

# **Ikwezi Municipality**

## **Audit Report**

For the year ended 30 June 2013

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

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the financial statements of the Ikwezi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, 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 (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) (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 conducting the 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 (ISA). Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain enough audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Property, plant and equipment**

4. I was unable to obtain enough audit evidence to confirm the balance of infrastructure assets and moveable assets within property, plant and equipment. The municipality could not provide a fixed asset register with sufficient detail of descriptions, locations, purchase prices and purchase dates supported by valid documentation and as a result I was unable to obtain sufficient appropriate audit evidence to confirm the balance of infrastructure assets and moveable assets within property, plant and equipment. Consequently, I was unable to determine whether any adjustments to infrastructure assets, stated at a cost of R102,8 million (2011-12: R93,4 million) and movable assets stated at a cost of R3,2 million (2011-12: R2,7 million) in the financial statements was necessary.
5. The municipality did not value all items of property, plant and equipment in accordance with GRAP 17 *Property, plant and equipment*. The municipality does not review the useful lives of property, plant and equipment and moveable assets recorded at R1 whilst still being in use at each reporting date. In addition, the municipality recorded duplicate finance lease assets. Consequently, property, plant and equipment and accumulated depreciation is understated by R4,1 million, depreciation expense is understated by R917 913 and accumulated surplus is overstated by R3,2 million. Furthermore, not all land and buildings, per the deed search, were recorded in the fixed asset register. I was unable to verify the balance by alternative means. Consequently I was unable to determine whether any adjustment to land and buildings stated at a cost of R3,3 million (2011-12: R3,3 million) in the financial statements was necessary.

6. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for property, plant and equipment. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment to the property, plant and equipment corresponding figure stated at R66,7 million in the financial statements was necessary.
7. GRAP 17 requires the preparers of financial statements to disclose land and buildings as separate classes of assets where they apply the cost model to land and buildings. Furthermore, GRAP 17 requires the preparers of financial statements to classify items of property, plant and equipment into distinct categories that are representative of the characteristics of those items of property, plant and equipment. During the current year the municipality applied the cost model to land and buildings but did not disclose land and buildings as separate classes of assets. Also, the municipality did not classify and separately disclose the various categories of property, plant and equipment.
8. GRAP 17 also requires entities to disclose impairments, restrictions on the use or realisability of items of property, plant and equipment and whether any items of property, plant and equipment have been pledged as security for any liabilities. The municipality has not disclosed the impairment of items of property, plant and equipment, the restrictions on the use of property, plant and equipment and the fact that assets held under finance lease were pledged as security for those finance lease liabilities. Furthermore, the municipality did not disclose the prior year depreciation for assets held under finance leases and land and buildings. It should also be noted that the amount disclosed for depreciation is not consistent throughout the financial statements as different amounts are disclosed for depreciation in different notes.
9. In addition the municipality did not disclose any information on GRAP 21 *Impairment of non cash generating assets*, which requires the entity to disclose the criteria developed by the entity to distinguish non cash generating assets from cash generating assets and for each class of assets, the amount of impairment losses recognised in surplus or deficit during the period and the line item(s) of the statement in financial performance in which impairment losses are included, the amount of reversals of impairment losses recognised in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed. Furthermore, the municipality failed to disclose an accounting policy for GRAP 21 and GRAP 103 *Heritage assets*.

#### **Accumulated surplus**

10. I was unable to obtain enough audit evidence to confirm the balance of accumulated surplus. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to accumulated surplus stated at R91,9 million (2011-12: R90,6 million) in the financial statements was necessary.
11. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for accumulated surplus. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the accumulated surplus corresponding figure stated at R90,6 million in the financial statements was necessary.



### **Investment property**

12. I was unable to obtain enough audit evidence to confirm the balance of investment property. The municipality did not have a property management system in place for the identification and recognition of investment property. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to investment property, stated at a cost of R35,2 million (2011-12: R35,2 million) in the financial statements was necessary. Furthermore, not all investment properties, per the deed search, were recorded in the investment property register. I was unable to verify the balance by alternative means. Consequently I was unable to determine whether any adjustment to investment property, stated at a cost of R35,2 million (2011-12: R35,2 million) in the financial statements was necessary.
13. The municipality did not value all items of investment property in accordance with GRAP 16 *Investment property*. The municipality does not review the valuation of investment property according to the latest valuation roll. Consequently investment property and accumulated surplus is overstated by R 2,2 million.
14. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for investment property. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the investment property corresponding figure stated at R35,2 million in the financial statements was necessary.
15. GRAP 16 allows the preparers of financial statements to elect either the cost model or the revaluation model for the subsequent measurement of its investment properties. Once the entity has selected either of the models it is required to apply that model consistently. During the current year audit it was noted that the municipality selected the cost model for the subsequent measurement of its investment properties, but it appears that the municipality has applied it inconsistently as it discloses a revaluation discussion on investment properties.

### **Unspent conditional grants and receipts**

16. I was unable to obtain enough audit evidence to confirm the balance of the unspent conditional grants and receipts. The municipality did not have adequate systems in place to maintain records of unspent conditional grants and receipts. Furthermore inter-grant transfers occurred which were not in terms of the grant conditions and the sub-ledger did not reconcile to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to unspent conditional grants and receipts stated at R8,8 million (2011-12: R3,6 million) in the financial statements was necessary.
17. In terms of GRAP 23 *Revenue from non-exchange transactions*, as a result of a non-exchange transaction, the municipality recognises an asset, it also recognises revenue equivalent to the amount of the asset measured in accordance with paragraph 40, unless it is also required to recognise a liability. The municipality did not have adequate systems in place to maintain records and supporting documentation for revenue recognition and expenditure incurred from unconditional and conditional grant funds to recognize revenue. Consequently, government grants and subsidies revenue is understated and unspent conditional grants and receipts are overstated by R332 739. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus. In addition, I was unable to obtain enough audit evidence for the operating and capital grant expenditure and resulting recognition of government grants and subsidies revenue and capitalization of expenditure. Consequently I was unable to determine whether any further adjustment to government grants and subsidies revenue stated at R28,4 million

(2011-12: R26 million) in the financial statements was necessary.

18. GRAP 23 requires the municipality to disclose revenue from non-exchange transactions as a separate reconciliation of the outstanding liability for each conditional grant. The municipality did not disclose this in the financial statements
19. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for unspent conditional grants and receipts. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the unspent conditional grants and receipts corresponding figure stated at R3,6 million in the financial statements was necessary.

#### **Employee related cost**

20. The municipality did not account for employee costs in terms of GRAP1 *Presentation of financial statements*. I was unable to obtain enough audit evidence for employee related costs. The municipality did not have adequate systems in place to maintain records and supporting documentation for employee related costs that reconciled to the financial statements and was unable to provide supporting documentation for travel and subsistence and wage payments. I was unable to confirm the employee related costs by alternative means. Consequently I was unable to determine whether any adjustment to employee related costs stated at R17,5 million (2011-12: R13 million) in the financial statements was necessary.
21. The financial statements as a whole are further materially misstated due to the cumulative effect of a number of individually immaterial uncorrected misstatements in the leave pay provision and employee costs of R21 266 and R35 392 respectively as disclosed in note 11 and 22 to the financial statements.
22. The municipality disclosed leave pay accrual and bonus accrual under current provisions in note 11 to the financial statements instead of disclosing these as accruals in the financial statements. Furthermore, the municipality has failed to disclose any information relating to employee benefit plans.

#### **Trade receivables from exchange transactions**

23. I was unable to obtain enough evidence to confirm the balances and disclosure of trade and other receivables from exchange transactions, the provision for doubtful debts as disclosed in note 2 to the financial statements and the bad debt expense as disclosed in the financial statements. The municipality did not have a receivables management system in place to maintain records and supporting documentation for the trade and other receivables from exchange transactions, the provision for doubtful debts and the bad debt expense. I was unable to confirm the balances by alternative means. Consequently I was unable to determine whether any adjustments to trade and other receivables from exchange transactions stated at R16,4 million (2011-12: R10,9 million), the provision for doubtful debts stated at R12,5 million (2011-12: R9,6 million) and the bad debt expense stated at R3 million (2011-12: R2,7 million) in the financial statements was necessary.

#### **Revenue from exchange transactions**

24. The municipality did not recognise electricity, refuse and sewerage revenue for certain consumers or did not recognise revenue at the correct tariff as required by GRAP 9 *Revenue from exchange transactions*. Consequently revenue from exchange transactions and trade and other receivables from exchange transactions are understated by R373 643 (2011-12: R153 102). Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.



25. I was unable to obtain enough audit evidence for revenue from exchange transactions disclosed in notes 15-18 and 21 to the financial statements. The municipality did not have adequate systems in place to maintain records and supporting documentation for revenue that reconciled to the financial statements. I was unable to confirm the revenue from exchange transactions by alternative means. Consequently I was unable to determine whether any adjustment relating to revenue from exchange transactions stated at R12,8 million (2011-12: R9,7 million) in the financial statements was necessary.
26. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for revenue from exchange transactions as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment to the revenue from exchange transactions corresponding figure stated at R9,7 million in the financial statements was necessary. Furthermore, the municipality did not disclose the restatements as a prior period error as required by GRAP 3 *Errors, changes in accounting policies and estimates*.
27. GRAP 9 *Revenue from exchange transactions*, requires the entity to disclose revenue from exchange transactions separately on the face of the statement of financial performance and if not on the face, to clearly disclose the separation in the notes to the financial statements. The municipality did not split revenue from exchange transactions and non exchange transactions on the face of the statement of financial performance or in the notes to the financial statements. Furthermore, the municipality has failed to disclose the material amounts of "other income" as per the statement of financial performance, in the notes to the financial statements.

#### **Trade and other payables from exchange transactions**

28. The municipality did not have a payables management system in place to compile a payables sub-ledger, retain supporting documentation and for the identification and recognition of liabilities for goods and services received but not yet paid for, which resulted in an understatement of trade and other payables from exchange transactions, general expenditure and VAT receivable by at least R1,3 million, R1,1 million and R158 892 respectively.
29. In addition, I was unable to obtain enough audit evidence to confirm the balances and disclosure of trade and other payables from exchange transactions as disclosed in note 9 to the financial statements as well as payments made after year end. I was unable to confirm the balance or disclosure by alternative means. Consequently due to the lack of systems in place it was impracticable to determine the full extent of the understatement of trade and other payables from exchange transactions, therefore I was unable to determine whether any further adjustments to trade and other payables from exchange transactions stated at R11,6 million (2011-12: R8 million) in the financial statements was necessary.
30. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for trade and other payables from exchange transactions. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustments to trade and other payables from exchange transactions corresponding figure stated at R8 million in the financial statements was necessary.

### **Expenditure**

31. The municipality did not account for expenditure in terms of GRAP 1 *Presentation of financial statements*. I was unable to obtain enough evidence for general expenditure. The municipality did not have a proper expenditure management system in place to maintain records and supporting documentation for expenditure. I was unable to confirm general expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to general expenditure stated at R10,1 million (2011-12: R9,5 million) in the financial statements was necessary.
32. During 2011-12 I was unable to obtain enough audit evidence for grant expenditure, bulk purchases and repairs and maintenance. I was unable to confirm the expenditure by alternative means. Consequently I was unable to determine whether any adjustment to grant expenditure stated at R453 718, bulk purchases stated at R5 million and repairs and maintenance stated at R1 million was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
33. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for general expenses as described in the financial statements. The restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any further adjustment to general expenses corresponding figure stated at R9,5 million in the financial statements was necessary.
34. The municipality did not disclose the restatement as a prior period error as required by GRAP 3 *Accounting policies, change in accounting estimates and errors*.
35. GRAP 13 *Leases*, requires entities to disclose the terms and conditions attached to operating leases as well as their straight-lined lease payments and contingent rentals. The municipality did not disclose information regarding the terms and conditions attached to the operating leases. Furthermore, the municipality did not disclose enough information to enable the users of the financial statements to discern the amount of straight-lined lease payments and the amount of contingent rentals

### **Irregular expenditure**

36. The municipality did not include particulars of irregular expenditure in the notes to the financial statements as required by section 122(1)(b) of the MFMA. The municipality made payments in contravention of the supply chain management requirements, which were not included in irregular expenditure, resulting in irregular expenditure being understated by R3,1 million. Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of irregular expenditure. Furthermore, I was unable to obtain enough audit evidence for the amounts disclosed as irregular expenditure in note 34 to the financial statements, as well as grant expenditure. I could not confirm the disclosure and grant expenditure by alternative means. Consequently I was unable to determine whether any further adjustments to irregular expenditure stated at R9,6 million in the financial statements was necessary.



#### **Other receivables from non exchange transactions**

37. I was unable to obtain enough evidence to confirm the balances and disclosure for other receivables from non exchange transactions and the provision for doubtful debts as disclosed in note 3 to the financial statements. The municipality did not have a receivables management system in place to maintain records and supporting documentation of the other receivables from non exchange transactions and the provision for doubtful debts. I was unable to confirm the balances by alternative means. Consequently I was unable to determine whether any adjustments to other receivables from non exchange transactions stated at R4,6 million (2011-12: R4,1 million) and the provision for doubtful debts stated at R2,3 million (2011-12: R2,3 million) in the financial statements was necessary.

#### **Capital Commitments**

38. I was unable to obtain enough audit evidence for the disclosure of commitments. The municipality did not have a contract management system in place for the identification and recognition of contracted commitments. I was unable to confirm the commitments by alternative means. Consequently I was unable to determine whether any adjustment to the commitments stated at R2,8 million (2011-12: R6,5 million) in the financial statements was necessary.

#### **Unauthorised expenditure**

39. The municipality did not include particulars of unauthorised expenditure in the notes to the financial statements as required by section 122(1) of the MFMA. The municipality exceeded the budget per vote, which was not entirely included in unauthorised expenditure, resulting in unauthorised expenditure being understated by R2,5 million. Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of unauthorised expenditure. Consequently, I was unable to determine whether any further adjustments to unauthorised expenditure stated at R10,4 million in the financial statements were necessary.

#### **Current Provisions**

40. I was unable to obtain enough audit evidence to confirm the balances and disclosure of current provisions as disclosed in note 11 to the financial statements. The municipality did not have an adequate management system in place and supporting documentation for the assessment of provisions on an annual basis at the reporting date and also no disclosure was made relating to employee long service bonus. I was unable to confirm the current provisions balance or disclosure by alternative means. Consequently I was unable to determine whether any adjustment to current provisions stated at R2 million (2011-12: R957 578) was necessary.
41. The municipality has failed to disclose a narration for each provision as required by GRAP 19 *Provisions*. The municipality did not explain the uncertainty involved in the provision and what the obligating event is as well as what assumptions/estimates were made in the measurement of the provision.

#### **Revenue from non exchange transactions**

42. I was unable to obtain enough audit evidence for property rates and property rates penalties and collection fees disclosed in note 15 to the financial statements. The municipality did not have adequate systems in place to maintain records of revenue and supporting documentation that reconciled to the financial statements. I was unable to confirm the revenue from non exchange transactions by alternative means. Consequently I was unable to determine whether any adjustment relating to property rates stated at R1,6 million in the financial statements was necessary.



43. GRAP 23 *Revenue from non exchange transactions* requires the entity to disclose revenue from non exchange transactions separately on the face of the statement of financial performance and if not on the face, to clearly disclose the separation in the notes to the financial statements. The municipality did not split revenue from exchange transactions and non exchange transactions on the face of the statement of financial statements or in the notes to the financial statements. Furthermore, the municipality did not disclose the unspent conditional grant liability in accordance with GRAP 23 as a separate reconciliation of the outstanding liability for each conditional grant was not included in the financial statements.

#### **Provision for landfill site**

44. I was unable to obtain enough audit evidence to confirm the balance of the provision for landfill sites as disclosed in note 14. The municipality did not have a management system in place for the identification and recognition of provisions. I was unable to confirm the balance by alternative means. Consequently I was unable to determine whether any adjustment to the provision for landfill sites stated at R1 million (2011-12: R1 million) in the financial statements was necessary.
45. I was unable to obtain enough audit evidence for the restatement of the corresponding figure of the provision for landfill sites. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the provision for landfill sites corresponding figure stated at R1 million in the financial statements was necessary.

#### **Cash and cash equivalents**

46. I was unable to obtain enough audit evidence to confirm the balance of cash and cash equivalents. The municipality did not have an adequate system in place to maintain records and supporting documentation for the bank reconciliation that reconciled to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to cash and cash equivalents stated at R41 088 (2011-12: R311 456), and the bank overdraft stated at R911 163 (2011-12: R1,3 million) in the financial statements was necessary.

#### **VAT Receivable**

47. I was unable to obtain enough audit evidence to confirm the balance of the VAT receivable. The municipality did not have an adequate system in place to maintain records and supporting documentation for the VAT reconciliation that reconciled to the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to the VAT receivable stated at R880 416 (2011-12: R336 273) in the financial statements was necessary.

#### **Non-current finance lease liability**

48. I was unable to obtain enough audit evidence for the restatement of the corresponding figure for non-current finance lease liabilities. As described in note 32 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the non-current finance lease liability corresponding figure stated at R385 970 in the financial statements was necessary.

### **Fruitless and wasteful expenditure**

49. The municipality did not include particulars of fruitless and wasteful expenditure in the notes to the financial statements as required by section 122 (1) of the MFMA. The municipality incurred expenditure in procurement, overpaid acting allowances and general salary increases which was not included in fruitless and wasteful expenditure, resulting in fruitless and wasteful expenditure being understated by R1 million (2011-12: R 80 641). Due to the lack of systems in place it was impracticable to determine the full extent of the understatement of fruitless and wasteful expenditure. Consequently I was unable to determine whether any further adjustments to fruitless and wasteful expenditure stated at R149 761 (2011-12: R149 761) in the financial statements were necessary.

### **Inventory**

50. During 2012 I was unable to obtain enough audit evidence about inventory. I was unable to confirm the inventory balance by alternative means. The municipality did not have a system in place for the recognition of water inventory in the prior year as no water inventory was reported or disclosed at 30 June 2012. Consequently I was unable to determine whether any adjustment to inventory stated at R0 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
51. GRAP 12 *Inventories* requires an entity to disclose the accounting policies adopted in measuring inventories, including the cost formula used in the measurement of inventories. The municipality did not disclose its accounting policy for inventory.

### **Budget information**

52. GRAP 24 *Presentation of budget information in financial statements* requires the presentation of a comparison between the budget and actual amounts. The budget comparison can be presented as either a separate additional financial statement or by including additional budget columns in the financial statements. The budget comparison must be accompanied by explanations of material differences between the budget and actual amounts as well explanations of changes from the approved budget to the final budget. The budget comparison presented by the municipality could not be verified due to a lack of enough appropriate audit evidence supporting the budget comparison. The budget comparison could not be verified by alternative means. Explanations were not consistently provided for all material variances noted. Furthermore, the municipality has failed to disclose an accounting policy relating to the disclosure of budget information in the financial statements.

### **Other Disclosure**

53. I was unable to obtain sufficient appropriate audit evidence to confirm compulsory disclosure in Note 35 to the financial statements. The municipality did not have an adequate system in place to maintain records and supporting documentation for compulsory disclosure. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments to compulsory disclosure in the financial statements were necessary.

### **Cash flow statement**

54. GRAP 2 *Cash flow statements* require the presentation of a cash flow statement, summarising the entity's operating, investing and financing activities. The cash flow statement for the current and prior year could not be confirmed due to the limitations imposed by the lack of enough audit evidence as included in this report.



55. GRAP 2 requires entities to prepare and present cash flow statements using the direct method. Application of this method entails providing a breakdown of receipts and payments related to operating activities on the face of the cash flow statement. The municipality did not provide this breakdown and therefore did not present the cash flow statement in accordance with GRAP 2 requirements.

#### **Basis of Presentation**

56. GRAP 1 *Presentation of financial statements*, stipulates that an entity can only achieve fair presentation in its financial statements where it complies with all the applicable disclosures prescribed by the Standards of GRAP. The municipality did not make the minimum disclosures required by a number of Standards, the most pertinent being GRAP 1, GRAP 104 and GRAP 13.
57. GRAP 1 also requires entities to disclose information to enable the users of the financial statements to understand and evaluate the impact of significant judgements and estimates applied in the preparation of the financial statements. The municipality did not disclose information regarding the significant judgements and estimations applied in the preparation of the financial statements. The municipality included references to transitional provisions that are no longer available for use by the municipality. Furthermore, the municipality did not map accounts consistently between the current and the comparative periods presented in the financial statements, which impedes the comparability of the two reporting periods presented.
58. GRAP 104 *Financial instruments*, requires entities to disclose information that would aid the users of the financial statements to understand the nature of the financial instruments of the entity as well as the risks that the financial instruments pose to the entity. The municipality did not disclose the minimum information prescribed by GRAP 104 to aid users of the financial statements to understand the credit risk and liquidity risk posed by its financial instruments. Furthermore, the municipality did not disclose information regarding the terms and conditions attached to assets pledged as security for financial liabilities that may affect the realisability of those assets. Due to the lack of information provided the impact of the omitted disclosures could not be quantified. Alternative procedures could not be performed to determine the impact of the incomplete disclosures.
59. GRAP 13 *Leases*, requires entities to disclose a reconciliation of its finance lease obligation that differentiates between the total lease payments, the capital portion and the future finance charges that make up the finance lease obligation. The municipality did not disclose the future finance charges attributable to the finance lease obligation. Furthermore, note 13 provided for finance leases does not cast or cross cast and is therefore not accurate.

#### **Disclaimer of opinion**

60. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain enough audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

#### **Emphasis of matters**

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



**Financial sustainability**

62. Note 40 to the financial statements indicate that the municipality's current liabilities exceeded its total current assets by approximately R16,3 million (2011-12: R13 million). These conditions indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to settle its accounts as they fall due, and therefore operate as a going concern.

**Significant uncertainties**

63. With reference to note 14 to the financial statements, the municipality has two active landfill sites which are not licensed as required by the National Environmental Management Waste Act, 2008 (Act No 59 of 2008). The municipality has taken steps to obtain the required licenses. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

**Material losses and impairments**

64. As disclosed in note 2 and 3 to the financial statements, trade and other receivables from exchange and non exchange transactions to the amount of approximately R16,4 million (2011-12: R10,9 million) and approximately R4,6 million (2011-12: R4,1 million) were impaired by an amount of approximately R12,5 million (2011-12: R9,6 million) and approximately R2,3 million (2011-12: R2,3 million) respectively as it is unlikely that the municipality will recover the amount from the debtors.

**Additional matters**

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

**Unaudited Supplementary schedules**

66. The supplementary information set out on pages 39 to 43 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

**Conditional grant funds are not supported by liquid cash investments**

67. As disclosed in note 12 to the financial statements, there is a conditional grant liability of approximately R8,8 million. However, the bank is in an overdraft position of approximately R911 163 as disclosed in note 1 to the financial statements. This indicates that conditional grant funds are being used for other expenditures not in terms of the grant.

**Fraud consideration**

68. The numerous misstatements identified in the financial statements are indicative of possible fraud which calls into question the reliability of evidence obtained and the genuineness of the accounting records and documentation.

**Withdrawal from the audit engagement**

69. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of Ikwezi local municipality, I would have withdrawn from the engagement in terms of the International Standards of Auditing.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

70. 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**

71. The annual performance report was not presented for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.
72. The information was assessed to determine whether performance 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*).
73. The material findings are as follows:

### **Usefulness of information**

#### **Measurability**

##### **Performance indicators are not well defined**

74. The *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 100% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the annual performance report not being provided for audit.

##### **Performance indicators are not verifiable**

75. The *FMPPI* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the annual performance report and quarterly reports not being provided for audit.

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

76. 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:

### **Strategic and performance management**

77. The municipal council did not consult with the local community in the drafting and implementation of the municipality's IDP, by means of a municipal wide structure for community participation through a forum that enhances community participation, as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
78. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by Municipal planning and performance management regulation 15(3).

79. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
80. The municipal council did not review its integrated development plan annually in accordance with an assessment of its performance measurements in terms of section 41 to the extent that changing circumstances demanded, as required by section 34 of the MSA and Municipal planning and performance management regulation 3.
81. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
82. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
83. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
84. 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, as required by section 72(1)(a)(ii) of the MFMA .
85. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
86. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
87. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal planning and performance management regulation 14(1)(a).
88. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1)(b)(i).
89. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1)(b)(iii).
90. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal planning and performance management regulation 14(1)(c).
91. The annual performance report for the financial year under review was not prepared, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
92. The annual performance report for the year under review does not include the



performance of the municipality and each external service provider) with a comparison of the performance with set targets and a comparison with the previous financial year with measures taken to improve performance, as required by section 46 (1)(a),(b),(c) of the MSA.

93. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

#### **Budgets**

94. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
95. Quarterly reports were not submitted to the council on the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
96. Enough audit evidence could not be obtained that monthly budget statements were submitted to the mayor / relevant provincial treasury, as required by section 71(1) of the MFMA.

#### **Annual financial statements, audit and performance reports**

97. 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 expenditure and disclosure items identified by the audit process in the submitted financial statements were subsequently corrected and certain supporting records requested were subsequently provided. However, the effects of uncorrected material misstatements and of supporting records that could not be presented for audit resulted in the financial statements receiving a disclaimer audit opinion.
98. The 2011-12 annual report was not made public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
99. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.
100. The performance report for the financial year under review was not prepared as required by section 46 of the MSA read with section 121(3)(c) of the MFMA.

#### **Audit committee**

101. An audit committee was not in place, as required by section 166(1) of the MFMA. A new audit committee was appointed in the current financial year, however there was a period of 4 months during the transition between the previous audit committee and the new audit committee taking effect that there was no audit committee in place.
102. Enough audit evidence could not be obtained to indicate that The audit committee advised the council and accounting officer on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
103. The audit committee did not advise the council and accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information,

as required by section 166(2)(a)(iv) of the MFMA.

104. The audit committee did not advise the council and accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
105. The audit committee did not review the financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
106. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
107. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
108. The audit committee was not constituted, in the manner required by section 166(4)(a) MFMA as the following requirements were not adhered to

#### **Internal audit**

109. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
  - It did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
  - It did not report to the audit committee on the implementation of the internal audit plan.
  - It did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
110. The internal audit unit did not advise the accounting officer and 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)(vii) of the MFMA.

#### **Asset management**

111. 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.
112. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

#### **Revenue management**

113. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
114. An adequate management, accounting and information system was not in place which recognised revenue when it was earned / accounted for debtors / accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
115. An effective system of internal control for debtors / revenue was not in place, as required by section 64(2)(f) of the MFMA.
116. Enough audit evidence could not be obtained that accounts for municipal tax and

service charges were prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.

117. Enough audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

#### **Liability management**

118. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
119. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.
120. Changes to the terms of agreement (including the credit limit) of a bank overdraft facility were made without a resolution by the municipal council approving the changes to the debt agreement, in contravention of section 45(3)(b)(ii) of the MFMA.
121. A bank overdraft facility was not repaid within the financial year, as required by section 45(4)(a) of the MFMA

#### **Expenditure management**

122. 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.
123. Payments were made without the approval of the accounting officer or a properly authorised official as required by section 11(1) of the MFMA.
124. 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.
125. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and recorded payments made, as required by section 65(2)(b) of the MFMA.
126. 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

#### **Procurement and contract management**

127. 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) and (c).
128. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
129. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
130. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
131. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).



132. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
133. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
134. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
135. Contracts 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).
136. Contracts were awarded to bidders based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act no 5 of 2000 (PPPF) and its regulations.

**Conditional grants received**

137. Enough audit evidence could not be obtained that the municipality submitted 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 DoRA.
138. Enough audit evidence could not be obtained that the allocation for the Municipal Infrastructure Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
139. Enough audit evidence could not be obtained that the municipality did evaluate its performance in respect of programmes funded by the allocation for the Municipal Infrastructure Grant / submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
140. Enough audit evidence could not be obtained that the municipality did table a three year capital budget as part of its 2012/13 financial year's budget, as required by the Division of Revenue Grant Framework, Gazette No.35399.
141. Enough audit evidence could not be obtained that the municipality did timeously submit project registration forms, for projects it intends implementing in the financial year 2013-14, to the department of local government, as required by the Division of Revenue Grant Framework, Gazette No.35399.
142. Enough audit evidence could not be obtained that the municipality did submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
143. Enough audit evidence could not be obtained that the allocation for the Local Government Financial Management Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
144. Enough audit evidence could not be obtained that the municipality did evaluate its performance in respect of programmes funded by the allocation for the Local Government Financial Management Grant / submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by

section 12(5) of the DoRA.

145. Enough audit evidence could not be obtained that the municipality did submit MFMA implementation plans to National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework, Gazette No.35399.
146. Enough audit evidence could not be obtained that the allocation for the Municipal Systems Improvement Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the DoRA.
147. Enough audit evidence could not be obtained that the municipality did evaluate its performance in respect of programmes funded by allocation for the Municipal Systems Improvement Grant / submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
148. Enough audit evidence could not be obtained that the municipality did submit its signed activity plan and/or in the prescribed format to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
149. Enough audit evidence could not be obtained that the municipality submitted, within 10 days after the end of each month, its monthly expenditure reports to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
150. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to National Revenue Fund, as required by section 21(1) of the DoRA.

#### **Human resources management**

151. An acting Head of Department (responsibilities associated with Chief Financial Officer) was appointed for a period of more than six months, and without having met the prescribed minimum competency levels which is in contravention of section 54A(2A) and 56(1)(c) of the MSA.
152. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
153. The accounting officer did not meet any of the prescribed competency areas (still under training) as required by section 83 of the MFMA and regulations 2 and 3 of the Municipal Regulations on Minimum Competency (MRMC) Levels.
154. The accounting officer, senior managers and supply chain management manager did not meet all of the prescribed competency areas as required by section 83 of the MFMA and regulation 2, 3, 6 and 7 of the MRMC Levels. The key competency areas for accounting officer, senior managers, SCM managers and head of SCM are:
  - strategic leadership and management (does not apply to SCM manager)
  - operational financial management
  - governance, ethics and values in financial management
  - financial and performance reporting (does not apply to Head and manager of SCM)
  - risk and change management
  - project management
  - legislation, policy and implementation
  - supply chain management

- audit and assurance (does not apply to Head and manager of SCM)
- stakeholder relations (applies only to head of SCM).

155. The head of SCM did not meet all of the prescribed competency areas as required by section 119 of the MFMA and the regulation 10 and 11 of the MRMC Levels. The position of head of supply chain management is filled by either the chief financial officer or the municipal manager while the post of the chief financial officer was vacant.
156. Enough audit evidence could not be obtained that finance officials at middle management and supply chain management managers met any of the prescribed competency areas as required by regulation 8 and 9 of the MRMC Levels.

#### **Consequence management compliance**

157. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

#### **Internal control**

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

#### **Leadership**

159. Ineffective leadership and oversight responsibility continues to prevail as evidenced by the numerous findings that have been repeated in the current year regarding the financial statements, performance reporting, compliance and internal controls. There is a complete disregard of accountability and commitment to improve significant internal control deficiencies which does not protect and enhance the best interests of the municipality due to the control environment being susceptible to the risk of fraud.
160. Effective HR management was not implemented as the delegation process was not implemented adequately to ensure the delegates were held accountable for their responsibilities. The extensive vacancies during the year resulted in a lack of segregation of duties resulting in a significant breakdown in internal controls, significant audit findings, as well as susceptibility to fraud.
161. Management did not have policies and procedures in place for a number of processes, the most significant being the financial statement close process, performance reporting and a formally approved information technology (IT) security policy.
162. Actions plans were not monitored to address the risks relating to the achievement of complete, accurate and valid financial and performance reporting supported by easily accessible supporting documentation.

#### **Financial and performance management**

163. Management did not implement an effective records management system to ensure that supporting documentation was filed timeously and methodically, accessible only to authorized personal and easily accessible and available to support valid, accurate and complete financial and performance information for audit purposes. The annual financial statements submitted for audit were materially misstated and the annual performance report was not submitted for audit.



164. The extensive vacancies and lack of adequately skilled staff during the year and the absence of communication and delegation of authority resulted in the breakdown of controls around daily and monthly processing, authorizations, reconciliations, reviews, filing and retaining of information and adequate knowledge of understanding the financial reporting framework and performance management requirements.
165. Management did not sufficiently and effectively implement and execute monitoring controls to ensure compliance with its laws and regulations. This contributed to repeated as well as newly identified non-compliance findings in the current year.

**Governance**

166. Management did not ensure that their audit committee and internal audit functioned throughout the year to provide an oversight role. Management did not respond to or address risks raised by internal audit nor provide the audit committee and internal audit with all the necessary information to perform their duties.

*Auditor General*  
East London

29 November 2013



AUDITOR - GENERAL  
SOUTH AFRICA

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