



ENGAGEMENT LETTER

The Accounting Officer
Matjhabeng Local Municipality
P.O BOX 708
WELKOM
9460

23 August 2018

Reference: 21386REG17/18

Dear Mr. T Tsoaeli

AUDIT ENGAGEMENT LETTER

Introduction

1. The purpose of this letter is to outline and obtain agreement on:
 - the terms of the audit engagement as well as the nature and limitations of the annual audit.
 - the respective responsibilities of the auditor and the accounting officer regarding the annual audit.
2. The objective of the annual audit is to:
 - provide an opinion on the separate financial statements.
 - report findings regarding reported performance information against predetermined objectives for the selected objectives as presented in the annual performance report.
 - report findings regarding instances of non-compliance with specific legislation in terms of selected subject matters as applicable.
 - report deficiencies in internal control.
3. The annual audit is performed in terms of the Public Audit Act (PAA), the general notice issued in terms thereof, International Standards on Auditing (ISAs), International Standard on Assurance Engagements, (ISAE) 3000: *Assurance engagements other than audits or reviews of historical financial information* and the relevant principles from the International Standards of Supreme Audit Institutions (ISSAIs).
4. Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some, even material, misstatements or non-compliance may not be detected, even though the audit is properly planned and performed in accordance with ISAs and ISAE 3000.
5. As part of an audit in accordance with ISAs and ISAE 3000, we exercise professional judgement and maintain professional scepticism throughout the engagement.
6. We are independent of the type of auditee in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements in South Africa and have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

7. In accordance with International Standard on Quality Control 1, the Auditor-General of South Africa maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements and professional standards.
8. An audit is performed on the premise that management and those charged with governance have acknowledged certain responsibilities that are fundamental to the performance of the audit. The audit does not relieve the accounting officer of his responsibilities for the separate financial statements and annual performance report and compliance with legislation.

Responsibilities regarding the separate financial statements

Accounting officer

9. The accounting officer is responsible for the preparation and fair presentation of the separate financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice as required by section 126(1) of the Municipal Finance Management Act (MFMA).
10. The preparation of the separate financial statements by the accounting officer requires:
 - identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
 - the inclusion of an adequate description of that framework in the financial statements.
 - the preparation of the financial statements in accordance with that framework.
 - the selection and application of appropriate accounting policies.
 - the application of judgement in making accounting estimates that are reasonable in the circumstances.

Auditor

11. Our responsibility is 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 an opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. As part of this responsibility we:
 - 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 our 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 [type of auditee]'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 concern basis of accounting in the preparation of the financial statements. We 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 ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. Our conclusions are based on the information available at the date of the auditor's report however, future events or conditions may cause to cease to continue 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.

Responsibilities regarding the annual performance report

Accounting officer

12. The accounting officer is required to prepare an annual performance report as per section 121(4)(d) of the MFMA in accordance with the performance management and reporting framework (PMRF) that constitutes:
 - Legislation applicable to performance planning, management and reporting which includes the following:
 - The *Framework for the managing of programme performance information* (FMPPI), issued by the National Treasury.
 - Circulars and guidance issued by the National Treasury, regarding the planning, management, monitoring and reporting of performance against predetermined objectives.

Auditor

13. In accordance with the PAA and the general notice issued in terms thereof, we have a responsibility to report findings on the reported performance against predetermined objectives for selected objectives presented in the annual performance report.
14. We will perform procedures to identify material findings. Our procedures address the reported performance information, which must be based on the approved performance planning documents of the Municipality. We will not evaluate the appropriateness of the performance indicators/ measures established and included in the planning documents. Our procedures also do not extend to any disclosures or assertions relating to planned performance strategies and information relating to future periods that may be included as part of the reported performance information. Accordingly our findings do not extend to these matters.
15. We will perform procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report:

KPA 1 – Basic Service Delivery and infrastructure investment
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16. We will evaluate the usefulness and reliability of the reported performance information in accordance with criteria from the performance management and reporting framework to determine whether it was properly presented and whether performance was consistent with the planned objectives. We will perform further procedures to determine whether the indicators and targets were measurable and relevant, and will assess the reliability of the reported performance information to determine whether it was valid, accurate and complete.
17. The criteria applicable to the audit as developed from the PMRF are as follows:

CRITERIA	REFERENCE TO PMRF
<i>Consistency: Objectives, performance measures / indicators and targets are consistent between planning and reporting documents</i>	
Reported strategic or development objectives are consistent or complete when compared to planned objectives.	Sec 121(3)(f) of the MFMA Sec 41 (a) - (c) & 46 of the MSA
Changes to strategic or development objectives are approved	Sec 25(2) of the MSA
Reported measures or indicators are consistent or complete when compared to planned measures or indicators	Sec 121(3)(f) of the MFMA Sec 41 (a) - (c) & sec 46 of the

	MSA
Changes to measures or indicators are approved	Sec 25(2) of the MSA
Reported targets are consistent or complete compared to planned targets	Sec 121(3)(f) of the MFMA Sec 41 (a) - (c) & sec 46 of the MSA
Changes to targets are approved	Sec 25(2) of the MSA
<i>Measurability: Performance measures / indicators are well defined and verifiable, and targets are specific, measurable and time bound.</i>	
A performance measure or indicator is well defined when it has a clear definition so that data will be collected consistently and is easy to understand and use.	FMPPI chapter 3.2 issued by NT
A performance measure/indicator is verifiable when it is possible to validate or verify the processes and systems that produce the indicator.	FMPPI chapter 3. issued by NT
A target is specific when the nature and required level of performance of the target is clearly identifiable.	FMPPI chapter 3.3 issued by NT
A target is measurable when the required performance can be measured.	FMPPI chapter 3.3 issued by NT
A target is time bound when the timeframes for achievement of targets are indicated.	FMPPI chapter 3.3 issued by NT
<i>Relevance: Performance measures / indicators relate logically and directly to an aspect of the entity's mandate and the realisation of its strategic goals and objectives.</i>	
The performance measure/ indicator and target relates logically and directly to an aspect of the entity's mandate and the realisation of its strategic goals and objectives.	FMPPI chapter 3.2 issued by NT
<i>Presentation and disclosure: Performance information in the annual performance report are presented and disclosed in accordance with the requirements contained in the legislation, frameworks, circulars and guidance.</i>	
Reasons for variances between planned and actual performance are disclosed.	Criteria not applicable
Reasons for variances are supported by corroborating source documentation.	Criteria not applicable
Changes to objectives, performance measures/ indicators and performance targets are disclosed.	Criteria not applicable
Actual performance compared to planned targets and prior year performance is disclosed.	Sec 46 of the MSA
Measures taken to improve performance are disclosed.	Sec 46 of the MSA
Measures taken to improve performance are supported by corroborating source documentation.	Sec 46 of the MSA

<i>Reliability: Recording, measuring, collating, preparing and presenting information on actual performance / target achievements is valid, accurate and complete.</i>	
Reported performance occurred and pertains to the reporting entity (valid).	Sec 45 of the MSA Chapter 5 of the FMPPI
Reported performance is recorded and reported accurately (accurate).	Sec 45 of the MSA Chapter 5 of the FMPPI
All actual performance is recorded and included in the reported	Sec 45 of the MSA Chapter 5 of the FMPPI

18. In addition, the criteria below will be tested but any material findings identified will only be reported in the annexure to the management report and will not impact the audit opinion of the selected objectives. The criteria are as follows:

- **Relevance:**
 - Indicators/ measures and targets arising from the entity's mandate, applicable legislation and strategic goals and objectives are all included in the approved planning documents.
- **Presentation and disclosure:**
 - The overall presentation of the performance information in the annual performance report is comparable and understandable.

19. We will provide a reasonable assurance opinion on the selected objectives, as per paragraph 20, in the management report and all material findings reported therein will be included under the heading *Report on the audit of the annual performance report* in the auditor's report.

20. As part of our responsibility when providing reasonable assurance we:

- Identify and assess risks of material misstatement of the reported performance information, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate. In making those risk assessments we consider internal control relevant to the management and reporting of performance information per selected objective 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 documentation maintained by the Municipality that supports the generation, collation, aggregation, monitoring and reporting of performance indicators/measures and their related targets for the selected objectives.
- Evaluate and test the presentation in the annual performance report, its consistency with the approved performance planning documents of the Municipality, the appropriateness of measurement methods and reporting policies used, the reasonableness of estimates made, and the reliability of information on performance achievement at the level of reported performance targets (i.e. actual performance/ target achievements).

Responsibilities regarding compliance with applicable legislation relating to financial matters, financial management and other related matters

Accounting officer

21. The accounting officer is required to ensure that the entity complies with legislation applicable to it.

Auditor

22. With reference to the general notice issued in terms of the PAA, we have a responsibility to report findings on compliance with specific legislation in respect of the following subject matters :

- Strategic planning and performance management
- Financial statements, performance and annual reports
- Procurement and contract management
- Human resource management
- Expenditure management
- Utilisation of conditional grants
- Revenue management
- Assets management
- Liability management
- Consequence management

23. The criteria used to evaluate the above subject matters are developed from the applicable legislation, with specific focus on the following where applicable:

- Municipal Finance Management Act (MFMA), 2003 (Act No. 56 of 2003) and regulations issued in terms of the act
- Annual Division of Revenue Act (DoRA)
- Annual Appropriation Act
- Companies Act, 2008 (Act No. 71 of 2008) and regulations issued in terms of the act
- Municipal Structures Act, 1998 (Act No. 117 of 1998) and regulations and instructions issued in terms of the act
- Municipal Systems Act, 2000 (Act No. 32 of 2000) and regulations and instructions issued in terms of the act
- Municipal Property Rates Act, 2004 (Act No. 6 of 2004) and regulations and instructions issued in terms of the act
- Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and regulations issued in terms of the act
- Construction Industry Development Board Act, 2000 (Act No. 38 of 2000) and regulations issued in terms of the act
- Prevention and Combating of Corrupt Activities Act, 2004 (Act No. 12 of 2004)

24. We will report all material findings on the above-mentioned subject matters under the heading *Compliance with legislation* in the auditor's report.

Responsibilities regarding information systems

Accounting officer

25. The accounting officer is responsible for maintaining records that:

- correctly record and explain the transactions of the Municipality
- enable the municipality to monitor the resources, activities and entities under its control
- enable determination of the Municipality's financial position with reasonable accuracy at any time
- enable the preparation of financial statements and the annual performance report that comply with the MFMA and other applicable legislation.

Auditor

26. We will perform procedures in respect of the IT systems to obtain sufficient and appropriate audit evidence that the underlying records are reliable and adequate as a basis for the preparation of the financial statements and the annual performance report.

Responsibilities regarding other information to be included in the annual report

Accounting officer

27. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, the audit committee report required by the MFMA. The other information does not include the financial statements, the auditor's report thereon and those objectives in the annual performance report that has been specifically reported on in the auditor's report.

Auditor

28. In connection with our audit, our responsibility is to read the other information, and in so doing, to consider whether the other information is materially inconsistent with the financial statements and the selected objectives in the annual performance report or our knowledge obtained during the course of the audit.
29. our responsibilities relating to other information do not constitute an assurance engagement and accordingly we do not express an audit opinion or any form of assurance thereon in the auditor's report.

Responsibilities regarding internal control

Accounting officer

30. In terms of section 62(1)(c)(i)/95(c)(i) of the MFMA, the accounting officer is responsible for designing, implementing and maintaining internal control necessary to enable the preparation of financial statements and the annual performance report that are free from material misstatement, whether due to fraud or error, as well as to enable compliance with legislation.

Auditor

31. We obtain an understanding of internal control relevant to the financial statements, the annual performance report and compliance with legislation in order to design audit procedures.
32. The internal control deficiencies included in the auditor's report are limited to the significant control deficiencies that result in the basis for the modification of the opinion on the financial statements and the findings on the annual performance report and compliance with legislation.
33. In addition to year-end reporting, we will undertake visits during the financial year to discuss interim assessments of the status of the key drivers of internal control and to obtain commitment to addressing any deficiencies identified.

Responsibilities regarding prevention and detection of fraud and error

Accounting officer

34. The accounting officer is required to perform a risk assessment and develop a risk management strategy, which includes a fraud prevention plan.

Auditor

35. We will design and perform our audit procedures based on our assessment of the risks of material misstatement due to fraud or error and to obtain audit evidence that is sufficient and appropriate to form a basis for our audit opinion and findings.
36. If we become aware of the possible existence of fraud – whether through the application of audit procedures, advice from the Municipality's management or any other means – we will communicate this to the accounting officer with the expectation that action will be taken in compliance with the Municipality's fraud prevention plan and legislated requirements.

Form and content of reporting

37. We will report the results of our audit in two documents, namely the auditor's report and the management report.

38. During the audit we will communicate our findings and request management to correct the identified misstatements in the financial statements and reported performance against predetermined objectives, and material inconsistencies in other information in sufficient time for the applicable audit process to be completed within the legislated deadlines.

Materiality

39. The concept of materiality is applied when the audit is planned and performed, as well as in evaluating the effect of identified misstatements in the financial statements and reported performance information, as well as identified instances of non-compliance with legislation.
40. The auditor's determination of materiality is a matter of professional judgement and is affected by the auditor's perception/ understanding of the financial information needs of intended users, i.e. the quantitative and qualitative factors that determine the level at which relevant decisions taken by users would be affected by a misstatement or an instance of non-compliance.
41. In terms of the audit of predetermined objectives and compliance, materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the auditor's professional judgement.

Statutory reporting deadlines, submission of information for audit and correction of material misstatements

42. In terms of section 15(2)(b) of the PAA and in order to comply with applicable legislated auditing and tabling deadlines in the MFMA, as well as to allow adequate time for conducting the audit in accordance with the relevant auditing standards the Municipality should adhere to the following:
- The annual performance report should be submitted concurrently with the financial statements.
 - The trial balance and general ledger that agree to the financial statements, together with the supporting asset register, inventory register and subsidiary-ledgers for receivables and payables, must be submitted with the financial statements. If this information is not provided it will be regarded as a limitation on the audit which could result in a modification of the audit opinion.
 - All the approved planning documents and all other documentation and information in support of the annual performance report must be submitted at the latest with the annual performance report. If this information is not provided it will be regarded as a limitation on the audit which could result in a modification of the audit opinion.
 - The other information to be included in the annual report should be made available on or before [insert date]. If the other information is not provided before the date of the auditor's report management will be requested to provide written representation that the information will be provided as soon as possible and before the annual report is published. The fact that the other information is not provided before the date of the auditor's report does not preclude the auditor from issuing the auditor's report. The other information will be read and considered when it becomes available if inconsistencies are identified this may require amendments to the auditor's report.
 - All documentation and information in support of the [consolidated and separate] financial statements, the annual performance report and compliance with legislation must be available on request and be retrievable within a reasonable time, **should not exceed 3 working days**. This documentation and information is also relevant to disclosures in the financial statements and could include information outside the general and subsidiary ledgers. If this information is not provided in the time agreed, it will be regarded as a limitation on the audit which could result in a modification of the audit opinion.
 - Withdrawal and resubmission of financial statements and the annual performance report submitted for auditing will not be permitted, while the financial statements and the annual

performance report may only be corrected and amended in response to matters identified by the auditors during the audit.

- Audit findings concerning control deficiencies, identified misstatements in the financial statements and annual performance report and non-compliance with legislation will be communicated during the course of the audit and management will be requested to address these. Submission of a response to these communications, whether it be comments, information or documentation in support of action taken, will be required within a reasonable time, **which should not exceed 5 working days** from the date of the communication of the finding, unless a different timeline is expressly agreed in writing with the auditors.
43. Unrestricted access will be required to those within the entity with whom we determine it necessary to communicate regarding the audit. This will include discussions with the accounting officer, audit committee and senior management to gain an understanding of the auditee and to present the audit strategy.
44. Section 19 of the PAA requires you to render reasonable assistance to the AGSA or the authorised auditors performing this audit. You are requested to provide the AGSA or the authorised auditors with suitable office accommodation, logistical support and access to office equipment. Please ensure that the AGSA or the authorised auditors are made aware of any security and administrative arrangements with which they should comply.

Representation letter

45. As part of our audit, we will request written confirmation from the accounting officer and the chief financial officer of the representations that we have received during the course of our audit.
46. We will further request written confirmation of the responsibilities of management and those charged with governance, as outlined above, and that the Municipality had disclosed to us all known instances of fraud or suspected fraud affecting it.
47. Failure to provide this representation or misrepresentations may adversely impact on the auditor's opinion.

Other communication with those charged with governance and management

48. In addition to the audit report and the management report, it will be necessary to communicate other matters with those charged with governance and management, which may include persons in the Municipality's governance structure other than the accounting officer and management, such as the audit committee.
49. The form, timing and general content of this communication will depend on the circumstances, and may include:
- gaining an understanding of the Municipality and its environment
 - gaining an understanding of the Municipality's objectives and strategies and the related risks that may result in the misstatement of the financial statements and the annual performance report
 - discussion of the audit strategy
 - regular discussions on the status of key controls relevant to the audit
 - discussion of audit findings and required action to address them.
50. Although most communications will be initiated by the auditor, communication will also be required from those charged with governance. Such two-way communication is important in developing an understanding of the matters relating to the audit and a constructive working relationship. To this end we will require that those charged with governance make themselves available at the times agreed with the auditor to provide and discuss information relevant to the audit.

Fees

51. Our fees are based on the time spent on your affairs by our managers and staff, plus out-of-pocket expenses. Time may be spent on the audit at your premises or our premises, as necessary. Individual hourly rates vary according to the experience and skills required and the responsibility involved. Our fees will be billed at month-end during the course of the audit and settlement is due within 30 days of date of invoice.
52. In order to ensure that time on the audit is spent efficiently you are requested to ensure that all documentation as outlined in this letter is made available to the auditor in a timely manner and that management and those charged with governance are available for meetings when requested.

Acknowledgement of the terms of the engagement

53. This letter will remain effective until a new audit engagement letter is issued. We will be grateful if you could confirm your agreement to the terms of this letter and acknowledge your responsibilities as the accounting officer by signing and returning to us the acknowledgement of the terms of the audit engagement.
54. If you require any further information or wish to discuss the terms of the audit engagement further before replying, please do not hesitate to contact me.

Yours sincerely

Odwa Duda
Business Executive(BE): Free State Business Unit

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Acknowledgement of terms of the audit engagement

The terms of this audit engagement are acknowledged and agreed by designation of person signing on behalf of the Matjhabeng Local Municipality.

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T Tsoaeli - Municipal Manager

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Date