



AUDITOR - GENERAL  
SOUTH AFRICA

The Municipal Manager  
Nkonkobe Municipality  
PO Box 36  
Fort Beaufort  
5720

14 February 2013

Reference: 21300REG11/12

Dear Sir

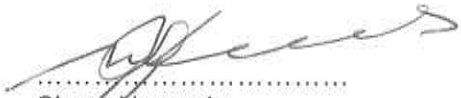
**Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Nkonkobe Municipality for the year ended 30 June 2012**

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) (municipality) 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 Business Executive 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



Singa Ngqwala  
Business Executive: Eastern Cape

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# REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON 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 and its subsidiary set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2012, the consolidated and separate statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended and 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 consolidated and separate 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, 2003 (Act No. 56 of 2003) (MFMA), 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 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 2001) (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

#### Service Charges and Trade Receivables

6. The municipality did not use the correct approved tariffs in charging consumer debtors for electricity consumed. The meter readings used in calculating the value of the electricity consumed were also not in agreement with the actual meter readings. Consequently, service charges in the statement of financial performance are overstated

by an estimated of R1,4 million and trade and other receivables are also overstated by the same amount.

7. Management was not able to provide substantiating documentation to explain a difference of R623 326 between the prepaid electricity revenue per general ledger and confirmation received from services providers that sell pre-paid electricity on behalf of the municipality. Consequently, I was unable to determine whether any adjustments to Service Charges were necessary.
8. Electricity consumed during the last month of the financial year (June 2012) was only recognised as revenue during July 2012, which falls in the following financial year. The GRAP reporting framework requires revenue to be recognised when it is earned. This misstatement was also made in the previous year. Consequently, Service charges in the statement of financial performance are understated by R519 322 (2011: overstated by R481 877) and trade and other receivables are understated by an estimated R519 322 (2011: overstated by R481 877). In addition the deficit for the period is overstated by R519 322 and accumulated surplus is understated by the same amount.

#### **Receivables from Exchange transactions**

9. Management was not able to provide substantiating documentation for debtors amounting to R1,3 million (2011: R6, 7 million) included in other receivables of R12,5 million as disclosed in note 2 of the financial statements. The accounting records did not allow for alternative procedures. Consequently I was unable to confirm the rights, valuation and existence of other receivables as disclose in note 2 to the financial statements.

#### **Interest Earned – outstanding receivables**

10. Interest charged on outstanding debtors is not correctly calculated as monthly interest is not charged on outstanding debts for the full month. Consequently, interest from outstanding debtors is understated by R1,2 million. Trade and other receivables are also understated by the same amount.

#### **Vat Receivables**

11. I was unable to obtain sufficient appropriate audit evidence from the municipality for VAT receivables of R1,6 million (2011:R1,7 million), included in the financial statements. The accounting records did not allow for alternative procedures. Consequently I was unable to determine whether any adjustments to VAT receivables were necessary.

#### **Non-Current provisions**

12. Costs incurred in the closure of a landfill site was incorrectly recorded against the provision and not capitalised against the property, plant and equipment. Consequently, non-current provisions are understated by R1,2 million, expenditure understated by R1 million and property, plant and equipment is also understated by R214 536.
13. The municipality was not able to provide details regarding the assumptions and input data used or the calculations made in estimating the value of the obligation to rehabilitate landfill sites. I was, therefore, unable to obtain sufficient appropriate audit evidence to confirm the valuation of the provision for landfill sites, stated at R10,4 million (2011: R8 million) in the financial statements. I was unable to confirm the value of this balance by alternative means. Consequently, I was unable to determine whether any adjustment relating to the provision for landfill sites in the consolidated and separate financial statements was necessary.

#### **Prior period – provision for long-service award**

14. Included in the provision for long-service awards is an amount of R1,3 million for which I could not obtain supporting documentation, as was reported in the previous year's audit report. I was, therefore, unable to determine if there are any adjustments necessary to the provision for long-service awards.

#### **Qualified opinion**

15. In my opinion, except for the 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 financial position of the Nkonkobe Local Municipality and its subsidiary as at 30 June 2012 and their financial performance and cash flows for the year then ended, in accordance with South African Generally Recognised Accounting Practice and the requirements of the MFMA and DoRA.

#### **Emphasis of matters**

##### **Restatement of corresponding figures**

16. As disclosed in notes 43 and 44 to the consolidated and separate financial statements, corresponding figures for 30 June 2011 have been restated as a result of errors discovered during 2012 in the financial statements of Nkonkobe Municipality at, and for the year ended, 30 June 2011.

##### **Transitional provisions**

17. As disclosed in accounting policy 2.6 Transitional provisions, the municipality has recognised previously unrecognised assets and valued these assets retrospectively. This change in accounting policy has been noted and included in note 44: Change in accounting policy.

##### **Additional matters**

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

##### **Unaudited supplementary schedules**

19. 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.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

##### **PAA REQUIREMENTS**

20. 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**

21. 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.
22. 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*.

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).

23. The material findings are as follows:

### **Usefulness of information**

#### Presentation

24. Section 46 of the Municipal Systems Act requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for all measures taken to improve performance as disclosed in the annual performance report. The municipal records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance

#### Consistency

25. The Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 97% of the reported targets are not consistent with targets as per the approved integrated development plan. This is due to the lack of internal control measures to ensure consistency.

#### Measurability

26. The National Treasury Framework for managing programme performance information (FMPPI) requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 67% 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 not aware of the requirements of the FMPPI.
27. The National Treasury Framework for managing programme performance information (FMPPI) requires that it must be possible to validate the processes and systems that produce the indicator. A total of 67% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection of actual performance information.
28. The National Treasury Framework for managing programme performance information (FMPPI) requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 61% 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.
29. The National Treasury Framework for managing programme performance information (FMPPI) requires that performance targets be measurable. The required performance could not be measured for a total of 44% 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.

30. The National Treasury Framework for managing programme performance information (FMPPI) requires that the time period or deadline for delivery be specified. A total of 61% 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 information**

31. The National Treasury Framework for managing programme performance information (FMPPI) requires that processes and systems which produce the indicator should be verifiable, accurate and complete. I was unable to obtain sufficient, appropriate audit evidence to satisfy myself as to the validity accuracy and completeness of the actual performance reported in the annual performance report for 76% of the reported performance for Strategic planning and Local Economic Development and for 63% of the reported performance for the Engineering Department. This was due to a lack of standard operating procedures and processes for the recording of actual achievements by senior management.

In addition to the above material findings, I draw attention to the following matter:

#### **Achievement of planned targets**

32. Of the total number of planned targets, only 92 (60%) were achieved during the year under review. A total of 40% of the planned targets were not achieved during the year under review. This was as a result of the institution not considering relevant systems and evidential requirements during the annual strategic planning process

#### **Municipal Entity**

33. The following was reported in the audit report of the Nkonkobe Economic Development Agency (NEDA) regarding predetermined objectives:

##### Usefulness of information

34. Presentation - Measures taken to improve performance were not disclosed.
35. Consistency - Reported objectives, indicators and targets were not consistent with planned objectives, indicators and targets
36. Measurability – Performance indicators were not well defined and the indicators were not verifiable

##### Reliability of information

37. Validity, accuracy and completeness - Reported indicators and targets were not supported by sufficient appropriate evidence.

##### Compliance with laws and regulations

38. 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:

#### **Strategic and Performance management**

39. By inspecting the Municipal Managers performance agreement, employment contract and delegation framework it was noted that there is no evidence of the executive committee assigning responsibility to the municipal manager for performance management as required by Section 39(b) of the Municipal Systems Act

40. The responsibilities of the accounting officer as set out in the MFMA were not included in the Municipal Managers performance agreement as required by Section 57 (4A) of the Municipal Systems Act
41. The municipality did not comply to section 7 of the Electricity Regulation Act 4 of 2006 by operating electricity transmission or distribution without a licence issued by the Regulator in accordance with this Act

#### **Budgets**

42. Expenditure was incurred that was not budgeted for in contravention of section 15 of the Municipal Finance Management Act.

#### **Annual financial statements**

43. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act.
44. Material misstatements of non-current assets, current assets, current liabilities, 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.

#### **Performance Audit Committee**

45. The performance 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 the Municipal Planning and Performance Management Regulation 14(4)(a)(iii) (GNR 796 of 24 August 2001).

#### **Internal Audit**

46. The internal audit did function as required by Section 45(1)(a) of the MSA and municipal planning and performance management regulations 14(1)(a) (GRN 796 of 04 August 2001) in that the municipality did not develop and mechanisms systems and processes for auditing the results of performance measurement as part of its internal audit processes.
47. The internal audit did not function as required by the Section 165(2) b of the MFMA in that it did not report to the audit committee on matters relating to compliance with the Municipal Finance Management Act the division of Revenue Act and other applicable legislation.

#### **Expenditure**

48. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2) (b) of the Municipal Finance Management Act.
49. The accounting officer did not take effective steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1) (d) of the Municipal Finance Management Act.
50. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.

#### **Liability Management**

51. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2) (a) of the Municipal Finance Management Act.
52. 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 Municipal Finance Management Act



### **Revenue Management**

53. Sufficient audit evidence could not be obtained that revenue had been reconciled on a weekly basis, as required by 64(2)(h) of the Municipal Finance Management Act.

### **Oversight of the Nkonkobe Economic development Agency**

54. Non compliance was reported in the audit report for the municipal entity for the following areas:

- The performance objectives of the municipal entity were not approved by the entity's board of directors.
- Mid-year budget and performance assessments were not reported to the parent municipality.
- The Annual financial statements submitted for audit were materially misstated.
- The audit committee and the internal audit function, which are shared between Nkonkobe municipality and its municipal entity, Nkonkobe Economic Development Agency (NEDA), did not discharge its duties as required by sections 165 and 166 of the MFMA in respect of NEDA during the current year under review.
- NEDA failed to adhere to Supply Chain management regulation 17(a), 17(c), 19(a) and 36(1) while procuring good and services resulting in irregular expenditure.
- Contrary to the requirements of section 93J (1) of the Municipal Systems Act, the board of directors of the municipal entity has not appointed a chief executive officer of the municipal entity. This position has been vacant since September 2009 and there has been an acting CEO since September 2009.
- The accounting officer did not take all reasonable steps to ensure that the municipal entity had and maintained a management, accounting and information system which accounts for the assets of the entity as required by section 96(2)(a) of the MFMA.

### **Internal control**

55. 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**

56. 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

### **Financial and performance management**

57. 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**

58. 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

## OTHER REPORTS

### Investigations

59. In the prior year, a forensic investigation was undertaken which was finalised and presented to management and the council.

*Auditor-General*

East London

14 February 2013



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*