

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Inkwanca Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, 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 (SA Standards of 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, 2012 (Act No. 5 of 2012) (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

Service charges

6. The municipality did not recognise items that meet the definition of revenue as per GRAP 9 – Revenue from Exchange Transactions as required. Service charges revenue and trade receivables are understated by R241 465 as a result of service charges not being billed.
7. In addition, sufficient appropriate audit evidence was not available as documentation in support of service charges to indigent consumers was incomplete. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to service charges of R13,7 million as disclosed in note 15 to the financial statements.

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 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 31 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R12,5 million (2012: R 4,9 million). Due to the lack of systems, and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R 243 865 (2012: R647 646).

Trade and other payables

9. 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 R921 105 (2012: R684 120). Consequently expenditure is understated by R807 987 and VAT receivable is understated by R113 118. 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.

Commitments

10. GRAP 17 - Property, plant and equipment requires disclosure of contractual commitments for the acquisition of property, plant and equipment. No amounts were disclosed in note 32.8 as being committed to such contractual commitments although relevant commitments were identified. Due to the lack of systems it was impracticable to determine the full extent of the understatement of commitments.

Material losses

11. The municipality did not disclose material losses for water and electricity in the financial statements as required by section 125(2)(d)(i) of the MFMA. I am unable to determine the correct disclosure amounts for material losses as it was impracticable to do so.

Aggregation of immaterial uncorrected misstatements

12. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance:
13. Current year figures:
- VAT receivable as disclosed in note 5 is understated by R550 478.
 - Accumulated depreciation as disclosed in note 7 is overstated by R371 811.
 - General Expenditure as disclosed in note 28 is understated by R400 578.
 - Bad debt impairment as disclosed is overstated by R186 303.
 - Depreciation as disclosed in note 23 is overstated by R163 707.
14. Prior-year corresponding figures:
- Repairs and maintenance expense as disclosed on the statement of financial performance is understated by R296 472.
 - Property rates revenue as disclosed in note 14 is understated by R529 945.
 - Inventories as disclosed in note 4 are overstated by R612 996.
 - Current provisions as disclosed in note 10 are understated by R303 759.
 - Consumer deposits as disclosed in note 9 and other receivables from non-exchange transactions as disclosed in note 3 are understated by R125 639.

Corresponding figures

15. During 2011-12, I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements:
- Interest earned on outstanding receivables and the gross balance of trade and other receivables from exchange transactions from the prior year are understated by R1,8 million as a result of incorrect interest rates being used to calculate interest on outstanding receivables during the year.
 - Bad debts impairment of R12,6 million as disclosed was not calculated in accordance with GRAP 104 – Financial Instruments as the present value of estimated future cash flows was not determined by the municipality. It was impracticable to determine the full amount of the impairment.
 - Gross trade and other receivables and revenue on the statement of financial performance are overstated by R1,6 million, while the accumulated deficit is understated by the same amount as the municipality recorded revenue that does not meet the definition of revenue as per GRAP 9.
 - Government grants and subsidies revenue is overstated by R992 316 as a result of incorrect recording of entries related to conditional grants.
 - Service charges revenue is overstated by R4,9 million as a result of revenue from indigent debtors being incorrectly recorded, incorrect tariffs used to calculate service charges and revenue recorded in the incorrect period. Consequently general expenses are overstated by R5,7 million and other receivables are understated by R815 509.
 - General expenditure is overstated by R745 505 as a result of errors in capturing of grants, misclassification of expenditure, duplicate orders incorrectly raised as liabilities and other misstatements.
16. In addition during 2011-12, I was unable to obtain sufficient appropriate audit evidence concerning:
- General expenditure of R17,2 million as disclosed in note 28.
 - Other income of R2,8 million as disclosed in note 20.
 - Current portion of unspent conditional grants and receipts of R2,9 million as disclosed in note 11.
 - Government grants and subsidies – Revenue of R32 million as disclosed in note 19.
17. Service charges of R15,8 million as disclosed in note 15.
18. I was unable to obtain sufficient appropriate audit evidence for the corresponding figures relating to the above items or to confirm them by alternative means. Consequently I was unable to determine whether any adjustments to these amounts were necessary. My audit opinion on the financial statements for the period ended 2011-12 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Qualified opinion

19. In my opinion, except for the 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 Inkwanca Municipality as at 30 June 2013 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 matters

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

Restatement of corresponding figures

21. As disclosed in note 38 to the financial statements, the corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the financial statements at, and for the year ended, 30 June 2012.

Material Impairments

22. As disclosed in note 2 and 3 to the financial statements, an amount of R4 million (2012: R646 025) has been impaired due to nonpayment of billings raised during the year.

Unauthorised expenditure

23. As disclosed in note 31 to the financial statements, unauthorised expenditure amounting to R17,1 million was incurred by the municipality during the year.

Financial sustainability

24. Note 41 to the financial statements indicate indicators or conditions, individually and collectively, that may impact on the financial sustainability of the municipality to continue its normal operations.

Additional matter

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

Unaudited schedules

26. Appendix A – Schedule of External Loans supplementary information set out on page xx does not form part of the financial statements and is presented as additional information. This schedule has not been audited and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

27. 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

28. 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.
29. 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 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 (FMPP)*.
30. 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).
31. The material findings are as follows concerning the usefulness and reliability of the information:

Usefulness of information

Presentation

32. Section 46 of the Municipal Systems Act requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for all of the planned targets not achieved were not reflected in the annual performance report. This was due to the requirements of the Municipal Systems Act not being followed and undue reliance being placed on the service provider to draft the annual performance report.

Reliability of information

33. The National Treasury *FMPPI requires* that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
34. Significantly important targets with respect to the development priorities – Water, Electricity, Housing, Waste and Roads are materially misstated. This was due to the lack of standard operating procedures for the accurate recording of actual achievements as well as the monitoring of the completeness of source documentation in support of actual achievements and frequent review of validity of reported achievements against source documentation.
35. The information presented with respect to the development priority - Sanitation was not reliable when compared to the source information or evidence provided. This was due to limitations placed on the scope of my work due the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the development priority.

Compliance with laws and regulations

36. 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:

Expenditure management

37. An effective system of expenditure control, including procedures for the approval, authorisation and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
38. Reasonable steps were not taken to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Budgets

39. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the MFMA.

Annual financial statements and performance report

40. 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, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected or the supporting records were provided subsequently, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

41. 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.

42. 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.

Asset management

43. An effective system of internal control for assets (including an up to date asset register) was not in place, as required by section 63(2)(c) of the MFMA.
44. 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.

Revenue management

45. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
46. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

Conditional grants

47. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
48. The municipality did not 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.
49. The municipality did not 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.
50. 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 DoRA.
51. The municipality did not timely 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.
52. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No.35399.
53. The municipality did not evaluate its performance in respect of programmes funded by the Local government Finance Management Grant and the Municipal Systems Improvement Grant within two months after the end of the financial year, as required by section 12(5) of the DoRA.
54. The municipality did not submit, 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.

Consequences Management

55. Unauthorised, irregular expenditure 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.
56. The condoning of irregular expenditure was not approved by the appropriate relevant authority, in accordance with the requirements of sections 1 and 170 of the MFMA.

Audit committee

57. The audit committee did not advise the council on matters relating to risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.

58. The audit committee did not advise the council 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.
59. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
60. 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.

Internal Audit

61. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not advise the accounting officer or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
62. The internal audit unit did not advise the accounting officer and/or 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.

Performance management

63. 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 Municipal Systems Act (Act 32 of 2000) (MSA) and the Municipal planning and performance management regulation 1 and 9(1)(a).
64. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
65. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulation 12(1) and 12(2)(e).
66. 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).
67. 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).
68. The internal audit unit did not submit quarterly reports on their audits to the municipal manager and the audit committee, as required by Municipal planning and performance management regulation 14(1)(c).
69. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46 (1)(b) of the MSA.

Human Resource Management

70. An acting CFO was appointed for a period of more than six months, in contravention of section 54A(2A) and 56(1)(c) of the MSA.

Procurement

71. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).

72. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).
73. Sufficient appropriate audit evidence could not be obtained that bids were 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).
74. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
75. 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).
76. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
77. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
78. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as incomplete tender documents were submitted.
79. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
80. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).

Internal control

81. 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

82. The leadership and senior management team has been stable throughout the year and has taken a proactive approach to meet commitments made in improving their audit outcome. These positive actions have assisted in the improvement of the audit opinion.
83. While improved, sufficient monitoring and oversight controls are still not in place to ensure the proper functioning of the overall process of planning, budgeting, implementation, reporting and adherence to internal policies and procedures and compliance with laws and regulations for the purpose of taking corrective action.

Financial and performance management

84. As reported in the previous year, the municipality did not have sufficient and appropriate daily and monthly controls over financial statement reporting, resulting in year-end processes being onerous and susceptible to material misstatement.
85. Reconciliations and registers were not adequately prepared and reviewed, resulting in errors that could have been detected by management. Additionally, controls to ensure compliance with laws and regulations are not in place.
86. There are inadequate internal policies and procedures over the processes pertaining to the reporting of performance information and undue reliance was placed on the

consultants who prepared the annual performance report. Management did not ensure compliance with the requirements of the FMPPI.

Governance

87. The audit committee was not given sufficient time to discharge their function of reviewing the accuracy, reliability and adequacy of the financial statements and as a result the review performed on the annual financial statements did not have the desired impact on the fair presentation thereof as material misstatements were identified during the audit.
88. Additionally, the audit committee has not interacted with council sufficiently on matters relating to risk management and internal control in order to provide the assurance required to address weaknesses identified.
89. The audit committee's effectiveness is impaired due to an under resourced internal audit unit not providing credible information for discussion at the audit committee meetings.
90. Although the Municipal Public Accounts Committee (MPAC) was in place during the financial year under review, the responsibilities of the committee were not sufficiently discharged because it only had one meeting during the year under review and sufficient audit evidence could not be obtained to substantiate that MPAC submitted the required quarterly reports to Council. Due to this the desired impact of this committee was not realised.

Auditor-General

East London

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence