



AUDITOR-GENERAL
SOUTH AFRICA

The Municipal Manager
Nxuba Local Municipality
Private Bag X350
Adelaide
5760

Date: 30 November 2013

Reference: 21301REG12-13

Dear sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Nxuba 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. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the Nxuba Local Municipality's annual report to be tabled.
4. 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.
5. 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.

6. Please notify the undersigned deputy business executive well in advance of the date on which the annual report containing this audit report will be tabled.
7. 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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Shereen Noble
Deputy Business Executive: ECBU

Enquiries: Sazi Ndwandwa
Telephone: 043 -709 7200
Fax: 043 -709 7300

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Nxuba Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and cash flows for the year then ended, and 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, (Act No. 56 of 2003) (MFMA), the Division of Revenue Act of South Africa, 2011 (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 the 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

Property, plant and equipment

6. The municipality did not maintain an adequate fixed asset register as it did not agree to the financial statements or the underlying financial accounting records. Sufficient appropriate evidence was not available for both the current and the comparative year in support of ownership and valuation of immovable assets included in the financial statements to the value of R203,2 million (2011-12: R202,3 million), as disclosed in note 7 to the financial statements. Furthermore, owing to the weaknesses in controls over the maintenance of the fixed assets register, I was unable to determine if all assets were recorded. I was unable to confirm the balance by alternative means.
7. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment of R203,2 million (2011-12: R202,3 million) in note 7 to the financial statements and the related depreciation disclosed at R8,2 million (2011-12: R8,3 million) in note 7 to the financial statements.

Investment property

8. Investment property of R20,3 million (2011-12: R20,3 million) is disclosed in the statement of financial position and note 8 to the financial statements. Sufficient appropriate evidence was not available for both the current and the comparative year to substantiate this amount. I was unable to confirm these amounts by means of alternative procedures. Consequently, I was unable to determine whether any further adjustments were necessary to the investment property in the financial statements.

Irregular expenditure

9. 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. Due to the inadequate systems and non-availability of sufficient appropriate audit evidence for awards, it was impracticable for me to determine the full extent of the understatement of irregular expenditure disclosed at R30,7 million (2011-12: R30,5 million) in note 41 to the financial statements. I was unable to confirm the disclosure by alternative means.
10. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure as disclosed in note 41 to the financial statements.

Unauthorised expenditure

11. The municipality did not have adequate systems in place to identify and disclose all unauthorised expenditure incurred during the year, as required by section 125(2)(d)(i) of the MFMA. As a result, unauthorised expenditure included in note 41 is understated by R11,6 million.

Corresponding figures

12. During 2011-12 the financial statements contained material misstatements which were included in the basis for the modified audit opinion. I was unable to obtain sufficient appropriate evidence that the following misstatements in the corresponding figures had been corrected:

- Trade receivables and revenue, as disclosed in notes 4 and 19 respectively, were overstated by R2,8 million because the municipality charged itself property rates.
- The municipality did not provide supporting documentation for journal entries and invoices or statements for value-added tax (VAT) receivable. I was unable to confirm this account balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the VAT receivable balance disclosed in the financial statements as R3,5 million.

Aggregation of immaterial misstatements in corresponding figures

13. The financial statements as a whole with respect to corresponding figures 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:
- Expenditure not agreeing between the trial balance and the financial statements, as disclosed in the statement of financial performance, is understated by R2,0 million.
 - Depreciation expense as disclosed in the statement of financial statements under general expenses is understated by R1,0 million.
 - Leave accrual calculated using incorrect gross salaries as disclosed in the statement of financial position is understated by an amount of R118 678.
14. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated in the corresponding figures and I was unable to confirm the following elements by alternative means:
- Stores and materials expenses disclosed under bulk purchases in the statement of financial performance at the amount of R1,8 million.
 - Supporting documentation was not submitted for cancellation fines disclosed in the statement of financial performance at an amount of R115 300.
15. As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Qualified opinion

16. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements fairly present, in all material respects, the financial position of the Nxuba Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

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

Illegal landfill closure liability

17. As disclosed in note 16 to the financial statements, the municipality is illegally operating waste disposal operations within Adelaide and Bedford. The Bedford site is expected to reach its maximum capacity by the end of 2013. A total liability amount of R4,3 million has been provided for rehabilitation of the land.

Additional matter

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

Unaudited supplementary schedules

18. The supplementary information set out on pages ... to ... do not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

19. 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

20. 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.
21. 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 annual reporting principles and whether the reported performance is consistent with the planned 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).
22. The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete). The material findings are as follows:

Usefulness of annual performance report

Presentation

Measures taken to improve performance were not reported in the annual performance report

23. Section 46 of the Municipal Systems Act (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 74% of the planned targets not achieved were not reflected in the annual performance report. Furthermore, adequate and reliable corroborating evidence could not be provided for 20% of the measures taken to improve performance as disclosed in the annual performance report. This was due to a lack of proper and relevant controls being put in place by the municipality to ensure the consistent and accurate collection and recording of relevant information. The municipality's records did not permit the application of alternative audit procedures.
24. 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

Reported performance not valid, accurate and complete

Local economic development

25. National Treasury FMPPI requires that processes and systems which produce the indicator should be verifiable. A significantly important target relevant to *local economic development* was not reliable when compared to the evidence examined. This was due to a lack of monitoring by senior management, an inadequate review process to verify all supporting evidence before the performance report was submitted for audit, as well as a lack of standard operating procedures that are in line with the requirements of the FMPPI for the recording of actual achievements.

Infrastructure development and service delivery

26. National Treasury FMPPI requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity, accuracy and completeness of the actual reported performance relevant to *infrastructure development and service delivery*. This was due to a lack of monitoring by senior management, an inadequate review process to verify all supporting evidence before the performance report was submitted for audit, as well as a lack of standard operating procedures that are in line with the requirements of the FMPPI for the recording of actual achievements.

Compliance with laws and regulations

27. I performed procedures to obtain evidence that the entity had 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:

Financial statements, annual report and annual performance report

28. 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 assets, current assets, 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 resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

29. The municipality did not formally establish a performance management system, as required by section 38(a) of the MSA.
30. The performance management system of the municipality did not clarify the roles and responsibilities of each role-player in the functioning of the system and did not determine the frequency of reporting and the lines of accountability for performance as required by section 38(a) of the MSA.
31. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

32. 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 (MPPMR) 14(4)(a)(iii).
33. The annual performance report for the year under review does not include the names of external service providers, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1) of the MSA.
34. The municipality did not have and 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.

Expenditure

35. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Procurement

36. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by Supply Chain Management (SCM) regulation 29(5)(b).
37. Contracts and quotations were awarded to and accepted from providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
38. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act (PPPFA) and SCM regulation 28(1)(a).
39. Contracts and quotations were awarded to and accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
40. Awards were made to providers who are persons in service of other state institutions, in contravention of SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Asset management

41. 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.

Budget

42. 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.

Conditional grants

43. The allocation for the Municipal Infrastructure Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of DoRA.

44. The municipality did not timeously 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 (DRGF), Gazette No. 35399.
45. The municipality did not submit project implementation plans to the national department (CoGTA), as required by the DRGF, Gazette No. 35399.
46. Unspent conditional grant funds were not surrendered to National Revenue Fund, as required by section 21(1) of DoRA.

Human resource management

47. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.
48. Sufficient appropriate audit evidence could not be obtained that the senior managers dismissed for financial misconduct in previous employments were not later re-appointed by the municipality before the expiry of 10 years in contravention of section 57A of the MFMA.
43. The competencies of financial and SCM officials were not assessed in order to identify and address gaps in competency levels, as required by the Municipal regulations on minimum competency levels regulation 13.
44. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by the Regulations on minimum competency levels regulation 14(2)(a).
45. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the Regulations on minimum competency levels regulation 14(2)(b).

Revenue management

46. A tariff policy was not implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the MSA and section 62(1)(f)(i) of the MFMA.
47. 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.
48. A policy was not implemented for the levying of rates on rateable property within the municipality, as required by section 3(1) of the Property Rates Act and section 62(1)(f)(ii) of the MFMA.

Internal audit

49. 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, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Consequence Management

50. Sufficient appropriate audit evidence could not be obtained that unauthorised 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.

Internal control

51. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

52. Oversight responsibilities regarding the monitoring of internal controls over financial reporting, compliance with applicable laws and regulations were not adequately performed.
53. Leadership failed to implement adequate controls to prevent or detect (and subsequently report on) irregular expenditure and unauthorised expenditure incurred.
54. The municipality has vacancies in key management positions. These vacancies affect the leadership's ability to effectively manage the control environment by addressing identified control risks and deficiencies.

Financial and performance management

55. The municipality does not perform daily and monthly processing and reconciling of transactions throughout the financial year with the result that material misstatements were identified during the audit and could not be substantially corrected by management, thereby having a negative impact on the audit outcome.
56. The municipality did not prepare reliable and accurate monthly and quarterly management accounts. This is due to the instability that existed in key positions in the finance department and management not understanding the requirements of the applicable reporting framework.
57. The municipality did not have updated policies and procedures in place to support compliance with the GRAP reporting framework and accounting for transactions in accordance with this framework.
58. The municipality has not implemented adequate review mechanisms to ensure that the report on predetermined objectives and the financial statements are reviewed for accuracy and completeness prior to submission for audit.
59. The municipality has not implemented controls to ensure that the information supporting the report on predetermined objectives is credible, accurate and complete as misstatements were identified in respect of the accuracy and validity of reported performance.
60. Management did not review and monitor compliance with applicable laws and regulations.

Governance

61. 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 therefore have no impact in addressing control deficiencies identified in the municipality's control environment.

Auditor - General

East London

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence