

DRAFT REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON PORT ST JOHNS MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Port St Johns Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows 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 (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (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 the 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 2001) (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

Capital commitments

6. No contract management system was in place for the identification and recognition of capital commitments outstanding at year end as required by GRAP 17 – *Property, plant and equipment*. Commitments disclosed in note 22.5 of R38 789 887 are overstated as not all payments made in respect of the awarded contracts have been taken into account when determining the outstanding commitment remaining at year end. The 2011

disclosure of R9 469 368 is however understated as not all projects in progress were included in this amount. I have not determined the correct amounts of outstanding commitments as it was impracticable to do so.

Trade and other payables

7. The municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end, and did not include all outstanding amounts meeting the definition of a liability as per GRAP 1 - *Presentation of Financial Statements*, in the financial statements, resulting in an understatement of trade and other payables as disclosed in note 8 to the financial statements by at least R1 329 648, while expenditure and VAT receivable are also understated as a result. Due to the lack of systems in place, it was impracticable for me to determine the full extent of the understatement in trade and other payables.
8. In addition trade and other payables and expenditure are overstated by R1 744 753 as a result of incorrect adjustments and accrual of expenditure not relating to the financial year under review.
9. The comparative figure for trade and other payables excludes an amount of R4 339 241 paid in the current financial year relating to services rendered in the previous financial period, for which a service level agreement existed with a provincial department. Sufficient appropriate audit evidence was not available to confirm that the municipality did not have an obligation regarding this payment. I was unable to confirm the amount by alternative means. Consequently I was unable to determine whether any adjustments to the comparative figure for trade and other payables were necessary

VAT receivable

10. Sufficient appropriate audit evidence was not available in support of reconciling variances for the VAT receivable at year end. I was unable to confirm the outstanding amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to VAT receivable of R5 675 699 (2011: R2 966 904) as disclosed in note 9 to the financial statements

Unauthorised and Irregular expenditure

11. The municipality did not have adequate systems in place to identify and disclose all unauthorised and irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The unauthorised expenditure disclosed in note 21.2 of the financial statements is understated by R27 265 550 as the municipality only included overspending of the total vote in this disclosure, and not the overspending per department. The irregular expenditure disclosed in note 21.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R1 597 843 (2011: R55 633). Due to the lack of systems, it was impracticable to determine the full extent of the understatement of the irregular expenditure disclosures for the current and prior period. In addition the closing balance of irregular expenditure for the current year is further understated by R6 199 522 as council has not yet written off the current or prior year's non compliance with Supply chain requirements.

Contingent liabilities

12. I was unable to obtain sufficient appropriate audit evidence for the completeness of contingent liabilities of R13 300 000 as disclosed in note 33 to the financial statements. I was unable to confirm this amount by alternative means. Consequently I was unable to determine whether any adjustments to the contingent liabilities figure were necessary.

Prior year adjustments

13. I was unable to obtain sufficient appropriate audit evidence for the restatement in the corresponding figure of property, plant and equipment and receivables. As described in note 25 to the financial statements, the restatements of R34 861 424, and R6 774 284 respectively were made in order to rectify prior year misstatements. I was unable to confirm the restatements by alternative means. Consequently I was unable to determine whether any adjustments to the property, plant and equipment or receivables corresponding figure were necessary. Note 8 to the financial statements also does not include the comparative disclosure of Provision for impairment and net balances.

Other Disclosures

14. The statement of changes in net assets does not contain comparative information, including the prior year opening balance and movements for that period as required by GRAP 1 – *Presentation of financial statements*. The prior period correction of error has consequently been adjusted to the 2011 closing balance of accumulated surplus in error, instead of to the opening balance as required.
15. The accounting policy note 5 for financial instruments indicates that the municipality bases their measurement of financial instruments on International Accounting Standard 39 - *Financial Instruments: Recognition and measurement*, whereas they have in fact formulated their accounting policy off of GRAP 104 – *Financial instruments*.

Qualified Opinion

16. In my opinion, except for the effects and possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Port St Johns Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

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

Restatement of corresponding figures

18. As disclosed in note 25 to the financial statements, the corresponding figures which relate to the year ended 30 June 2011 have been restated during the current financial year.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

PAA REQUIREMENTS

19. 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 thereon.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
21. 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 annual reporting principles and whether the reported performance is consistent with the planned development priorities. 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* (FMPPI).

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

23. The material findings are as follows:

Usefulness of information

Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets

24. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires that the annual performance plan 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 44% of the reported objectives, 65% of the reported indicators and 65% of the reported targets are not consistent with the objectives, indicators and targets as per the approved annual performance plan

Performance Indicators not well defined or verifiable

25. The FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use, and it also requires that it must be possible to validate the processes and systems that produce the indicator. A total of 50% of the indicators were not well defined or verifiable, in that clear, unambiguous data definitions were not available to allow for data to be collected consistently and that valid processes and systems that produce the information on actual performance did not exist.

Performance targets not specific, measurable or time bound

26. The FMPPI requires that performance targets be measurable, that the time period or deadline for delivery be specified and that they be specific in clearly identifying the nature and required level of performance. A total of 40% of the performance targets were not specific in clearly identifying the nature and the required level of performance, while 50% could not be measured, and were not time bound.

Reliability of information

Annual performance report not supported by sufficient appropriate evidence

27. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain sufficient, appropriate audit evidence for the selected objectives to satisfy myself as to the validity, accuracy and completeness of the actual performance reported in the annual performance report.

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:

Annual financial statements, performance and annual report

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets and liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but there were further uncorrected material misstatements and supporting records that could not be provided which resulted in the financial statements receiving a qualified audit opinion.
30. The accounting officer did not make public the council's oversight report on the 2010/11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
31. The annual performance report for the year under review does not include a comparison with the targets set for and performances of the previous financial year as required by section 46(1)(b) of the MSA

Strategic planning and performance management

32. The municipality did not ensure that the annual performance objectives and indicators for its municipal entity are established by agreement with the entity and included in the entity's multi-year business plan, and that its performance was monitored and annually reviewed, as part of the annual budget process, as required by section 93B(a) and (b) of the MSA.

Audit committee

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).

Expenditure management

34. 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.
35. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.
36. The accounting officer did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability Management

37. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
38. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Asset management

39. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
40. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Procurement and contract management

41. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
42. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
43. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
44. 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.
45. 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).

Internal control

46. 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

47. The administrative leadership does not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls. The municipality implemented an action plan to address internal control deficiencies however there were still repeat findings noted.
48. Management have documented policies and procedures to guide the operations of the municipality, however these policies were not properly implemented resulting in numerous instances of noncompliance – also mostly repeat findings from the prior year.
49. Management has not implemented effective HR management practices to address the high vacancy rate and ensure that adequate and sufficiently skilled resources are in place.

Financial and performance management

50. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting and this resulted in errors on the financial statements and performance report
51. Manual or automated controls are not design to ensure that the transactions have occurred, are authorised and completely and accurately processed – regular reconciliations are not instilled as a financial discipline.
52. Management has not implemented proper policies to identify and record transactions when they occur and the financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.
53. There are ineffective tools to enable the regular review and monitoring of compliance with laws and regulations.

54. There is a lack of a document management system for performance reporting as well as lack of review of the annual performance report which was prepared by the consultants.

Governance

55. The Risk register is completed by internal audit. A lack of oversight resulted in the mitigating controls not being included in the risk register

East London

xx December 2012

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