



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

# **Audit Report**

## **Sunday's River Valley Municipality**

For the Year ended 30 June 2012

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON SUNDAYS RIVER VALLEY MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Sundays River Valley Municipality set out on pages 4 to 49, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### 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, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011 as amended) (DoRA), and for such internal control as the accounting officer determines is 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. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. 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.
4. 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.
5. 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**

### **Provision for leave pay**

6. Sufficient appropriate audit evidence was not available for the support of the provision for leave pay of R2,2 million in the statement of financial position and disclosed in note 14 to the financial statements. Documentation in support of leave taken, leave accrued and the approval of leave balances was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the provision for leave pay by alternative means. Consequently, I was unable to determine whether any further adjustments to provision for leave pay was necessary.

### **VAT payable and VAT receivable**

7. Sufficient appropriate evidence was not available for the support of the net value-added tax (VAT) receivable of R3,8 million in the statement of financial position and disclosed in note 13 and 12 to the financial statements. A reconciliation of the amounts recorded in the financial statements to the VAT amounts owing to the South African Revenue Service was not submitted for audit purposed or that which was submitted, was incomplete. I was unable to confirm the VAT accounts by alternative means. Consequently, I was unable to determine whether any further adjustments to VAT accounts was necessary.

### **Irregular expenditure**

8. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 32 of the MFMA. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R11,6 million (2011: R5,5 million). Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

### **Prior year comparative information**

9. Sufficient appropriate audit evidence was not available for the support of the provision for leave pay of R1,8 million as disclosed in the comparative amount of note 14 to the financial statements. Documentation in support of leave taken, leave accrued and the approval of leave balances was either not submitted for audit purposes or that which was submitted, was incomplete. I was unable to confirm the provision for leave pay by alternative means. Consequently, I was unable to determine whether any further adjustments to provision for leave pay was necessary.

## **Opinion**

10. In my opinion, except for the effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Sundays River Valley Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of MFMA.

**Emphasis of matters**

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

**Restatement in corresponding figures**

12. As disclosed in note 48 to the financial statements, the comparative figures for 30 June 2011 have been restated as a result of errors discovered during the financial year ended 30 June 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011. These restatements relate mainly to housing creditors and the corresponding housing debtors, the provision for long service awards, and the post-retirement medical aid fund which was previously not accounted for.

**Material impairments**

13. As disclosed in note 2 to the financial statements, bad debts expenditure amounted to R7,5 million. This is due to an increase in the provision for doubtful debts.

14. As disclosed in note 23 to the financial statements, material losses of approximately R6 million were incurred as the municipality did not charge interest on outstanding receivables for the first ten months of the financial year due to billing problems experienced with the new accounting system.



## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

15. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report of Sundays River Valley Municipality as set out in the annual report.

17. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

18. The material findings are as follows:

### **Usefulness of information**

19. Improvement measures in the annual performance report for all of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act (MSA). This was due to a lack of adequately and sufficiently skilled resources in place to ensure that performance is monitored and accurately reported on.

20. The MSA, section 41(c) requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 65% of the reported indicators are not consistent with the indicators as per the approved integrated development plan and a total of 78% of the reported targets are not consistent with the targets as per the approved integrated development plan. This is due to the lack of an established performance management system which entails reviews from management, internal audit and the audit committee of the annual performance report against the integrated development plan.

21. The National Treasury *FMPPI* requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 66% of the indicators relevant to social and economic development, institutional transformation and development, financial viability, and infrastructure and service delivery development priorities were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. These deficiencies regarding the definition of the indicators occurred as a result of inadequate training of staff on the setting of KPI's.



22. The National Treasury FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 46% of the indicators relevant to social and economic development, institutional transformation and development, financial viability and infrastructure and service delivery were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. These deficiencies regarding the validation of the indicators occurred as a result of inadequate training of staff on the setting of KPI's.
23. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 43% of the targets relevant to social and economic development, institutional transformation and development, financial viability and infrastructure and service delivery were not specific in clearly identifying the nature and the required level of performance. These deficiencies regarding the setting of the targets occurred as a result of inadequate training of staff.
24. The National Treasury *FMPPI* requires that performance targets be measurable. The required performance could not be measured for a total of 43% of the targets relevant to social and economic development, institutional transformation and development, financial viability, and infrastructure and service delivery priorities were not specific in clearly identifying the nature and the required level of performance. These deficiencies regarding the measurability of the targets occurred as a result of inadequate training of staff on the setting of targets.

#### **Reliability of selected development priorities in the annual performance report**

25. I was unable to obtain sufficient, appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the actual performance reported in the annual performance report. This was due to a lack of an established document management system which did not allow us to perform alternate procedures as a result of the unavailability of supporting evidence.

#### **Additional matter**

26. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

#### **Achievement of planned targets**

27. As reported in the annual performance report, only 32% of the planned targets were achieved during the year under review. The main reason for the under achievement is the lack of staff training and the fact that indicators and targets were not suitably developed during the strategic planning process.

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

28. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

#### **Budgets**

29. Monthly budget statements were not submitted to the relevant provincial treasury as required by section 71(1) and 87(11) of the MFMA.
30. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.

### **Annual financial statements**

31. 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 identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a qualified opinion.
32. The annual performance report for the year under review does not include a comparison with the previous financial year or measures taken to improve performance, as required by section 46 of the MSA.

### **Audit committees**

33. A performance audit committee was not in place and the audit committee established in terms of MFMA section 166(1) was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

### **Internal audit**

34. An internal audit unit was not established, as required by section 165(1) of the MFMA.

### **Expenditure management**

35. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal, and payment of funds, was not in place as required by section 65(2)(a) of the MFMA.
36. 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.
37. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
38. Unauthorised, irregular and fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the Municipal Finance Management Act.

### **Revenue management**

39. An adequate management, accounting and information system was not in place which recognised revenue when it was earned and accounted for debtors, as required by section 64(2)(e) of the MFMA, as is evident by the material corrections to trade receivables and property rates revenue.
40. Interest was not charged on all arrears accounts as required by section 64(2)(g) of the MFMA.



### **Conditional grants received**

41. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act (DORA).
42. The municipality did not evaluate its performance in respect of programmes funded by the allocation and submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of the DORA.
43. The municipality did not submit project implementation plans to the national department, Cooperative Government and Traditional Affairs (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.34280.

### **Asset management**

44. The accounting officer did not submit within 10 working days of the end of each month, a report to the mayor describing, in accordance with GRAP, the investment portfolio at the end of the month, as required by section 9(1) of the Municipal Investment Regulation.
45. All investments were not made in accordance with the requirements of the investment policy which states that if the investments are above R1 million such investments should be invested in different institutions, as required by Municipal Investment Regulation 3(3).

### **Human resource management**

46. The municipality did not submit a report on compliance with prescribed competency levels to the national treasury and relevant provincial treasury as required by regulation 14(2)(a) of the Municipal Regulations on Minimum Competency Levels (MRoMCL).
47. The performance agreements of the municipal manager, chief financial officer, senior manager and head of supply chain did not have the minimum competencies and did not include the attainment of minimum competencies as a performance target, as required by regulation 62 of the MRoMCL.
48. Sufficient appropriate audit evidence could not be obtained to, determine whether the municipal manager who was appointed during the financial year, was not dismissed for financial misconduct within the last of 10 years.
49. The competencies of financial and SCM officials were not assessed promptly in order to identify and address gaps in competency levels as required by regulation 13 of the MRoMCL.

### **Procurement and contract management**

50. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB), in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
51. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
52. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state as required by SCM regulation 13(c).
53. Awards are made to providers who are persons who are in service of other state institutions in contravention of SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

### **Internal control**

54. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control 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 mechanisms established by management to communicate to and hold individuals accountable for performance of internal controls which has resulted in there being a lack of review over financial and performance reporting and repeated instances of non-compliance with laws and regulations.

56. The human resource policies are not adequately implemented as certain individuals do not have the appropriate level of understanding of the applicable financial and reporting frameworks and there is also a lack of capacity at management level within the municipality.

57. Key staff members were not always available for meetings throughout the audit.

### **Financial and performance management**

58. There was inadequate planning and testing performed before the implementation of the new accounting system, which has resulted in inaccurate and unreliable information being produced by the system.

59. There was inadequate controls implemented over daily and monthly processing and reconciling of transactions as reconciliations for various accounts and schedules were either not performed timeously or could not be provided for the audit.

60. There is an inadequate performance management system in place as the staff lack the required knowledge and understanding of the requirements of the MSA with regards to planning, executing and reporting on the performance of the municipality.

### **Governance**

61. The risk strategy which was poorly implemented which contributed to the control deficiencies identified during the audit.

62. There was no effective internal audit department established during the financial year which could assist the audit committee in providing oversight over the financial and performance management of municipality.

*Auditor General*

East London

30 November 2012



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