

Audit Report
Engcobo Municipality
For the Year ended 30 June 2011

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Engcobo Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to ...

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 manner required by the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010 as amended) (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.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 1111 of 2010 issued in Government Gazette 33872 of 15 December 2010. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Revenue from non-exchange transactions

4. Section 2(3) of the Municipal Property Rates Act (Act No. 6 of 2004) requires that a municipality exercise its power to levy a rate on property. The municipality has not levied property rates on all erven within the municipal jurisdiction. Consequently, revenue from property rates disclosed at R3,38 million on the face of the statement of financial performance is understated. As the municipality does not perform a reconciliation of rates revenue from the valuation roll to the general ledger, it was not possible to perform alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence relating to the completeness and accuracy of rates revenue.
5. The municipality does not maintain an adequate system of control over licences, permits and fines on which I could rely for the purpose of my audit. The register's for these items are not updated with all relevant fields and reconciled to the daily cash takings. The municipality's systems did not allow for the application of satisfactory alternative audit procedures that I could perform in order to obtain reasonable assurance that revenue from licences, permits and fines was completely and accurately recorded on the face of the statement of financial performance. Consequently, I was unable to determine the appropriateness of the R3,36 million disclosed as revenue from licences, permits and fines .

VAT receivable

6. The municipality has disclosed a net VAT receivable of R3,71 million (2010: R3,68 million) in the statement of financial position. Transactions that increased the VAT receivable in the current year could not be agreed to VAT returns submitted to the South African Revenue Service. The municipality processed unsupported VAT adjustments for the year ended 30 June 2011 which increased the VAT receivable balance by R1,08 million as disclosed in note 34. In addition, input VAT claims of R5,28 million, which were processed but not disclosed in note 34, did not amend the corresponding figure for the VAT receivable in order to correct and attend to limitations that caused me, not to express an opinion on the financial statements for the year ended 30 June 2010. The absence of adequate reconciliations between the accounting records and the VAT returns, supporting documentation and explanations for variances prohibited the application of alternative audit procedures to confirm the appropriate valuation of the VAT receivable and the possible effect of these VAT transactions on revenue and expenditure disclosed in the statement of financial performance for the year ended 30 June 2011.

Trade and other payables

7. The municipality has disclosed a leave accrual of R3,14 million (2010: R1,98 million) in note 5 to the financial statements. Adequate systems to monitor the capturing of leave days taken by employees and the rates used to calculate the leave accrual were not maintained. In addition, supporting documentation was not available to confirm the completeness and accuracy of adjustments processed to the opening balance of the leave accrual. Consequently, the leave balance was not amended in the corresponding figures and the disclosure required for prior period errors was not included in the financial statements in terms of GRAP 3, Accounting Policies, *Changes In Accounting Estimates and Errors*. The municipality's records did not permit the application of alternative audit procedures to confirm adjustments made to the leave accrual balance in the current financial year. I was therefore unable to determine the completeness, existence and valuation of the leave accrual as disclosed in note 5 to the financial statements.
8. The municipality has not raised an accrual for R0,51 million related to long service awards in respect of the monetary award given to staff members that have completed five or more year's service. Consequently the balance of trade and other payables is understated by this amount.

Trade and other receivables from exchange and non-exchange transactions

9. The municipality has disclosed service debtors amounting to R0,69 million and rates debtors amounting to R2,80 million respectively, in notes 2 and 3 to the financial statements. In the absence of debtor's receipts, subsequent receipts, monthly statements or updated customer records in order to request confirmations, it was not possible to determine the existence, rights, valuation and completeness of the receivables figure disclosed in the financial statements. Furthermore, incorrect allocations of manual receipts and inadequate information retained on property transfers, indigent debtor accounts and poor collection practices did not permit the application of alternative audit procedures and further prohibited the confirmation of the completeness of service and rates debtors.

Irregular expenditure

10. Section 79(1) of the MFMA requires the accounting officer to develop an appropriate system of delegation. In addition section 112(1) requires the implementation of a procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Payments totalling R1,21 million (2010: R3,02 million) were made without proper delegation and in contravention of supply chain management requirements. These payments were not included in irregular expenditure, disclosed in note 25.3 to the financial statements. Consequently, irregular expenditure as disclosed is understated by at least this amount. It was however not practicable to determine the full extent of the understatement as there was no system of control in place to identify all irregular expenditure incurred.

Unauthorised expenditure

11. Section 125(2) of the MFMA requires that the notes to the annual financial statement of a municipality must disclose the particulars of any material unauthorised expenditure, that occurred during the financial year and whether these are recoverable, any criminal or disciplinary steps taken as a result of such unauthorised expenditures; and any material losses recovered or written off. The municipality has not included an amount of R0,91 million recoverable from the former accounting officer in the disclosure of unauthorised expenditure contained in note 25.1 to the financial statements. In addition note 25.1 does not include sufficient detail on the recoverability of this unauthorised expenditure and steps taken and whether any material losses have been recovered or written off. Consequently, unauthorised expenditure as disclosed in the financial statements is understated by this amount.

Cash and cash equivalents

12. An unidentified difference of R0,17 million (2010: R0,37 million) exists between the balance of the main bank account per the general ledger and the balance as per the bank confirmation received. The municipality could not provide sufficient appropriate audit evidence for the difference between these two balances. There were no satisfactory alternative audit procedures that I could perform to obtain assurance as to the reasons for this difference. Consequently I was unable to satisfy myself as to the accuracy, occurrence, classification and completeness of transactions processed to the primary bank account.

Other corresponding figures

13. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. The matter's which gave rise to the limitation, as described below remain unresolved in the current year.
14. The municipality could not provide sufficient appropriate audit evidence regarding:
 - Employee costs of R20,27 million disclosed in note 17 to the financial statements;
 - General expenditure of R85,93 million disclosed in note 21 to the financial statements;
 - Accumulated surplus of R227,50 million disclosed in the statement of changes in net assets and
 - The debit transactions decreasing the opening balance of unspent conditional grants by R2,53 million disclosed in note 34 to the financial statements.
15. I was unable to confirm or verify these amounts by alternative means and as a result could not confirm the existence, accuracy, rights and obligations and completeness of the account balances and the occurrence, accuracy and completeness of the class of transactions.

Disclaimer of opinion

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

Emphasis of matters

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

Significant uncertainties

18. The municipality is a defendant in several lawsuits. The ultimate outcome of these matters cannot presently be determined. These claims have been disclosed as a contingent liability in note 29 to the financial statements.

Restatement of corresponding figures

19. Misstatements, in the corresponding figures which were identified during the prior period audit of the financial statements, were corrected by management. Restatement of a number of classes of transactions and account balances took place as disclosed in note 34 to the financial statements.

Material under-spending of conditional grants

20. The municipality has materially under-spent on conditional grants with a resulting increase in the unspent conditional grant balance to R22,5 million (2010: R15,8 million), as disclosed in the statement of financial position and notes 8 and 15 to the financial statements

Additional matters

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. I was unable to conduct the audit of performance against predetermined objectives as the municipality did not submit the annual performance report as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

COMPLIANCE WITH LAWS AND REGULATIONS**Strategic planning and performance management**

23. The municipality has not developed and adopted policies, plans, strategies and programmes, including setting targets for delivery in terms of section 11(3)(a) of the MSA.

Budgets

24. The mayor did not submit all quarterly reports to council on the implementation of the budget and 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.

25. The accounting officer did not report in writing to the municipal council any impending overspending of the municipality's budget and any steps taken to prevent or rectify such shortfalls or overspending as required by section 70(1)(a) and (b) of the MFMA. The accounting officer also did not perform a comparison between the monthly budget and the amounts in the entity's approved budget as required by section 70(3) of the MFMA. Furthermore, the accounting officer did not submit an explanation of variances between budgeted and actual expenditure as envisaged in section 70(1)(g) of the MFMA.
26. The accounting officer did not comply with the requirements of section 34(1) of the municipal budget and reporting regulations (published in Government Notice (GNR) 393 of 17 April 2009) by making the mid-year budget and performance assessment public by placing it on the official website of the municipality within five working days of 25 January 2011. The monthly budget statements were also not published on the website.
27. The accounting officer did not timeously assess the performance of the municipality for the first half of the financial year as required by section 72(1) of the MFMA.
28. The accounting officer did not within 10 working days of the end of each month submit to National Treasury, the mayor of the municipality and the relevant provincial treasury a statement on the state of the municipality's budget as required by section 71(1)(g).

Annual financial statements, performance and annual report

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of assets, liabilities, revenue, expenditure and disclosure items identified by the auditors were subsequently adjusted; however the uncorrected material misstatements together with the limitations imposed on the audit resulted in the financial statements receiving a disclaimed audit opinion.
30. The accounting officer did not ensure that the municipality has and maintains an effective, efficient and transparent system of financial and risk management and internal control as prescribed by section 62(1)(c).
31. The accounting officer did not submit an annual report on predetermined objectives with the financial statements for auditing as required by section 45(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
32. Section 125(2)(d)(i) of the MFMA has not been complied with regarding the disclosure of any material losses and any material irregular expenditure, including in the case of a municipality, any material unauthorised expenditure, that occurred during the financial year, and whether these are recoverable.

Audit Committee

33. The audit committee has not dispensed with all its duties under section 166(2)(a)(v) of the MFMA as it did not review the performance of the municipality. Internal audit reports related to the audit of predetermined objectives were also not reviewed during the financial year.
34. No evidence of interaction between the audit committee and council was identified during the financial year as envisaged in section 166(2)(c) MFMA.

Internal Audit

35. The internal audit unit has not fulfilled all of their duties included in the MFMA. The internal audit unit operated without a risk based audit plan as required by section 165(2)(a) of the MFMA, until December 2010 when the plan was approved. In addition, no evidence was obtained that the internal audit unit advised the accounting officer and reported to the audit committee on accounting policies and practices, risk and risk management, performance management and compliance with the MFMA, DoRA and other legislation as required by section 165(2)(b) (iii), (iv), (v) and (vii) of the MFMA respectively.

36. The accounting officer did not take all reasonable steps to ensure that internal audit has been operating in accordance with any prescribed norms and standards as required by section 62(1)(c)(ii) of the MFMA.

Governance

37. The municipality has not established a Municipal Public Accounts Committee (MPAC), as required by section 79(1)(a) of the MSA, read in conjunction with the Framework for the Establishment of the Municipal Public Accounts Committee, in order to serve as an oversight committee over the executive obligations of council.

Procurement and contract management

38. The municipality acted in contravention of the Municipal Supply Chain Management Regulation 12(2)(b) and did not (i) obtain verbal quotations for all expenditure between R2 000 and R10 000, (ii) did not obtain written price quotations from at least three suppliers for procurement of items of a transaction value between R10 000 and R200 000 and (iii) did not enter into the competitive bidding process for all expenditure above R200 000.

39. The municipality did not disclose in the notes to the annual financial statements the particulars of awards of more than R 2000 made to a person who is a spouse, child or parent of a person in the service of the state, or who has been on the service of the state in the previous twelve months as required by the Supply Chain Management Regulation 45.

40. The municipality did not complete the necessary requisition forms for approval by the relevant Manager or Senior Manager within the municipality for all expenditure incurred, as required by the Supply Chain Management Policy of the municipality. Furthermore, services were procured without generating an official purchase order and payments were made without the original invoice in contravention of the aforementioned policy.

41. The municipality awarded contracts to suppliers who did not furnish a tax clearance certificate as required by Municipal Supply Chain Management Regulation 13(b).

42. The municipality signed contracts with suppliers before the date of official award of the tender, which contravenes the requirement in section 65(2)(i) of the MFMA which requires the supply chain management policy to be implemented in a manner that is fair, equitable, transparent, competitive and cost effective.

Human resources management and compensation

43. The municipality has not limited the maximum leave that can be accumulated by officials to 48 days as required by section 3.1.4 of the South African Local Government Association Main Collective Agreement.

44. The municipality has not put in place a process or mechanism to regularly evaluate the staff establishment and, if necessary, review the staff establishment and the remuneration and conditions of service as required by section 66(1)(d) of the MSA. Job descriptions has not been provided for each post in the staff establishment as required by section 66(1)(b) of the MSA.

45. The municipality has not limited overtime worked by employees to ten hours per week as required by section 10(1)(b) of the Basic Conditions of Employment Act

Expenditure management

46. The accounting officer did not take effective and appropriate steps to prevent unauthorised, and irregular expenditure, as per the requirements of section 62(1)(d) of the MFMA.

47. All payments to creditors were not settled within 30 days from receipt of an invoice, as per the requirements of section 65(2)(e) of the MFMA.

48. The accounting officer did not ensure that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards in terms of section 62(1)(b) of the MFMA.
49. The municipality did not submit all Value Added Tax returns on a timeous basis to the SA Revenue Service as required by section 28 of the Value (VAT) Added Tax Act, 1991 (Act No. 89 of 1991).
50. Input tax on VAT was claimed in contravention of section 20(4)(c) of the Value Added Tax Act, as the municipality did not possess a valid tax invoices in the name of the municipality and containing the municipal VAT registration number.

Revenue management

51. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a system of internal control in respect of debtors and revenue as required by section 64(2)(f) of the MFMA.
52. The municipality did not charge interest on arrear debtors as required by section 64(2)(g) of the MFMA.
53. Adequate system of internal controls has not been implemented to ensure that the debt and credit policy of the municipality is effectively enforced as required by section 97(1) of the MSA.
54. The accounting officer did not correctly report to the relevant provincial treasury, the National Treasury and the transferring national officer on spending and financial performance against programmes funded by any Schedule 4 allocation as required by section 11(2)(b) of the Division of Revenue Act.

Asset management

55. The municipality has not maintained a management, accounting and information system that accounts for the assets and liabilities of the municipality as required by section 63(2)(a) of the MFMA.

INTERNAL CONTROL

56. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

57. Adequate delegations of responsibility are not in place, as set out in section 106 of the MFMA.
58. The leadership structure at the municipality has remained constant during the financial year. Oversight responsibilities over reporting, compliance with laws and regulations and internal control have not been adequately exercised. This is as a result of an organisational structure that is inadequately staffed to respond appropriately to organisational risks. In addition, municipal officials do not monitor tasks delegated to subordinates and excessive reliance is placed on certain staff.
59. The leadership tone at the top refers to leadership's commitment to creating a sound control environment emphasised by accountability for public funds. An appropriate leadership tone towards financial reporting was displayed but did not result in improvements in the audit opinion as a result of a poor monitoring of action plans and monthly financial and performance processes. Monthly management information is not reliable and useful as a result of management not fulfilling their responsibilities and accepting accountability for their areas of responsibility.

60. Supply chain management regulations are not enforced; breaches of these regulations occur frequently and do not receive the attention of leadership. This reinforces a negative culture with regards to procurement and leads to further irregularities.

Financial and performance management

61. The municipality was unable to provide the auditor with adequate supporting documentation for various components of the audit. This is as a result of the municipality not having an adequate record management system in place to ensure easy retrieval of documents

62. The municipality's manual and automated controls are not designed and controls are not implemented to ensure that the transactions have occurred, are authorised and are complete and accurately processed. Management does not adequately monitor transactions upon recording. Management does not have adequate controls over the daily and monthly processing and reconciling of transactions and account balances. The control systems also do not respond adequately to the risks of fraud in payroll, procurement and the payment for expenditure.

63. The systems or process for the preparation and reporting of performance against predetermined objectives is neither adequate nor sufficient. Required reports and supporting documentation are not readily available.

64. Management does not adequately review and monitor compliance with laws and regulations. In addition management does not have adequate controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

Governance

65. The municipality has not established a Municipal Public Accounts Committee (MPAC), as required by section 79(1)(a) of the MSA, read in conjunction with the Framework for the Establishment of the Municipal Public Accounts Committee, in order to serve as an oversight committee to exercise oversight over the executive obligations of council.

66. Inadequate committees were established for Human Resources and Information Technology. No Performance Audit Committee was established. The risk committee did not function adequately and no risk assessment was performed during the year.

67. The audit committee has not dispensed with all its duties under section 166(2)(a)(v) of the MFMA as it did not review the performance of the municipality. Internal audit reports related to the audit of predetermined objectives also were not reviewed during the financial year.

68. The internal audit unit has not fulfilled all of their duties included in the MFMA. The internal audit unit operated without a risk based audit plan required by section 165(2)(a) of the MFMA until December 2010 when the plan was approved. In addition, no evidence was obtained that the internal audit unit advised the accounting officer and reported to the audit committee on accounting policies and practices, risk and risk management, performance management and compliance with the MFMA, DoRA and other legislation as required by section 165(2)(b) (iii), (iv), (v) and (vii) of the MFMA respectively.

69. The accounting officer did not take all reasonable steps to ensure that internal audit has been operating in accordance with any prescribed norms and standards as required by section 62(1)(c)(ii) of the MFMA.

70. The municipality has not implemented a fraud prevention plan. A fraud hotline does not exist and no processes have been established for officials in the SCM unit to report to the accounting officer any alleged irregular conduct in the SCM system which they become aware of, including any alleged fraud, corruption, favouritism, unfair conduct, failure to comply with SCM regulation 47(1) or breach of the code of the ethical standards.

Auditor - General

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence