

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

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated and separate financial statements of the Port St Johns Municipality and its subsidiary as set out on pages xx to xx, which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statement of financial performance, statement of changes in net assets, the cash flow statement and the statement of comparison of budget and actual amounts 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 consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate 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 consolidated and separate 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 consolidated and separate 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 consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 consolidated and separate 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

VAT receivable

6. Sufficient appropriate audit evidence was not available in support of reconciling variances for the Value Added Tax (VAT) receivable at year end. Adequate reconciliations between the accounting records, VAT returns and statement of account were not performed. Input VAT was not correctly claimed in all circumstances and VAT receivable is consequently understated but it was impracticable to determine the extent thereof due to the lack of reconciliations. I was unable to confirm the balance by alternative means due to the absence of supporting documentation and explanations for variances. Consequently, I was unable to determine whether any further adjustments were necessary to the consolidated and separate VAT receivable of, respectively R2,48 million and R4.66 million (2012 : R3,95 million and R5.68 million) as disclosed in the consolidated and separate statement of financial position and note 6 to the financial statements.

Irregular expenditure

7. The prior-period corresponding figure for irregular expenditure disclosed in note 34.3 to the consolidated and separate financial statements is understated in respect of R1.72 million of irregular expenditure incurred during the 2011-12 year that was identified during the previous audit process. Due to the lack of systems, it was impracticable to determine the full extent of this understatement in corresponding figures. The corresponding and current year closing balance of irregular expenditure is consequently understated by at least R1.72 million.

Liabilities

8. I was unable to obtain sufficient appropriate audit evidence regarding the completeness of liabilities of the municipality. Supporting documentation was not available for transactions with other government institutions regarding financial assistance of at least R3.5 million received in previous financial periods and included in accumulated surplus. The non-availability of evidence made it impracticable to determine the extent of amounts involved and I could not confirm these amounts by alternative means. Consequently I was unable to determine whether any adjustments were necessary to liabilities on the consolidated and separate statement of financial position in the current and prior period.

Other disclosures

9. Sufficient appropriate audit evidence was not available for the prior year cash receipts disclosed on the consolidated and separate cash flow statement, and for reconciling items included as correction of prior period errors in note 31 - cash generated from operations. I was unable to confirm the prior year disclosures by alternative means. Consequently I was unable to determine whether any adjustments to the consolidated and separate prior year cash flow disclosures were necessary.
10. The separate municipality's restated accumulated surplus at 1 July 2012 of R354.09 million disclosed in the statement of changes in net assets does not agree to the R352.44 million accumulated surplus included in the statement of financial position. The surplus for the year ended 30 June 2012 of R7.19 million disclosed in the consolidated (group) statement of changes in net assets, furthermore, does not agree to the prior period surplus for the year included in the consolidated statement of financial performance amounting to R15 million. In addition, a reconciling difference included in the consolidated and separate statement of changes in net assets of R1.6 million was not supported. Sufficient appropriate evidence was not available for these variances, and I was unable to confirm them by alternative means. Consequently I was unable to determine whether any adjustments to the consolidated and separate statement of changes in net assets were necessary.
11. The ageing of consumer receivables disclosed in note 5 to the consolidated and separate financial statements is misstated as the municipal accounting system inappropriately allocates receipts to the most current debt. In addition, receivables that are past due as at the end of the reporting period but not impaired are not disclosed as required by GRAP 104 - Financial Instruments. Due to the system limitations it was not practicable for me to determine the correct disclosure amounts.

Aggregation of immaterial uncorrected misstatements

12. The consolidated and separate 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 and as disclosed on the consolidated and separate statement of financial performance:

- Revenue is overstated by R0.21 million (2012: Understated by R0.6 million)
- Expenses are overstated by R0.32 million (2012: R0.94 million)

Making up and as disclosed on the consolidated and separate statement of financial position:

- Current assets are understated by R0.60 million (2012: R0.51 million)
- Current liabilities are understated by R0.52 million (2012: R0.78 million)
- Non-current assets are understated by R0.30 million (2012: R0.6 million)
- Non-current liabilities are understated by R0.65 million
- The accumulated surplus is understated by R1.06 million (2012: R0.45 million)

13. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to government grants & subsidies revenue for the current and corresponding figures and unspent conditional grants as disclosed on the consolidated and separate statement of financial performance and position respectively.

Qualified opinion

14. In my opinion, except for the effects and possible effects of the matters described in the Basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Port St Johns Municipality and its subsidiary 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 matter

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

Restatement of corresponding figures

16. As disclosed in note 33 to the consolidated and separate financial statements, the prior-year corresponding figures for 30 June 2012 have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the consolidated and separate financial statements at, and for the year ended, 30 June 2012.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. 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

18. I performed procedures to obtain evidence about the usefulness and reliability of the Performance Information as set out on pages xx to xx, of the annual report.
19. 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 key priorities and objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury Framework for managing programme performance information (FMPPI). The reliability of the information in respect of the selected key priorities and objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

20. The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed or not supported by sufficient appropriate evidence

21. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the Performance Information report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 40% of the planned targets not achieved were not reflected in the Performance Information report. This was due to the lack of documented and approved internal policies and procedures to address reporting requirements.
22. In addition, adequate and reliable corroborating evidence could not be provided for 36% of the measures taken to improve performance that were disclosed in the Performance Information report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

Reliability of information

Infrastructure Planning and Development

23. The 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.
24. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of 19% of significantly important targets with respect to the Infrastructure Planning and Development priority, and in addition 13% of the significantly important targets for this priority were not reliable when compared to the source information and evidence provided. This was due to the lack of monitoring of the completeness of source documentation in support of actual achievements.

Additional matter

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

Achievement of planned targets

26. Of the total number of 145 targets planned for the year, 78 targets were not achieved. This represents 54% of the total planned targets not achieved during the year under review. Included in these 78 targets not achieved is 13 out of 14 targets that were not achieved relating to the Local Economic Development (LED) priority, and 23 out of 27 targets not achieved relating to the Good governance priority meaning that 93% of LED targets and 85% of Good governance targets respectively, were not achieved during the year under review.

Compliance with laws and regulations

27. 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

28. 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.
29. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

Asset Management

30. The municipality did not establish an investment policy that was adopted by council, as required by section 13(2) of the MFMA and Municipal investment regulation 3(1) (a) and 3(2).

Budgets

31. 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.
32. Monthly budget statements were not submitted to provincial treasury, as required by section 71(1) of the MFMA.

Revenue Management

33. 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 the MFMA.

Conditional Grants

34. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant, Municipal Systems Improvement Grant and Financial Management Grant or submit such evaluations to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.

Annual financial statements, performance and annual reports

35. 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 non-current and current assets, liabilities, revenue, expenditure and certain disclosure items as identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
36. An 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.

Audit committees

37. The audit committee met only three times during the financial year instead of the minimum of four times, as is required by section 166(4) (b) of the MFMA.

Strategic planning and performance management

38. The municipality, as the parent municipality with sole control of the Port St Johns Development Agency (its municipal entity), did not ensure that annual performance objectives and indicators for the entity were established by agreement and included in the entity's business plan, as required by section 93B(a) of the MSA.
39. The internal audit unit only submitted three quarterly reports to the municipal manager and the audit committee, and not all four quarters as required by Municipal planning and performance management regulation (MPPR) 14(1)(c).
40. The annual performance report for the year under review does not include a comparison of performance for the current year with that of the previous financial year, as required by section 46 (1) (b) of the MSA.
41. The municipality did not 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.
42. Only one report was submitted by the Audit committee to council on the review of the performance management system, and not two, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
43. The municipality did not set key performance indicators, or measurable performance targets in respect of each of the development priorities as included in their Integrated Development Plan, as required by section 41(1)(a) and (b) of the MSA and MPPR 1, 9(1)(a), 12(1) and 12(2)(e). This specifically relates to the Housing and Spatial Development priority as well as the Environmental Sustainability priority.

Financial misconduct

44. Unauthorised, Irregular and 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.

Procurement and contract management

45. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
46. Construction projects were not registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

Internal control

47. I considered internal control relevant to my audit of the financial statements, the 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 information report and the findings on compliance with laws and regulations included in this report.

Leadership

48. Leadership did not exercise sufficient oversight responsibility in terms of regular reviews regarding financial and performance reporting and compliance and related internal controls, and did not effectively monitor the implementation of the audit action plan to resolve findings from the previous audit - resulting in repeat findings.
49. Leadership did not develop and implement all required policies resulting in instances of non-compliance.

Financial and performance management

50. Management has not implemented effective controls over monthly reconciling of the financial records for regular, accurate and complete financial and performance reporting and have not implemented proper record keeping in a timely manner to support financial and performance reporting. The lack of complete and credible in-year reporting resulted in misstatements requiring adjustment during the audit process.
51. There are ineffective tools to enable the regular review and monitoring of compliance with laws and regulations.

Governance

52. Management did not implement appropriate risk management activities to ensure that regular risk assessments were conducted and that a risk strategy was developed and monitored to mitigate financial, performance and compliance risks facing the municipality. Recommendations of internal audit and the audit committee were not effectively and timeously implemented.

Auditor-General

East London

11 December 2013



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence