulting from the incorrect calculation of service charges charged to consumer debtors. These debtors have credit balances at year end and are included in trade and other payables on the statement of financial position. Consequently trade and other payables as well as revenue is understated by R 252 196.

Expenditure

27. Included in grants and subsidies expensed is an amount of R 3 989 183 (2010: R 1 355 400) for which adequate supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, occurrence, accuracy, cut-off and classification of grants and subsidies expensed.
28. In terms of paragraph 98 of GRAP 1, the nature and amount of all material items of revenue and expenses must be disclosed separately in the annual financial statements.
29. Included in the general expenses Note 28 is an amount of R 2 859 128 relating to the prior year of which a breakdown was not disclosed in the prior year annual financial statements. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy of the disclosure of individual, material prior year general expenses.

Financial sustainability

30. The municipality is currently in a net liability position of R 12 852 657 represented by an accumulated deficit of the same amount. The municipality is unable to settle short term debts timeously and could not provide indication of planned mitigating actions regarding the liquidity situation. There is a significant uncertainty as to whether the municipality will be able to settle its obligations as they fall due. The annual financial statements and notes thereto do not disclose this fact.

Cash flow statements

31. Included in the Cash flow statement is an amount of R 25 800 792 relating to payments of cash flows from operating activities for which supporting documentation could not be provided. The municipality's accounting records did not permit the application of alternative audit procedures. Consequently, I could not obtain sufficient appropriate audit evidence as to the presentation and disclosure of the cash flow statement.

Other explanatory information

32. Commitments have not been disclosed for the comparative figures included in note 33 to the financial statements. No contract management system was in place for the identification and recognition of contracts at the municipality. Consequently, I was unable to satisfy myself as to the completeness of the prior year disclosure.
33. The municipality did not disclose all the relevant information such as the maturity analysis for financial liabilities and financial instruments per category as required by the International Financial Reporting Standards – IFRS 7, Financial instruments: Disclosures.

Disclaimer of opinion

34. Because of the significance of the matters described in the Basis for disclaimer for disclaimer paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an opinion. Accordingly, I do not express an opinion on

the financial statements.

Emphasis of matters

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

Unauthorised expenditure

1. As disclosed in note 31 to the financial statements, unauthorised expenditure of R12 370 401 was incurred during the financial year.

Additional matter

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

Unaudited supplementary schedule

3. The supplementary information set out in appendix A, does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

4. 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 xx to xx and material non-compliance with laws and regulations applicable to the municipality.

Predetermined Objectives

Presentation of information

1. The following criteria are relevant to the findings below:
 - Performance against predetermined objectives is reported in accordance with section 46 of the MSA.
2. Audit findings:

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

- Measures taken to improve performance were not provided in the performance report, as required in terms of section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). None of the reported targets had details of the measures taken to improve performance.

Usefulness of information

3. 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 and measurable and time-bound

4. Audit findings:

Changes (including reasons for and approval thereof) to planned indicators and targets are not disclosed in the report on predetermined objectives

- Changes to the indicators and targets of the service delivery and budget implementation plan for the year under review were not disclosed and explained as required in terms of the Framework for Managing Programme Performance Information issued by National Treasury.

Indicators not consistent between the integrated development plan and the service delivery and budget implementation plan

- All of the indicators and targets of the service delivery and budget implementation plan were inconsistent with the integrated development plan.

Planned objectives and indicators are not relevant to the mandate and objectives of the entity

- The indicators and targets as per the integrated development plan did not relate directly in more than 46% of instances to the institution's strategic goals and objectives as per the five year integrated development plan.

Planned and reported indicators are not well defined

- For the selected objectives, 44% of the planned and reported indicators were not clear, as well defined data definitions were not available to allow for data to be collected consistently

Planned and reported targets are not specific

- For the selected objectives, 32% of the planned and reported targets were not specific in clearly identifying the nature and the required level of performance.

Reliability of information

5. The following criteria are relevant to the findings below:

- **Validity:** Actual reported performance has occurred and pertains to the entity
- **Accuracy:** Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately
- **Completeness:** All actual results and events that should have been recorded have been included in the annual performance report.

6. Audit findings:

Reported performance against targets is not complete when compared to source information

- For the selected objectives, ensure that all households have access to roads, communities have appropriate community lighting and provide a high level of water service, 17% of indicators selected for testing were not complete.

Reported performance against targets is not valid and accurate when compared to source information

- For the objectives related to ensuring that communities have appropriate community lighting, facilitating management of water demand, 100% expenditure on the capital projects funded by MIG grant, providing facilities for the dignified and environmentally safe disposal of human remains, promoting local business and facilitating SMME's training, and General key performance indicators as prescribed by section 43 of the MSA and regulation 10 of the Municipal Planning and Performance management Regulations, 2001, 38% of indicators selected for testing were not valid and accurate when compared to source information.

Reported performance against targets is not valid, accurate and complete as inadequate supporting source information was provided

- For the objectives relating to ensuring that all households have access to roads, facilitating the provision of adequate housing by 2014, creating a growing and sustainable economic sector, promoting local business and facilitating SMME's training, and General key performance indicators as prescribed by section 43 of the MSA and regulation 10 of the Municipal Planning and Performance management Regulations, 2001, 38% of indicators selected for testing could not be verified due to inadequate supporting source information. No alternative procedures could be performed to verify the reported performance.

Compliance with laws and regulations

Strategic planning and performance management

7. The accounting officer of the municipality did not by 25 January 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 Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA).
8. 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.

9. The integrated development plan does not contain an assessment of the existing level of development and identification of communities which do not have access to sanitation and solid waste removal as required by section(26)(b) of the MSA.
10. The integrated development plan did not include the key performance indicators and performance targets determined in according to 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.
11. The integrated development plan did not include the organogram as required by sections 26(a) of the MSA and regulation 2(3) of the Municipal Planning and Performance Management Regulations, 2001.
12. The integrated development plan did not include the financial plan and budget projection for at least the next three financial years, as required by sections 26(h) of the MSA and regulation 2(3) of the Municipal Planning and Performance Management Regulations, 2001.

Budgets

13. The municipality incurred expenditure that was not budgeted for and 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.
14. The accounting officer did not always submit the monthly budget statements to the mayor and the relevant provincial treasury, as required by section 71(1) of the MFMA.
15. Unforeseeable and unavoidable expenditure not provided for in the annual budget was incurred but was then not appropriated in an adjustment budget, as required by section 29(2)(d) of the MFMA.
16. The annual budget of the municipality is not based on the development priorities and objectives as well as the performance targets set by the municipality in its IDP as required by regulation 6 of the Municipal Planning and Performance Management Regulations, 2001.

Annual financial statements, performance and annual reports

17. 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, current liabilities, revenue, expenditure, net assets and disclosure items, , identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving an a disclaimer of opinion.
18. The municipal council did not adopt an oversight report containing the council's comments on the annual report within two months from the date on which the 2009/10 annual report was tabled in the council as required by section 129(1) of the MFMA.
19. The accounting officer did not make public the council's oversight report on the 2009/10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

20. The performance report for the 2009/10 financial year was not included in the 2009/10 annual report as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) read with section 121(3)(c) of the MFMA.

Audit Committees

21. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information as required by section 166(2)(a)(iv) of the MFMA.
22. The audit committee did not advise the municipal council, the political office bearers, the accounting officer and the management staff of the municipality on matters relating to compliance with the MFMA, the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010) (DoRA) and other applicable legislation as required by section 166(2)(a) of the MFMA.
23. The performance audit committee or another committee functioning as the performance audit committee did not perform the following as required by Municipal Planning and Performance Management Regulation 14:
24.
 - 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 Audit

25. Internal audit did not report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation as required by section 165(2)(b) of the MFMA.
26. 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.
27. 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 MSA as required by Municipal Planning and Performance Management Regulation 14.
28. 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.
29. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee as required by Municipal Planning and Performance Management Regulation 14.

Procurement and contract management

30. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of the Municipal Supply Chain Management Regulations (Notice 868 of 2005) (SCM regulation) 19(a) and 36(1).
31. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
32. 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

33. 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.
34. 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 / accounted for creditors of the municipality / accounted for payments made by the municipality, as required by section 65(2)(b) of the MFMA.
35. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
36. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.
37. Money received by the municipality for conditional grants was used for purposes other than per the conditions of the related grant, as required by section 12(4) of the MFMA.

Revenue management

38. 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.
39. A credit control and debt collection policy was not implemented as required by section 96(b) of the MSA.
40. 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 / accounted for debtors / accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.

Asset Management

41. 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.

42. 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.

INTERNAL CONTROL

43. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

44. Leadership

Management performed inadequate reviews of recording and processing of data into the general ledger system and as a result numerous unnecessary material errors were found.

Municipality's Council performed inadequate reviews of the accounting policies, amounts and disclosure notes reported in the annual financial statements and relied on the financial statement consultants to prepare the financial statements. As a result the financial statements included incomplete accounting policies and disclosure notes and inaccurate balances / totals.

There is a lack of / inadequate policy and procedure documents addressing fundamental accounting practices, and for which no persons are held responsible.

Responsibility and accountability has not adequately been delegated to management to ensure compliance with the applicable legislation.

45. Financial and performance management

Monthly reconciliations are not performed between general ledger / trial balance accounts and the sub-ledgers, specifically with regards to revenue, trade receivables and employee related costs. As a result information from the sub-ledgers updated to the general ledger is incomplete or inaccurate.

Management performed inadequate reviews of recording and processing of data into the general ledger system and as a result numerous unnecessary material errors were found.

Cash flow problems of the Municipality resulted in numerous supplier invoices not being paid within 30 days of invoice, resulting in non-compliance with the MFMA.

Transactions taking place after year end are not evaluated to determine if there is a possible effect for the related financial year, for example supplier payments made after year end are not evaluated to establish if they give an indication of purchases not recorded in the correct financial year.

Inadequate reviews take place to ensure the procurement processes are followed as required by the SCM requirements and the MFMA.

Fixed asset registers are not updated adequately for changes made with regards to immovable property and other fixed assets.

Documentation is inadequately filed and stored by the Municipality resulting in documentation not being timeously provided for audit.

46. Governance

The work of the internal audit unit is not regularly reviewed to ensure that the responsibilities of the internal auditors are being performed effectively and reliably. The Audit Committee did not perform ongoing monitoring and supervision to enable management to determine whether internal control over financial reporting is present and functioning.

East London

30 November 2011



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence