

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Intsika Yethu Municipality, which comprise the statement of financial position as at 31 June 2011, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, and a summary of significant accounting policies and the accounting authority's report, as set out on pages ... to ...

Accounting officer's responsibility for the annual 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 General Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as management determines necessary to enable the preparation of the 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 South Africa 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 the 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 an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. The property, plant and equipment balance of R61.6 million as disclosed in note 4 to the annual financial statements does not agree to the balance of R177.2 million per the underlying accounting records. Furthermore, the municipality did not reconcile this difference of R115.6 million between the financial statements and the underlying accounting records and could not provide sufficient appropriate audit evidence to support this amount.
5. Included in note 4 to the annual financial statements are additions of R34.4 million. The municipality could not provide supporting documentation for additions amounting to R5.4 million. The existence of these assets could also not be physically verified.
6. Property, plant and equipment amounting to R38.1 million were selected from the fixed asset register but could not be physically verified. Further, moveable assets amounting to R28.2 million, and additions of R 26.3 million, were selected from the floor but could not be traced to the fixed asset register. There were no satisfactory alternative procedures that could be performed to obtain reasonable assurance that property, plant and equipment of R98.0 million exists and was completely recorded.

7. The fixed asset register reflects municipal land at a value of R7 million while the valuation roll of municipal properties totals R90.2 million. The municipality could not provide appropriate audit evidence to support the difference totalling R83.2 million. Further, a title deed search was performed and 625 properties, the value of which could not be determined, were identified as being registered to the municipality however were not included on the fixed asset register.
8. Accounting policy note 1.3 and note 4 to the annual financial statements refers to relief relating to the subsequent measurement of property, plant and equipment in terms of Directive 4 issued by the Accounting Standards Board. This directive, however, requires that the municipality identify and correctly classify all their assets between different types of assets, and to recognise the assets using the principles in the Standards of Generally Recognised Accounting Practice (GRAP) or at provisional amounts using the relief allowed in Directive 4. These requirements were not fully adhered to by the municipality, and as a result, Directive 4 was not correctly applied.
9. Insufficient disclosure was made regarding the progress made by the municipality in respect of measuring property, plant and equipment, investment properties and intangible assets as well as recognising major classes of assets that have not been recognised in full, as required by the Standard of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements*.
10. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence, valuation, rights and obligations and presentation and disclosure of the property, plant and equipment balance of R61.6 million as disclosed on the Statement of Financial Position and in note 4 to the annual financial statements.

Investment property

11. The municipality did not disclose investment property, in accordance with GRAP 16: *Investment Property* and Directive 4. Although the municipality is not required to disclose a value for investment property, any investment property of the municipality should be recognised and disclosed in the notes to the financial statements, with the transitional provisions of directive 4 included. Investment property was identified at the municipality and therefore the disclosure with regards to investment property is not complete.

Cash and cash equivalents

12. As disclosed on the statement of financial position and note 2 to the financial statements, cash and cash equivalents of R9.5 million do not agree to the bank reconciliation. This is a result of the general ledger not agreeing to the annual financial statements to the value of R502 387 and bank accounts not being included on the general ledger of R862 439. Consequently, cash and cash equivalents are understated by an amount of R1.4 million and the impact on the financial statements as a whole could not be determined.
13. The municipality could not provide sufficient appropriate audit evidence to support reconciling items totalling R2.3 million between cash and cash equivalents stated in the statement of financial position and the year-end bank reconciliation, as well as amounts totalling R1.5 million not being cleared timeously from the suspense accounts. Further, no sufficient, appropriate audit evidence could be provided to support transfers between the municipality's bank accounts of R27.7 million.
14. Municipal bank accounts to the value of R2.2 million have been incorrectly classified as investments resulting in the understatement of cash and cash equivalents and the overstatement of investments.

15. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, valuation, rights and presentation and disclosure pertaining to cash and cash equivalents of R9.9 million disclosed in note 2 to the financial statements.

Investments

16. Included in the Statement of Financial Position are investments of R2.4 million. Bank confirmations for the balances totalling R678 270 were not provided for audit purposes and there were no satisfactory alternative audit procedures that I could perform.
17. Municipal bank accounts to the value of R2.2 million have been incorrectly classified as investments resulting in the understatement of cash and cash equivalents and the overstatement of investments.
18. Further comparison with the investment register identified differences totalling R793 463 between the investment register and general ledger. The municipality did not reconcile this difference of R793 463 between the annual financial statements and the underlying accounting records and could not provide sufficient appropriate audit evidence to support this amount.
19. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself that investments exist, are complete, accurately valued and appropriately presented and disclosed.

Trade receivables from exchange transactions

20. Included in the balance of R2.2 million for trade receivables from exchange transactions are credit balances for an amount of R956,000. Consequently, trade receivables from exchange transactions disclosed on the statement of financial position and note 9 to the financial statements, and trade and other payables from exchange transactions in note 11, are understated by R956,000 respectively.
21. The trade receivables for exchange transactions balance of R3.9 million as disclosed in note 7 to the annual financial statements does not agree to the balance of R2.2 million per the underlying accounting records. Furthermore, the municipality did not reconcile this difference of R1.7 million between the annual financial statements and the underlying accounting records and could not provide sufficient appropriate audit evidence to support this amount.
22. Included in note 7 to the annual financial statements are trade receivables for exchange transactions of R3.9 million. The municipality could not provide supporting documentation for these receivables amounting to R3.3 million. The existence of these debtors could also not be confirmed.
23. The corresponding amount for trade receivables for exchange transactions of R3.97 million does not agree to the prior year audited amount of R930 998. No supporting documentation was available for the difference of R3 million.
24. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the trade receivables for exchange transactions balance of R3.9 million, and the corresponding amount of R3.97 million, as disclosed on the Statement of Financial Position.

Other receivables from non-exchange transactions

25. Trade receivables from non-exchange transactions of R11.5 million, disclosed on the statement of financial performance and note 5 to the financial statements, consists of deposits of R15.9 million and a credit of R4.4 million for sundry debtors. Supporting

documentation to support these balances could not be provided for audit purposes, and the records of the municipality did not permit the application of alternative procedures.

26. In addition to the above, staff debtors of R2.5 million have not been included in other receivables from non-exchange transactions in note 5 to the financial statements. Consequently, other receivables from non-exchange transactions is understated by R2.5 million.
27. The municipality could not provide sufficient appropriate evidence to support credit journals of R6.2 million for receivables. There were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
28. Consequently, I was unable to obtain sufficient appropriate evidence to satisfy myself as to the existence, completeness, valuation, rights and obligations of trade receivables from non-exchange transactions of R11.5 million as disclosed in note 5.

VAT Receivable

29. The municipality could not provide sufficient appropriate evidence for VAT output charged for R4.7 million. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance regarding the occurrence, accuracy, classification and completeness of VAT output.
30. The municipality has overstated VAT output on certain revenue transactions. Therefore, the VAT receivable disclosed in the statement of financial position and note 6 to the financial statements is understated by R232 823.
31. The municipality did not include output VAT on all eligible revenue payable to the South African Revenue Service (SARS). Consequently, the VAT receivable disclosed in the statement of financial position and note 6 to the financial statements is overstated by R579 115.
32. The municipality did not claim input VAT on all eligible expenditure. Consequently, the VAT receivable disclosed in the statement of financial position and note 6 to the financial statements is understated by R591 536.
33. The municipality could not provide sufficient appropriate evidence to support debit journals of R626 512 for VAT receivables. There were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
34. Consequently, I was unable to satisfy myself regarding the valuation, allocation of and existence of the VAT receivable amounting to R1.4 million disclosed in the statement of financial position and note 6 to the financial statements.
35. The corresponding amount for the VAT receivable of R2.2 million does not agree to the prior year audited amount of R1.8 million. No supporting documentation was available for the difference of R385 973. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy, completeness and occurrence of the VAT Receivable corresponding amount of R2.2 million as disclosed on the Statement of Financial Position and note 6 to the annual financial statements.

Trade and other payables from exchange transactions

36. Credit balances on trade receivables were not classified as trade and other payables. Consequently, trade and other payables disclosed in note 11 to the financial statements, and accounts receivable disclosed in note 9, are understated by an amount of R956 000 respectively.

37. The municipality could not provide sufficient appropriate evidence to support a balance of R11.4 million for trade and other payables disclosed in the statement of financial position and note 11 to the financial statements. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that the balance of R11.4 million is fairly stated.
38. Credit purchases was not disclosed and measured at fair value taking into account imputed interest as required by International Financial Reporting Standards, IFRS 7, *Financial Instruments: Disclosure* and International Accounting Standards, IAS 39, *Financial Instruments: Recognition and Measurement* respectively. As a result, payables from exchange transactions on the statement of financial position of R11.5 million is overstated by R609 561, and the corresponding adjustment is accounted for in finance costs which are disclosed on the statement of financial performance.
39. The corresponding amount for trade and other payables from exchange transactions of R5.8 million does not agree to the prior year audited amount of R11.1 million. No supporting documentation was available for the difference of R5.3 million.
40. Consequently, I was unable to satisfy myself regarding valuation, allocation of, completeness, existence and obligations on trade and other payables of R11.4 million.

Provisions

41. In accordance with GRAP 19: *Provisions, Contingent liabilities and Contingent assets*, a provision should be recognised when the entity has a present obligation as a result of a past event and a reliable estimate can be made of this amount. In contravention of the standard, the municipality has not provided for service bonuses, calculated to be R309 280, and performance bonuses, amounting R311 727, for the next financial period.
42. The municipality could not provide sufficient appropriate evidence for the provision for landfill sites of R209 275 as disclosed in note 8 to the annual financial statements. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that the provision of R209 275 is fairly stated.
43. Note 8 to the financial statements reflects an amount of R2.9 million for leave provision. This balance was incorrectly accounted for as a provision instead of an accrual. Therefore provisions are overstated by R2.9 million and accruals understated by the same amount.

Accumulated surplus

44. The accumulated surplus balance of R53.5 million as disclosed in the Statement of Changes in Net Assets does not agree to the balance of R132 million per the underlying accounting records. Furthermore, the municipality did not reconcile the difference of R78.6 million between the financial statements and the underlying accounting records and could not provide sufficient, appropriate audit evidence to support this amount.
45. Recalculation of the Statement of Changes in Net Assets identified errors in the computation of the figures resulting in an error of R1.1 million. The accumulated surplus at 30 June 2011 is therefore understated by this amount.
46. The opening balance for Accumulated Surplus for the current year in the Statement of Changes in Net Assets of R52,4 million does not agree to the prior year audited amount of R54.3 million. No supporting documentation was available for the difference of R1.9 million. Consequently, I was unable to obtain sufficient, appropriate audit evidence to satisfy myself as to the valuation and allocation of and rights pertaining to the accumulated surplus opening balance figure of R52.4 million.

Revenue

47. Supporting registers for other income amounting R1.1 million, including agency fees of R442 059, could not be provided for audit purposes. There were no satisfactory alternative procedures that could be performed to obtain reasonable assurance that Other income of R635 602 as disclosed on the statement of financial performance and note 14 to the annual financial statements was accurately and completely disclosed.
48. Agency fees of R442 059 was identified in the general ledger but was not reported in the annual financial statements. Further, no supporting documentation could be provided for this amount and there were no satisfactory alternative procedures that could be performed to determine the accuracy of this amount.
49. Revenue from grants was recorded twice as a result of journals that were processed incorrectly. Consequently, grants revenue disclosed in the statement of financial performance and note 13 to the financial statements is overstated by R3 million.
50. The municipality could not provide sufficient appropriate evidence to support credit journals of R6.2 million for revenue. There were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all transactions were properly recorded.
51. The corresponding amount for revenue of R86.9 million does not agree to the prior year audited amount of R88.7 million. No supporting documentation was available for the difference of R1.8 million. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy, completeness and occurrence of the revenue corresponding amount of R86.9 million as disclosed on the Statement of Financial Performance.
52. Consequently, I was unable to satisfy myself regarding completeness, occurrence, accuracy and classification of revenue disclosed in the statement of financial performance.

Government grants and subsidies expenditure

53. The Standards of Generally Recognised Accounting Practice (GRAP) 23: *Revenue from Non-Exchange Transactions* requires that revenue is recognised as the goods and services are provided. Through inspection of the general ledger, grants and subsidies revenue of R29.6 million relating to conditional grants has been recognised. However, corresponding expenditure of only R9.7 million was identified. The municipality could not provide sufficient appropriate evidence to support the difference of R19.9 million.
54. The government grants and subsidies revenue is therefore overstated by R19.9 million and unspent conditional grants liability is understated by the same amount.

General Expenditure

55. The municipality could not provide sufficient appropriate evidence for expenditure incurred for R21.4 million. There were no satisfactory alternative procedures that I could perform to obtain assurance regarding the occurrence and accuracy of this expenditure.
56. Operating expenditure of R32.9 million disclosed on the Statement of Financial Performance and note 15 to the annual financial statements contains misclassifications between expenditure accounts amounting to R449 760. Further, errors between the amounts recorded in the general ledger and the supporting documentation amounting R325 723 were identified which resulted in expenditure being overstated by this amount.
57. Value Added Tax (VAT) was accounted for incorrectly on certain expenditure transactions resulting in expenditure being understated by R157 980. Had these transactions been accounted for correctly, expenditure would have increased by R157 980 and the VAT receivable would have decreased by the same amount.

58. Included in legal fees per note 15 to the annual financial statements is an amount of R462 380 which relates to the prior financial year. This has resulted in expenditure in the current financial year being overstated, prior year expenditure being understated as well as prior year accounts payable being understated by R455 505.
59. The municipality wrote off bad debts in the current year of R3.6 million but did not write this off against the provision for debt impairment which was raised in the prior year, but instead incorrectly expensed the bad debts written off. A further R3.4 million was written off and no provision was made for this write off and no explanations could be provided by management for this amount. Consequently, bad debts disclosed in the statement of financial performance and note 20 to the financial statements are overstated by R7.1 million.
60. The municipality's records did not permit the application of alternative procedures and consequently I could not satisfy myself as to the accuracy, cut-off and appropriate classification of expenditure.
61. Expenditure was not disclosed and measured at fair value taking into account imputed interest as required by International Financial Reporting Standards, IFRS 7, Financial Instruments: Disclosure and International Accounting Standards, IAS 39, Financial Instruments: Recognition and Measurement respectively. As a result, expenditure net of employee related costs and bad debts disclosed on the statement of financial performance at R41.9 million is overstated by R2.3 million and finance costs which are also disclosed on the statement of financial performance is understated by the same amount.
62. The corresponding amount for repairs and maintenance, bulk purchases and general expenses totalling R26.9 million does not agree to the prior year audited amounts for the same accounts of R27.9 million. No supporting documentation was available for the difference of R1 million. Consequently I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy, completeness and occurrence of the expenditure corresponding amount of R26.9 million as disclosed on the statement of financial performance.

Personnel costs

63. The municipality paid allowances to employees above the stipulated limits prescribed by the municipality's remuneration policy. Consequently, employee costs disclosed in the statement of financial performance and note 16 to the annual financial statements are overstated by R1.7 million.
64. The municipality could not provide sufficient appropriate evidence for third party payments, casual wages, promotions and overtime totalling R2.2 million. Due to the nature of the error identified, there were no alternative procedures that I could perform to verify this amount.
65. No supporting documentation could be provided for the authorisation of deductions to the value of R2.4 million. Due to the nature of the error identified, there were no alternative procedures that I could perform to verify this amount.
66. The Unemployment Insurance Fund (UIF) contributions and Pay As You Earn (PAYE) deductions were recalculated and errors amounting R2.2 million were identified, resulting in an overstatement of employee costs and an understatement of payables to third parties of the same amount.
67. The completeness of terminations and appointments could not be confirmed as the attendance registers of the municipality were not adequately updated and maintained. Due to the nature of the error identified, I was unable to quantify the extent of this

limitation and there were no alternate procedures that I could perform to verify the completeness.

68. Employee costs contained misclassifications of R4.6 million. This resulted in the overstatement of employee costs of R4.6 million and the understatement of general expenditure by the same amount.
69. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy, completeness and occurrence of personnel costs of R42.3 million as disclosed on the statement of financial performance.

Water services provider service level agreement

70. In terms of the water service level agreement between the municipality and the district municipality, the local municipality should account for revenue, general expenditure and compensation of employees relating to the provision of water services, as well as an agency account held with the district municipality. The municipality did not account for these transactions correctly and numerous errors were identified.
71. A limitation was imposed on the scope of my audit work relating to water services receipts to the value of R9.7 million included in note 10 to the annual financial statements. The records of the municipality did not permit the application of alternative audit procedures.
72. Further, employee related expenditure of R4.7 million relating to the provision of water services have not been included in personnel expenditure of R42.3 million on the Statement of Financial Performance. Personnel expenditure is thus understated by this amount.
73. Expenditure relating to expenditure incurred through the provision of water services should be accounted for within general expenditure of R32.9 million included in note 15 to the annual financial statements. No supporting documentation was provided for audit purposes to establish the extent of the misstatement to the Statement of Financial Performance as well as the effect on the contra account included within Accounts Receivable for non-exchange transactions.
74. Consequently, I was unable to obtain sufficient appropriate evidence to satisfy myself as to the completeness, occurrence and accuracy of revenue, expenditure, personnel expenditure and accounts receivable from non-exchange transactions on the Statement of Financial Performance and note 7 to the annual financial statements.

Take on balances

75. During the financial year the municipality changed the accounting system from Venus to Pastel Evolution. Through review of the take on balances it was noted that there were significant differences in the following balances resulting in a net difference of R24.2 million:
 - Cash and cash equivalents difference of R143 961
 - Trade receivables from non-exchange transactions difference of R309 186
 - Other receivables from non-exchange transactions difference of R621 802
 - Other receivables from exchange transactions difference of R7.3 million
 - Investments difference of R495 327
 - VAT receivable difference of R1.7 million
 - Property, plant and equipment difference of R8.8 million
 - Trade and other payables from exchange transactions difference of R8.3 million
76. The municipality did not reconcile this difference of R24.2 million and could not provide sufficient appropriate audit evidence to support this amount.

Irregular expenditure

77. Payments amounting to R17.1 million were made in contravention of the supply chain management (SCM) regulations. The amount was not included in irregular expenditure disclosed in note 27 to the financial statements, resulting in irregular expenditure being understated by R17.1 million.
78. Included in note 27 to the financial statements is an amount of R1 million for irregular expenditure incurred in the current financial year. This irregular expenditure was condoned by Council on 30 June 2011 and indicated in the note as amounts condoned. This is however in contravention of the MFMA which requires that irregular expenditure be condoned by Treasury. Irregular expenditure is therefore understated by R1 million.

Unauthorised expenditure

79. The municipality overspent its budget for employee related costs by R7.9 million. This amount has not been disclosed within unauthorised expenditure in the notes to the annual financial statements.

Fruitless and wasteful

80. Penalties and interest of R529 072 was incurred and paid by the municipality during the year. This amount has not been disclosed as fruitless and wasteful expenditure in the notes to the annual financial statements.

Related parties

81. International Public Sector Accounting Standard (IPSAS) 20, *Related Party Disclosures*, requires disclosure of employees related to councillors, section 57 employees and key management personnel as well as information in respect of entities under the control of key management personnel. The disclosures included in note 26 to the annual financial statements do not meet the onerous disclosure requirements of the standard.

Employee benefits

82. Note 26 to the annual financial statements for Related parties includes an amount of R7 million for post employment benefits. This balance is not a related party as defined and should not be reported as such. The note for related parties is therefore overstated by R7 million.
83. Further, the municipality could not provide sufficient appropriate evidence to support the balance of R7 million, and I consequently was not able to satisfy myself as to the existence, completeness, valuation, and allocation of and rights and obligations pertaining to the balance of post employment benefits.

Contingent liabilities

84. Contingent liabilities of R1.9 million have not been disclosed in accordance with GRAP 19: *Provisions, Contingent Liabilities and Contingent Assets* in note 30 to the annual financial statements. Contingent liabilities are therefore understated by this amount.

Commitments

85. Included in note 29 to the annual financial statements for commitments is a balance of R434 961 relating to operating leases as lessee, being expense items. This balance does not agree to the underlying accounting records which reflect a nil balance. The municipality did not reconcile the difference of R434 961 between the financial statements and the underlying accounting records and could not provide sufficient appropriate audit evidence to support this amount.

86. Additional reporting requirements of the MFMA require the source of finance for capital projects and for operating leases to be disclosed. Note 29 to the annual financial statements does not include details for capital projects and operating leases as lessor, despite the lease agreements being for a non-cancellable term of five years.

Statement of cash flows

87. Recalculation of the Statement of Cash Flows identified errors in the computation of the amounts resulting in an error of R1.7 million. Further, interest received in the Statement of Cash Flows of R556 400 does not agree with the amount per the Statement of Financial Performance of R1.2 million. The municipality did not reconcile the difference of R659 370 and could not provide sufficient appropriate audit evidence to support this amount.
88. The corresponding Statement of Cash Flows does not agree to the prior year audited Statement of Cash Flows. The total of the errors total R242 406 for which no supporting documentation was available.
89. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of the current and corresponding Statement of Cash Flows.

Other corresponding figures

90. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. The matters which gave rise to the limitation, as described below, remain unresolved in the current year.
91. The municipality could not provide sufficient appropriate audit evidence regarding:
- Property, plant and equipment of R27.2 million disclosed in note 4 to the financial statements;
 - Trade receivables from exchange transactions of R3.9 million disclosed in note 7 to the financial statements;
 - Trade and other payables from exchange transactions of R5.8 million disclosed in note 9 to the financial statements;
 - VAT receivable of R2.2 million disclosed in note 6 to the financial statements
 - Cash and cash equivalents of R24.4 million disclosed in note 2 to the financial statements
 - Service charges revenue and interest on outstanding receivables of R1.4 million disclosed on the statement of financial performance
 - Expenditure of R70.9 million disclosed on the statement of financial performance
 - Employee costs of R30.7 million disclosed on the statement of financial performance
92. I was unable to confirm or verify these amounts by alternative means and as a result, could not confirm the existence, valuation, completeness or rights and obligations of the abovementioned amounts included in the corresponding figures.

Disclaimer of opinion

93. 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 these financial statements.

Emphasis of matters

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

Significant uncertainties

95. With reference to note 30 to the annual financial statements, the municipality is the defendant in a number of lawsuits relating to pension funds and land claims. The outcome of these lawsuits cannot be determined at present. The municipality has disclosed a contingent liability of R2.1 million.

Irregular expenditure

96. As disclosed in note 27 of the financial statements, the municipality incurred irregular expenditure of R1.03 million. This was as a result of non compliance with the supply chain management regulations.

Material losses

97. As disclosed in note 18 to the annual financial statements, material losses to the amount of R3.4 million were incurred as a result of a write-off of irrecoverable trade debtors.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

98. 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

99. Included below are the findings raised during our audit of the report on predetermined objectives.

Usefulness of information

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

- Measurability: Indicators are well-defined, verifiable, and targets are specific, and measurable.

101. Audit findings:

Planned and reported targets are not specific

102. Planned and reported targets were not specific in clearly identifying the nature and the required level of performance. In total 35% of the reported targets on selected development objectives were not specific.

Planned and reported targets not measurable

103. Planned and reported targets were not measurable, they were not quantifiable as to how much deliverables are expected and areas to be covered are not stated. In total 33% of the targets on selected development objectives were not measurable.

Planned and reported indicators are not verifiable

104. Planned and reported indicators were not verifiable; it could not be determined from the indicator how to validate the processes and systems that would produce the indicators. In total 14% of the indicators on selected development objectives were not verifiable.

Planned and reported indicators are not well defined

105. Planned and reported indicators were not well defined, they are not clearly defined so that data will be collected consistently and were not easy to understand and use. In total 29% of the indicators on selected development objectives were not well defined.

Reliability of Information

106. 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.

107. Audit findings:

Reported targets have not occurred

108. Reported targets have not occurred as the projects reported on have not been started. In total 21% of the targets reported on selected development objectives have not occurred.

Reported targets not accurate

109. Reported targets are not accurate, information recorded as target achieved does not agree to supporting documentation. In total 54% of the targets reported on selected development objectives are inaccurate.
110. Further reported targets are not accurate, as supporting documentation provided for recorded targets are invalid. In total 29% of the targets reported on selected development objective are inaccurate.

Compliance with laws and regulations

Strategic planning and performance management

111. 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 56 of 2003) (MFMA).
112. 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

113. The municipality incurred expenditure in excess of the limits of the amounts provided for in the approved budget, in contravention of section 15 of the MFMA.
114. 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.

Annual financial statements, performance and annual report

115. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer of opinion.
116. The mayor did not table, in council, the 2009/10 annual report of the municipality, within seven months after the end of the financial year as required by section 127(2) of the MFMA.
117. The mayor did not submit a written explanation to the council setting out the reasons for the delay in the tabling of the 2009/10 annual report in council as required by section 127(3) of the MFMA.
118. 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.
119. 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.

Audit committees

120. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee as required by Municipal Planning and Performance Management Regulation 14.

Internal audit

121. Internal audit did not report to the audit committee on matters relating to compliance with the MFMA, the Division of Revenue Act (DORA) and other applicable legislation as required by section 165(2)(b) of the MFMA.
122. The internal auditors of the municipality 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

123. 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) and (c).
124. Awards were made to providers based on criteria that differed from those stipulated in the original bid documents as per the requirements of SCM regulation 21(b).
125. Invitations for competitive bidding were not always advertised for a required minimum period of days as per the requirements of SCM regulation 22(1) and 22(2).

126. Final awards and recommendation of awards to the accounting officer were not always made by an adjudication committee which was constituted of at least four senior managers as per the requirements SCM regulation 29(2).
127. 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 SCM regulation 13(c).
128. 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).
129. Awards were made to suppliers based on preference points that were not allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
130. Awards were made to suppliers that did not score the highest points in the evaluation process as per the requirements of section 2(1)(f) of PPPFA.
131. 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).
132. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer as required by SCM regulation 29(5)(b).
133. Awards were made to providers whose directors or principal shareholders are persons in service of other state institutions in contravention of the requirements of SCM regulations 44. Furthermore the provider failed to declare that he/she is in the service of the state as required by SCM regulation 13(c).

Expenditure management

134. 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.
135. The accounting officer did not take reasonable steps to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
136. 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.

Revenue management

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

Asset management

139. 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.
140. 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 as required by section 63(2)(c) of the MFMA.

INTERNAL CONTROL

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

Leadership

142. Although there was no change in leadership, the municipality has remained with minimal improvement from prior to current year. The municipality did not implement a system to monitor compliance with all applicable laws and regulations. The accounting officer was not always aware how the senior managers met their responsibilities for compliance with laws and regulations and document management.
143. Policies and procedures were not updated as these were not reviewed on an annual basis to ensure relevance and that they are effective under the changing circumstances.
144. The accounting officer did not implement a system for assessing performance information, not all targets were included in the IDP and SDBIP, midyear review report was not submitted timeously. Inadequate information provided to support the achieved targets as per the annual performance report.

Financial and performance management

145. There is a poor control environment within the finance division as evidenced by, lack of segregation of duties (cashier) and lack of reconciliations being performed on a daily and monthly basis.
146. Information requested for audit was not obtained without delays and supporting documents were not obtained for a significant amount of expenditure, payables and receivables.
147. The adopted policies of the municipality are not always implemented or applied correctly resulting in errors. Further, a lack of monitoring, supervision and review of errors resulted in these errors not being identified and corrected by management.
148. The accounting officer did not implement a system to ensure that suspense accounts were reviewed and cleared on a monthly basis.
149. Incorrect comparative amounts that do not agree to the prior year audited annual financial statements were used in the current year for the statement of financial performance, statement of financial position, statement of net assets and notes to the annual financial statements. The working paper file, with schedules supporting amounts in the annual financial statements was not prepared and submitted for audit purposes.
150. There were numerous errors between the general ledger, trial balance, annual financial statements and supporting schedules. This is a result of lack of review of information prior to submission of annual financial statements for audit purposes.
151. There is an inadequate process for preparation and processing of journals as journals processed were not adequately supported by documentation and in some instances journals have been processed before supporting documentation were prepared.

Governance

152. The accounting officer did not implement a system to ensure that the municipality has a performance audit committee or that its responsibilities were performed by the existing audit committee. Lack of this oversight has resulted in audit findings as reported on predetermined objectives above.
153. The internal audit committee and internal audit did not review information relating to the pre determined objectives.
154. The accounting officer did not prepare a fraud prevention plan and strategy and therefore the municipality is unable to prevent and identify fraudulent activities. The municipality did not evaluate the performance of the audit committee as required by section of the audit committee charter. The internal audit unit did not fully execute audits as listed on the internal audit plan for 2010/11. This has contributed to the weak control environment at the municipality.

Auditor General

East London

29 February 2012



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence