

Report of the auditor-general to the Eastern Cape provincial Legislature and council on Elundini Local Municipality

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Elundini Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amount for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, because of the significance of the matters described in the basis for adverse opinion section of this auditor's report, financial statements do not present fairly, in all material respects, the financial position of the Elundini Local Municipality as at 30 June 2018, and financial performance and its cash flows for the year then ended in accordance South African Standard of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa (Act No.3 of 2017) (DoRA).

Basis for adverse opinion

Property, plant and equipment

3. The municipality did not recognise all items of property, plant and equipment in accordance with GRAP 17, *property, plant and equipment* as disclosed in note 7. Assets in progress were incorrectly transferred to completed assets. As a result infrastructure assets are overstated by R 26,7 million and work in progress understated by R26,7million, depreciation understated by R 4,88 million and property, plant and equipment overstated by R4,88 million as disclosed in note 7 to the financial statements.
4. In addition, the municipality did not consider impairment to property, plant and equipment and incorrect useful lives were used for calculation of depreciation in accordance with GRAP 17, *property, plant and equipment* as disclosed in note 7. Consequently, I was unable to determine the full extent of the overstatement of property, plant and equipment stated at R405,2 million in note 7 to the financial statement, as it was impractical to do so.

Payables from exchange transactions

5. The municipality did not have adequate systems to maintain records of accounts payable for goods and services received but not yet paid for, as the listing included invoices already paid by the municipality. This resulted in accruals being overstated by R6,5 million. In addition, I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as payables from exchange transactions. I could not confirm payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to payables from exchange transactions stated at R29,5 million in the financial statements.

Receivables from non-exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for an adjustment made to receivables from non-exchange transactions due to the poor status of the accounting records. I could not confirm the validity of the adjustment to receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from non-exchange transactions stated at R23,1 million in the financial statements.

Revenue from exchange transactions

7. The municipality incorrectly recognised impairment recovered as revenue from exchange transactions, as result revenue from exchange transactions is overstated and debt impairment overstated by R7,1 million.

Operating grant expenditure

8. The municipality did not account for conditional grants according to DoRA. Consequently, operating grant expenditure is overstated by R5,8 million and general expenditure overstated by R5,8 million.

Statement of financial performance

9. Statement of financial performance was materially misstated by R4, 8 million due to the cumulative effect of individually immaterial uncorrected misstatements in the following items:

Total revenue

- Interest charged on trade and other receivables as stated in the statement of financial performance at R1,9 million is over stated by R873 743.

Total expenditure

- Repairs and maintenance as stated in the statement of financial performance at R13,5 million was overstated by R1,2 million.
- Employee related costs as stated in the statement of financial performance at R79,7 million was overstated by R2,7 million.

Capital commitments

10. I was unable to obtain sufficient appropriate audit evidence for an adjustment made to capital commitments due to the poor status of the accounting records. I could not confirm the validity of the adjustment to capital commitments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to capital commitments stated at R28,54 million in the financial statements.

Cash flow statements

11. The municipality incorrectly classified and incorrectly calculated various line items in the cash flow statement. This resulted in the following line items being misstated as described:
- Rates, services and other was overstated by R5,99 million.
 - Interest revenue is overstated by R3,36 million.
 - Suppliers and employees costs are overstated by R9 million.

Context for the opinion

12. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
13. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
14. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

Emphasis of matters

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

Material Losses - electricity

16. As disclosed in note 40 to the financial statements, electricity losses of R4,7million (2017: R4,5 million) was incurred which represent 23.66% (2017: 23.12%) of the total electricity purchased.

Impairment loss – trade debtors

17. As disclosed in notes 3 and 4 to the financial statements, material impairments of R14 million and R19,8 million respectively were incurred as a result of a provision of impairment of irrecoverable trade and other receivables from exchange and non-exchange transactions.

Irregular expenditure

18. As disclosed in note 39,3 to the financial statements, the municipality incurred irregular expenditure of R54,3 million as it did not follow proper tender processes.

Other matters

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

Unaudited disclosure notes

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

Unaudited supplementary information

21. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. We have not audited this schedule and accordingly we do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

22. The accounting authority is responsible for the preparation and fair presentation of the financial statements in accordance with GRAP and the requirements of the MFMA and 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.

23. In preparing the financial statements, the accounting officer is responsible for assessing the Elundini Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

24. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

25. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

26. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

27. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
28. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priorities	Pages in the annual performance report
<i>KPA 2: Basic services and infrastructure</i>	X -X
<i>KPA 3: Local Economic Development</i>	X-X

29. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
30. I did not raise any material findings on the usefulness and reliability of the reported performance information for these development priorities.

Other matters

31. I draw attention to the matters below.

Achievement of planned targets

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

Adjustment of material misstatements

33. I identified material misstatements in the annual performance report submitted for auditing. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

Report on the audit of compliance with legislation

Introduction and scope

34. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
35. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements, performance and annual reports

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected which resulted in the financial statements receiving an adverse audit opinion.

Asset management

37. 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.

Expenditure management

38. Effective steps were not taken to prevent irregular expenditure amounting to R54 342 394 as disclosed in note 39.3 to the annual financial statements, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

39. Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). Similar non-compliance was also reported in the prior year.

Human resource management

40. The senior managers did not sign performance agreements within the prescribed period, as required by section 57(2)(a) of the MSA.

Other information

41. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report.
42. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

43. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report.
44. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

Internal control deficiencies

45. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
46. Leadership did not provide adequate oversight in ensuring that there are policies and procedures in place and monitor implementation of such policies to enhance the control environment, as a result the existing controls could not prevent, detect or correct material misstatements on the financial statements, annual performance report and instances of non-compliance with laws and regulations before submission for audit purposes
47. The municipality did not perform monthly processing and reconciliation of transaction to ensure that accounting records are accurate, complete and supported by adequate supporting documentation, this is evidence by material misstatements identified in the financial statements and annual performance report submitted for audit. In addition compliance with legislation was not monitored adequately throughout the year, resulting in numerous material findings on compliance with legislation.

49. The risk management strategy of the municipality did not adequately respond to the Mscoa implementation as a result material misstatements were identified in the financial statements. Furthermore the audit committee and internal audit unit did not adequately review the financial statements and annual performance report submitted as results numerous material misstatements were identified and instances of non-compliance with laws and regulations.

Auditor - General

East London

30 November 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit 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 municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer’s use of the going concerns basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Emalahleni local municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.