

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Emalahleni Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement, statements of comparison of budget and actual amounts for the year then ended, as well as the 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 South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (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 these 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

Irregular expenditure

6. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose irregular expenditure that occurred during the financial year. Irregular expenditure of R 64,4 million (2013: R 73,9 million), as disclosed in note 39.3 to the financial statements, were materially understated as payments were made in contravention of the supply chain management (SCM) requirements. Due to inadequate systems, it was impractical for me to determine the full extent of the understatement of

irregular expenditure. Consequently I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosed at R138,5 million (2013: R74,1 million).

Revenue

7. I was unable to obtain sufficient appropriate audit evidence regarding water revenue due to incomplete meter readings. I was unable to confirm the water revenue by alternative means. Consequently, I was unable to determine whether any adjustment relating water revenue, stated at R7 million (2013: R2,9 million) in note 22 to the financial statements, was necessary.

Material losses

8. The municipality is required by section 125(2)d of the MFMA to disclose in the financial statements the amount of material water losses for the year. The municipality did not have a system for the identification and quantification of water losses and consequently, did not disclose any water losses. I was unable to confirm or verify by alternative means the water losses for the year and, as a result, I was unable to determine the water losses to be disclosed in the financial statements.

Aggregation of immaterial uncorrected misstatements

9. The financial statements as a whole were 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:
 - Value added tax (VAT) receivable of R1,2 million had been overstated in the comparatives in the statement of financial position.
 - Receivables from exchange transactions of R2,2 million had been understated in the comparatives in the statement of financial position.
 - Payables of R1,3 million had been overstated in the comparatives in the statement of financial position.

Qualified opinion

10. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Emalahleni Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP, the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

12. As disclosed in note 34 to the financial statements, the corresponding figures for the 30 June 2013 financial year, have been restated as a result of errors discovered during the 2014 financial year, in the financial statements of the municipality at, and for, the year ended 30 June 2014.

Material losses and impairments

13. As disclosed in note 39.4 to the financial statements, material electricity distribution losses to the amount of R6 million were incurred and have not been recovered from consumer debtors.
14. Debt impairments of R 19,2 million (2013: 9,5 million), as disclosed in note 27 to the financial statements, were made against trade receivables. These debts are long outstanding and considered to be irrecoverable.
15. An impairment of R11,3 million (2013: R nil), as disclosed in note 10 to the financial statements, was made against property, plant and equipment. The impairment related to community assets.

Unauthorised and Irregular expenditure

16. Unauthorised expenditure of R12,7 million, as disclosed in note 39 to the annual financial statements, was incurred due to overspending the budget. Irregular expenditure of R138,5 million, as disclosed in note 39 to the annual financial statements, was incurred as a result of supply chain management procedures not being followed.

Additional matter

17. 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 xx to xx does 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.

Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

20. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priority presented in the annual performance report, compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2014:
 - KPA 1: Basic Service Delivery and Infrastructure Development: on pages xx to xx

22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
23. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected development priority are as follows:

Basic service delivery and infrastructure development

Usefulness of reported performance information

Consistency of objectives

26. Section 41(c) of the Municipal Systems Act requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 40% of the reported objectives were not consistent with those in the approved IDP. This was due to inadequate controls over the alignment of objectives between the IDP, service delivery and budget implementation plan (SDBIP) and reported objectives.

Measurability of indicators and targets

27. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 26% of the targets were not specific.

And

- The period or deadline for the delivery of targets must be specified. A total of 23% of the targets were not time bound.

And

- Performance indicator/measure must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator/measure. A total of 21% of the indicators were not verifiable.

This was because management was not trained in the requirements of the FMPPI.

Relevance of indicators

28. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. A total of 21% of the indicators did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the five-year integrated development plan. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets included in the annual performance report.

Reliability of reported performance information

29. The FMPPI requires auditees to 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work as the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records did not permit the application of alternative audit procedures.

Additional matter

30. I draw attention to the following matter:

Achievement of planned targets

31. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraphs 22 to 24 of this report.

Compliance with legislation

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual financial statements, performance and annual reports

33. 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 current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

34. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the Municipal Systems Act and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
35. The annual performance report for the year under review did not include a comparison of the performance with set targets and a comparison with the previous financial year and measures taken to improve performance as required by section 46 (1)(b) and (c) of the Municipal Systems Act.
36. The performance management system and related controls were inadequate as they did not describe and represent the processes of performance monitoring and how it is conducted, organised and managed, as required by sections 38 of the Municipal Systems Act and regulation 7 of the Municipal planning and performance management regulations.

37. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner that was consistent with its IDP, as required by section 36 of the Municipal Systems Act, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.

Procurement

38. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).
39. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(1).
40. Invitations for competitive bidding were not always advertised for the minimum period required by SCM regulation 22(1) & 22(2).
41. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
42. 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 and SCM regulation 28(1)(a).
43. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
44. Contracts and quotations were awarded to bidders based on preference point systems that were not allocated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
45. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
46. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
47. The performance of contractors or providers was not monitored monthly, as required by section 116(2)(b) of the MFMA.
48. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
49. Awards were made to providers who are in the service of other state institutions in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Expenditure management

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

Audit committee

51. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
52. The audit committee did not make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
53. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
54. 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 14(4)(a)(iii).
55. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA, as the following requirement was not adhered to: the audit committee did not consist of three members for the entire financial year.
56. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.

Consequence Management

57. Unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Revenue Management

58. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
59. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated monthly, as required by section 64(2)(b) of the MFMA.
60. An adequate management, accounting and information system that accounts for revenue was not in place, as required by section 64(2)(e) of the MFMA

Internal control

61. I considered internal control relevant to my audit of the financial statements, and annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

62. Slow response to audit messages and effective leadership remain a challenge. The roles and responsibilities for recording and filing financial and performance information have been communicated to all relevant staff, but there is a lack of effective oversight by senior leadership to ensure accountability and adequate consequences for poor

performance and transgressions, which resulted in repeat financial, performance information and compliance findings raised during the audit.

63. The municipality did not develop documented and approved internal policies and procedures to address the collection, recording, processing, monitoring of, and reporting on predetermined objectives.

Financial and performance management

64. The municipality did not have a proper system of record management that provides for the maintenance of information to be reported in the annual performance report
Adequate daily and monthly financial processing and reconciliations did not always take place prior to the preparation of the financial statements and the audit process was used to correct the financial records.
65. The municipality's compliance monitoring process had not been effective in implementing and monitoring controls to ensure that non-compliance with its laws and regulations was prevented and detected. This contributed to repeat findings on compliance in the current year.

Governance

66. The audit committee was not effective in strengthening the control environment within the municipality as numerous material misstatements were identified during the audit. Furthermore, findings recurred on performance reporting and compliance matters. These were identified during the audit process.

Auditor-General

East London

28 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence