

# **REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NXUBA MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Nxuba municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

### **Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

### **Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. 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.

6. An audit also includes evaluating the:
  - appropriateness of accounting policies used
  - reasonableness of accounting estimates made by management
  - overall presentation of the financial statements.
  
7. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Nxuba municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

#### **Basis of accounting**

8. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1 to the financial statements.

#### **Basis for qualified opinion**

##### **Fixed Assets**

9. In terms of section 62(1)(b) and (c)(i) of the MFMA it is the responsibility of the accounting officer to ensure that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards and that the municipality has and maintains effective, efficient and transparent systems of financial, risk management and internal controls. The inability of the municipality to produce all supporting documentation places a limitation on the extent of audit work that could be performed. Consequently, it was not possible to gain satisfaction as to the valuation, existence, completeness, rights and obligations and disclosure relating to fixed assets account balances and classes of transactions. A suitable asset register reflecting the description of assets, numbers attached to individual assets, acquisitions and disposals of assets and the value at year-end, was not kept to support the value of R43 624 906 as disclosed on appendix C to the financial statements. Furthermore, there was no evidence that physical verification of assets was performed during the year under review.

##### **Waste Management**

10. The municipality which operates landfill sites has an obligation in terms of section 28 of the National Environment Management Act, Act No 107 of 1998 to restore such sites. The municipality does not assess the remaining useful life of landfill sites.

Detailed records of the capacity of landfill sites are not maintained by the municipality's engineers. Consequently a provision for the rehabilitation of landfill site has not been raised in the financial statements. Due to the specialist nature of such a provision and lack of appropriate records, I was unable to determine the extend of the misstatement.

### **Unauthorised Expenditure**

11. Expenses totalling R104 358 were incurred during the financial year under review in respect of fixed asset purchases. As no amount was budget for capital expenses, the amount of R104 358 is regarded as unauthorised expenditure. The amount was also not disclosed as unauthorised expenditure as required by section 125(2)(d)(i) of the MFMA.

### **Opinion**

12. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Nxuba municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 note 1 to the financial statements and in the manner required by the MFMA and DoRA.

### **Emphasis of matter(s)**

I draw attention to the following matter(s):

### **Going concern**

13. The municipality incurred a net loss of R4 603 544 for the year ended 30 June 2008 and as at that date the entity's total liabilities exceeded its total assets by R630 672. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

### **OTHER MATTER(S)**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### **Internal controls**

14. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal controls. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an

effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed Assets			X		
Waste Management			X		
Unauthorised Expenditure			X		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

### Non-compliance with applicable legislation

15. The accounting officer did not adhere to chapter 1 paragraph 3 of the supply chain management regulations. The municipality did not act in accordance with its supply chain management policy when procuring goods or services, disposing of goods no longer needed or when selecting contractors. In terms of paragraph 12 the municipality did not provide for procurement of goods and services by way of petty cash purchases, in some instances written or verbal quotations were not obtained.

In terms of chapter 37(2) the accounting officer did not record the reasons for deviations in terms of subregulation (1)(a) and (b) and report them to the council.

### Matters of governance

16. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
<b>Audit committee</b>		
<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	X	

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA.</li> </ul>	<b>X</b>	
<b>Internal audit</b>		
<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>		<b>X</b>
<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA.</li> </ul>		<b>X</b>
<b>Other matters of governance</b>		
<ul style="list-style-type: none"> <li>The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.</li> </ul>		<b>X</b>
<ul style="list-style-type: none"> <li>The financial statements submitted for audit were not subject to any material amendments resulting from the audit.</li> </ul>		<b>X</b>
<ul style="list-style-type: none"> <li>No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The prior year's external audit recommendations have been substantially implemented.</li> </ul>		<b>X</b>
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)<sup>1</sup></b>		
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.</li> </ul>	<b>X</b>	
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.</li> </ul>	<b>X</b>	

## **OTHER REPORTING RESPONSIBILITIES**

### **REPORT ON PERFORMANCE INFORMATION**

26. I was engaged to review the performance information.

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### **Responsibility of the accounting officer for the performance information**

27. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **Responsibility of the Auditor-General**

17. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* [and section 45 of the MSA].
18. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
19. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### **Audit findings (performance information)**

#### **Non-compliance with regulatory requirements**

20. Quarterly reviews of performance of all staff were not performed and no evidence to this effect could be submitted for audit purposes. This is in contravention with section 41(c) of the Municipal Systems Act, Act No 32 of 2000 (MSA).
21. The mid-year budget and performance assessment for 2007/2008 was not done on a timeous basis. This is in contravention with section 72(1)(iii) of the MFMA.
22. The annual performance report for 2007/2008 did not reflect the performance of the municipality and each service provider and a comparison of the performance with targets set. This is in contravention with section 46(1)(a-b) of the MSA.
23. The annual performance report of Nxuba municipality was not prepared and included in the 2006/2007 annual report. This is in contravention with section 46(2) of the MSA and section 121(3)(c) of the MFMA respectively.
24. No proof could be obtained that the 2006/2007 annual report was submitted to Provincial Treasury and the Provincial Department of Local Government & Traditional Affairs. This is in contravention with section 21A(1)(b) of the MSA and section 127(5)(b) of the MFMA respectively.
25. No internal auditing of the results of performance measurements were performed during the 2007/2008 financial year this is in contravention with paragraph 14(1)(a-c) of the Local Government Municipal Planning and Performance Management Regulations of 2001.
26. General key performance indicators were not included in the 2007/2008 integrated development plan (IDP). This is in contravention with section 43 of the MSA

27. A Service Delivery and Budget Implementation Plan (SDBIP) for the 2007/2008 financial year in the required format and containing all relevant information as per the MFMA Circular 13 dated 31/01/05 could not be submitted for audit purposes.

## **OTHER REPORTS**

### **Investigations**

28. The Eastern Cape Department of Local Government & Traditional Affairs is currently investigating alleged mismanagement of funds and is required to report back to the Office of the Public Service Commission.

## **APPRECIATION**

29. The assistance rendered by the staff of the Nxuba municipality during the audit is sincerely appreciated.

*Auditor-General*

East London

28/11/08



**A U D I T O R - G E N E R A L**