

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Engcobo Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and statement of cash flows and the statement of comparison of budget information with actual information 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), the Division of Revenue Act of South Africa, 2012 (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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Engcobo Local 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 and the requirements of the MFMA and DoRA.

Emphasis of matter

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

Material losses

8. As disclosed in note 53 to the financial statements, the municipality incurred water distribution losses amounting to R217,305 (2013: R491,271) during the financial year.

Additional matter

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

Unaudited disclosure notes

10. 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

11. 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 priorities presented in the annual performance report, non-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

12. 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:
 - Basic infrastructure and service delivery on pages X to X
13. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
14. 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 development priority. 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).
15. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
16. The material findings in respect of the selected development priority are as follows:

Usefulness of information

Reported objectives not consistent with planned objectives

17. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 30% of the reported objectives were not consistent with those in the approved integrated development plan. This is due to the lack of review and monitoring by management resulted to inconsistency between the Integrated Development Plan (IDP), SDBIP and annual performance report.

Reliability of reported performance information

Reported performance not valid, accurate and complete

18. The National Treasury FMPPI requires that processes and systems which produce the indicator should be verifiable, and that the indicators be accurate enough for its intended use and respond to changes in the level of performance. A total of 22.8% of the actual reported performance relevant to basic infrastructure and service delivery was not valid, accurate and complete when compared to the evidence provided. This was due to a lack of monitoring by senior management, an inadequate review process 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.

Additional matters

19. I draw attention to the following matter:

Achievement of planned targets

20. Refer to the annual performance report on pages X to X for information on the achievement of the planned targets for the year.

Compliance with legislation

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

Strategic planning and performance management

22. The performance management system and its related controls were inadequate as it did not describe and represent the processes of performance (planning, monitoring, measurement, review, reporting and improvement) 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 (MPPMR).
23. Measurable performance targets for the financial year with regard to each of the objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the Municipal Systems Act, 2000 and regulation 12(1) and 12(2)(e) of (Government Gazette 22605 of 2001).

Annual financial statements, performance and annual report

24. Oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012/2013 annual report was tabled, as required by section 129(1) of MFMA.
25. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of MFMA.
26. Material misstatements identified by the auditors relating to expenditure and other disclosure items in the submitted financial statements were subsequently corrected, which resulted in the financial statements receiving an unqualified audit opinion.

Revenue management

27. Interest was not charged on all accounts in arrears as, required by section 64(2)(g) of the MFMA.

Consequence management

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

Asset management

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

Human resource management

31. Bonuses were awarded to the municipal manager and/ or senior managers directly accountable to the municipal manager before the annual report was tabled and adopted by the municipal council, in contravention of regulation 8(1) of Municipal performance regulations (GNR 805)

Internal control

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

Leadership

33. Oversight responsibilities regarding the monitoring of internal controls over financial reporting and compliance with applicable laws and regulations were not adequately performed. This resulted in material misstatements in the annual financial statements that were submitted for audit, non-compliance with applicable laws and regulations as well as information presented in the report on predetermined objectives not being valid, accurate and complete.
34. Proper consequence management in respect of supply chain management transgressions that occurred in prior years was not implemented since the transgressions were not investigated to determine whether any official is liable for the expenditure.

Financial and performance management

35. The municipality continued to make use of consultants to perform certain financial administration and reporting functions that should be performed by the staff employed by the municipality. This is due to a lack of skills in key positions. A poor control environment over financial reporting exists as manual reconciliations of accounting records and supporting schedules are required to be performed at year end as these controls are not implemented on a regular basis throughout the year. Should adequate monitoring, supervision and controls be implemented, misstatements would be identified and corrected by management in a timely manner.
36. The financial statements submitted for audit contained material misstatements related to expenditure and other disclosure items. Furthermore, errors between the financial statements, general ledger and underlying supporting documents were identified. This is as a result of a lack of adequate review of the financial statements and supporting documentation prior to submission of the annual financial statements for audit purposes.
37. The systems or processes for the preparation and reporting of performance against predetermined objectives were not adequate or sufficient as the municipality did not comply with the reporting requirements as prescribed by National Treasury.

38. The municipality has not implemented adequate review mechanisms to ensure that the report on predetermined objectives is reviewed for accuracy and completeness prior to submission for audit.

Governance

39. The risks relating to financial, performance objectives and compliance with laws and regulations have not been adequately addressed during the year under review.

40. Internal audit did not properly review the financial and performance reports prior to submission to the audit committee and the external auditors and also did not adequately review compliance with laws and regulations. The position of chief internal auditor was vacant throughout the year and up to the date of this report and this impacted negatively on the performance of the internal audit unit.

Auditor-General

East London

29 November 2014



**AUDITOR - GENERAL
SOUTH AFRICA**

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