



The accounting officer
Nkonkobe Municipality
PO Box 36
Fort Beaufort
5720

30 December 2013

Reference: 21300REG12/13

Dear Sir

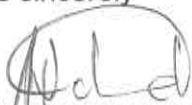
Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Nkonkobe Local Municipality for the year ended 30 June 2013

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
3. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
4. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

5. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
6. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely



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Senior Manager: Eastern Cape

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**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE NKONKOBÉ LOCAL MUNICIPALITY
REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS**

Introduction

1. I have audited the consolidated and separate financial statements of the Nkonkobe Local Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and the consolidated and separate cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information, including Annexure B.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with the South African Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No.6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of the 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

Non-current provisions

6. Sufficient and appropriate audit evidence could not be obtained to confirm the data used in the calculations made in estimating the value of the obligation to rehabilitate landfill sites of R2,4 million (2012: R2,4 million) as disclosed in note 13 to the annual financial

statements, as well as the prior period error relating to the obligation to rehabilitate landfill sites as disclosed in note 46 to the annual financial statements. Consequently I could not determine if any adjustments was necessary to Non-current Provision amounting to R5,9 million (2012: R4,9 million) as disclose in the statement of financial position.

Value Added Tax (VAT) receivable

7. The municipality recorded input VAT as expenditure resulting in a misstatement of the VAT receivable and expenditure by an estimated amount of R880 060. In addition, I was unable to obtain sufficient appropriate audit evidence from the municipality for VAT receivables of R1,2 million (2012: R1,7 million) included in the statement of financial position. The financial records did not allow for alternative procedures. Consequently, I was unable to determine whether any adjustment were necessary to the VAT receivables.

Trade and Other payables

8. Expenditure amounting to R1,3 million was recognised in the incorrect accounting period resulting in an overstatement of R1,3 million of the accruals and an understatement by the same amount of the general expenditure.
9. Sufficient appropriate audit evidence could not be obtained for the suspense account (unallocated deposits) and journal entries. Confirmations by alternative means were not made possible by the financial records. Consequently I could not determine if any adjustments were necessary to the trade and other payables amounting to R36,3 million as disclosed in the statement of financial position.

Expenditure

10. The municipality overstated expenditure by R2,2 million as a result of expenditure of R612 842 recognised in the incorrect accounting period, input VAT of R880 060 not claimed from expenditure and other misstatements amounting to R702 984..

Employee related costs

11. Casual labour was not capitalised to capital work in progress for capital projects undertaken internally by the municipality. The available records did not allow me to determine the portion of casual labour that should be capitalised as work in progress by alternative procedures.
12. Consequently I could not determine if any adjustments were necessary to employee costs amounting to R66,2 million as disclosed in the statement of financial performance and capital work in progress of R16,1 million as disclosed in note 5 to the financial statements.

Unauthorised expenditure

13. The municipality is required by section 125(2)(d)(i) of the MFMA to disclose unauthorised expenditure. I was unable to obtain sufficient and appropriate audit evidence for the amounts disclosed in note 38 to the financial statements amounting to R630 000. Consequently, I am unable to determine whether any adjustments are necessary to the amounts disclosed in note 38 of the annual financial statements.

Budget disclosure in terms of GRAP 24

14. The consolidated amounts disclosed in the budget statement included as Appendix B to the consolidated financial statements for employee cost of R58,1 million is understated

by R4,2 million and other expenditure of R56,5 million is understated by R4,8 million in accordance with the approved budgets.

15. Further, the amounts disclosed in the statement of comparative between budget and actual information under the Column heading "Unauthorised expenditure" do not meet the definition of unauthorised expenditure as per section 1 of the MFMA.

Irregular expenditure

16. 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 38 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of at least R9,4million.

Disclosure in respect of property plant and equipment

17. The municipality understated the disclosure of capital commitments in respect of property, plant and equipment in note 5.7 to the annual financial statements by R5,1 million (2012: R55,4 million).

Aggregation of immaterial misstatements in corresponding figures

18. The consolidated and separate financial statements as a whole with respect to corresponding figures are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements the more significant of which is the fact that management did not account for trade and other receivables and the related revenue from exchange transactions to the value of R1 million.

Opinion

19. In my opinion, except for the 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 consolidated and separate financial position of the Nkonkobe Local Municipality as at 30 June 2013 and its consolidated and separate financial performance and consolidated and separate cash flows for the year then ended, and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and DoRA Act No. 6 of 201

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 46 to the separate financial statements corresponding figures for 30 June 2012 have been restated as a result of errors discovered during the 2013 financial year in the financial statements of the Nkonkobe Local Municipality at, and for the year ended 30 June 2013.

Significant Uncertainties

22. With reference to note 42 to the financial statements, the municipality is the defendant in a material possible claim. The ultimate outcome of the matter cannot presently be determined and no provision for the liability that may result has been made in the financial statements.

Additional matters

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

Unaudited supplementary schedules

24. The supplementary information as set out on page ... in respect of Disclosure of grants and subsidies in terms of section 123 of the MFMA does not form part of the separate and consolidated financial statements. I have not audited this schedule and, accordingly, I do not express an opinion thereon.
25. The supplementary information set out on page ... in respect of Segmental Statement of Financial Performance was not submitted at 31 August 2013 for audit. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. 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

27. 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.
28. 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 objectives/ 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 FMPPI*).
29. The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

Usefulness of information

Presentation

Measures taken to improve performance not supported by sufficient appropriate evidence

30. Section 46 of the Municipal Systems Act, 2000 (Act No.32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 95% measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures.
31. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

Consistency

Changes to indicator and target not approved

32. The section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents.
33. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in terms of section 34 and remains in force until an integrated development plan is adopted by the next elected council. Therefore, if the integrated development plan is changed in-year this process has to take place in accordance with the process as prescribed per section 34 of the MSA.
34. The change made to the indicator and target under the Tourism development priority on the annual performance report was not approved. This was due to controls not being implemented to ensure compliance with all laws and regulations.

Measurability

Performance Indicators not well defined

35. The National Treasury FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 24% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance Targets not Specific

36. The National Treasury FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 32% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance Targets not Measurable

37. The National Treasury FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 32% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Performance Targets not Time-bound

38. The National Treasury FMPPI requires that the time period or deadline for delivery be specified. A total of 21% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.

Reliability of selected development priorities in the annual performance report

Electricity, Solid Waste, Unemployment

39. 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. The information presented with respect to Electricity, Solid Waste and Unemployment development priorities was not reliable when compared to the source information and/or evidence provided.

40. This was due to the lack of standard operating procedures for the accurate recording of actual achievements and monitoring of the completeness of source documentation in support of actual achievements and frequent review of validity of reported achievements against source documentation.

Roads, Sanitation, ICT, IDP and PMS

41. 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.
42. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to Roads, Sanitation, ICT, IDP and PMS development areas.
43. This was due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to Roads, Sanitation, ICT, IDP and PMS development areas.

Compliance with laws and regulations

44. 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:

Human Resource Management Compliance

45. An acting Chief Financial Officer (CFO) was appointed for a period of more than six months, in contravention of section 54A (2A) of the MSA.

Budgets

46. 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.

Annual financial statements, performance and annual reports

47. The financial statements submitted for audit were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
48. Material misstatements of non-current assets, current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Procurement and Contract management

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by Supply Chain Management (SCM) regulation 17(a) & (c).
50. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

Expenditure management

51. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors, as required by section 65(2)(b) of the MFMA.
52. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

Revenue management

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

Asset management

55. 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.
56. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2) (c) of the MFMA.

Liability management

57. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
58. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

59. Sufficient appropriate audit evidence could not be obtained to verify that Irregular expenditure incurred by the municipality was investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Oversight of the Nkonkobe Economic Development Agency

60. Non compliance was reported in the audit report for the municipal entity for the following areas:
 - Annual financial statements, performance and annual report
 - Strategic, planning and performance management
 - Expenditure Management
 - Procurement and contract management
 - Asset management

- Internal audit

61. The municipality did not monitor and review the performance of its municipal entity against the agreed performance objectives and indicators.

Internal control

62. 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

63. Oversight responsibilities regarding the monitoring of internal controls over financial reporting, compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatement in the annual financial statements that were submitted for audit, non compliance with applicable laws and regulations and also resulted in the information presented in the report on predetermined objectives not being valid, accurate and complete.

64. Leadership failed to implement adequate controls to prevent or detect (and subsequently report) on irregular expenditure and unauthorised expenditure incurred.

Financial and performance management

65. The municipality has not implemented adequate review mechanisms to ensure the report on predetermined objectives and the annual financial statements are reviewed for accuracy and completeness prior to submission for audit.

Governance

66. The municipality has an audit committee and internal audit unit in place. The recommendations of the audit committee and internal audit unit are not adequately addressed by management and will therefore have a negative impact in addressing control deficiencies that exist in the municipality's control environment.

Auditor - General.

East London

30 December 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence