

**Auditor-General of South Africa**

uMkhanyakude District  
Municipality - Audit report 2014-15

# **Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the Council on uMkhanyakude District Municipality**

## **Report on the consolidated and separate financial statements**

### **Introduction**

1. I was engaged to audit the consolidated and separate financial statements of the uMkhanyakude District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement 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 the 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 Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (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 the consolidated and separate financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Revenue and receivables from exchange transactions**

4. I was unable to obtain sufficient appropriate audit evidence that management had properly charged and accounted for all service charge revenue due to inadequate internal controls in the billing and estimation thereof. I was unable to confirm the service charge revenue by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R25,98 million (2014: R43,57 million) in note 16 and the related receivables from exchange transactions stated at R18,53 million (2014: R13,61 million) in note 3 to the financial statements was necessary.

## **Interest received outstanding receivables**

5. The municipality did not charge interest on overdue consumer accounts, contrary to the requirements of section 64(2) (g) of the MFMA. Consequently, interest was understated by R8,11 million and receivables from exchange transactions understated by this amount. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

## **Expenditure**

6. I was unable to obtain sufficient appropriate audit evidence related to expenditure of R87,64 million due to a lack of documentation to support the amounts recorded. Further expenses are not classified according to their nature or function in the financial statements as required by GRAP 1 *Presentation of financial statements*. I was unable to conduct alternative procedures to verify this amount. Consequently, I was unable to determine whether any adjustment relating to expenditure stated at R401,08 million in the financial statements was necessary.

## **Other receivables from exchange transactions**

7. I was unable to obtain sufficient appropriate audit evidence for other receivables from exchange transactions due to the lack of supporting documentation and reconciliation. I was unable to conduct alternative procedures to verify this amount. Consequently I was unable to determine whether any adjustment relating to receivables from exchange transactions stated at R1,35 million (2014:R2,42 million) disclosed in note 4 to the financial statements was necessary.

## **Value-added tax receivable**

8. The municipality did not recognise value-added tax (VAT) on the accrual basis of accounting, as required by GRAP 1 *Presentation of financial statements*. Adjustments were made to VAT that could not be explained. I was not able to determine the full extent of the misstatement of VAT receivable stated at R24,36 million, as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

## **Cash and cash equivalents**

9. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents. Supporting documents for adjustments processed to cash and cash equivalents could not be provided by management. I was unable to conduct alternative procedures to verify this amount. Consequently, I was unable to determine whether adjustments to the cash and cash equivalents stated at R13,80 million in the financial statements were necessary.

## **Water and electricity losses**

10. I was unable to obtain sufficient appropriate audit evidence for the R36,56 million (2014: R36,21 million), and R5,52 million (2014: R9,33 million) disclosed as water and electricity losses, respectively in note 45 to the financial statements due to inadequate systems and processes for the recording and monitoring of these losses. There were no satisfactory alternative audit procedures that I could perform in this regard. Consequently, I was unable to determine whether any adjustment relating to the water and electricity losses disclosed in note 45 to the financial statements was necessary.

## **Inventory**

11. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for water pipes that were recognised in inventory, due to the status of the accounting records. I was unable to confirm the inventory by alternative means. Consequently, I was unable to determine whether any adjustment to inventory stated at R86,98 million (2014: R86,84 million) disclosed in note 2 to the financial statements was necessary.

## **Payables from exchange transactions**

12. I was unable to obtain sufficient appropriate audit evidence that management had fully accounted for all payables from exchange transactions due to the lack of supporting documentation for the current year's payables, stated at R165,57 million (2014: R122,49 million) as disclosed in note 10 to the financial statements. I was unable to confirm the payables by alternative means. Consequently, I was unable to determine whether any adjustment to payables from exchange transactions stated at R165,57 million (2014: R122,49 million) disclosed in note 10 to the financial statements was necessary.

## **Consumer deposits**

13. I was unable to obtain sufficient appropriate audit evidence that management had fully accounted for all consumer deposits due to poor system controls when moving these transactions onto the new system. I was unable to confirm the consumer deposits by alternative means. Consequently, I was unable to determine whether any adjustment to consumer deposits stated at R1,99 million disclosed in note 11 to the financial statements was necessary.

## **Irregular expenditure**

14. The municipality made payments in contravention of the supply chain management (SCM) legislation that were not included in irregular expenditure of R134,79 million disclosed in note 36 to the financial statements. Adequate systems and controls were not in place to ensure that all irregular expenditure was accounted for. I was not able to determine the full extent of the irregular expenditure as it was impracticable to do so.

## **Commitments**

15. I was unable to obtain sufficient appropriate audit evidence that management had accounted for all contractual commitments disclosed in note 38 to the financial statements, due to significant deficiencies in procedures and controls. I was unable to confirm contractual commitments by alternative means. Consequently I was unable to determine whether any adjustment relating to contractual commitments stated at R324,17 million and disclosed in note 38 to the financial statements was necessary.

## **Statement of comparison of budget and actual amount**

16. The municipality did not disclose by way of a note an explanation for material variances between the budget for which the municipality is held publicly accountable and actual amounts spent. This is contrary to the requirements of GRAP 24 *Presentation of budget information in financial statements*. An explanation of whether changes between the approved and final budget were a consequence of reallocations within the budget, or of other factors was also not disclosed in the financial statements. It was not possible to confirm the variance due to the omission of the disclosure as it was impractical to do so.

## **Disclaimer of opinion**

17. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the consolidated and separate financial statements.

## **Emphasis of matter**

18. I draw attention to the matter below.

## **Going concern**

19. Note 48 to the financial statements indicates that the municipality's current liabilities exceeded its current assets by R69,9million (2014: R9,9million); certain unspent conditional grants were not cash backed, and there was also a large increase in the provision for doubtful debts due to debt not being collectable and indigent debtors. These conditions indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## **Report on other legal and regulatory requirements**

20. 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 findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and 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 selected development priorities: basic service delivery and infrastructure investment as well as local economic development presented in the annual performance report of the municipality for the year ended 30 June 2015.
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 development priorities. 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 priorities are as follows:

Basic service delivery and infrastructure

Usefulness of reported performance information

Measurability of indicators and targets

Performance targets not specific , measurable and indicators not well defined and verifiable

26. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 31% of the targets were not specific.
27. Performance targets should be measurable, as required by the FMPPI. I could not measure the required performance for 31% of the targets.
28. Performance indicators should be well-defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 29% of the indicators were not well-defined.
29. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 29% of the indicators were not verifiable.
30. This was due to a lack of proper systems and processes and technical indicator descriptions.

Relevance of indicators

## Performance indicators not relevant

31. The FMPPi requires indicators to relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives. A total of 29% of the indicators did not relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives as per the service delivery and budget implementation plan. This was because proper performance planning and management practices had not been developed and implemented to provide for the development of performance indicators and targets included in the annual performance plan.

## Basic service delivery and infrastructure and Local economic development

### Reliability of reported performance information

32. The FMPPi requires municipalities 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 we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was because the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

## Additional matter

33. I draw attention to the following matter:

### Achievement of planned targets

34. Refer to the annual performance report on page x to x and 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 priorities reported in paragraphs 26 to 32 of this report.

## Compliance with legislation

35. 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:

### Strategic planning and performance management

36. Key performance indicators of the municipality, including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the integrated development plan (IDP), as required by section 41(1) (a) of the Municipal Systems Act of South Africa, 2000 (Act No.32 of 2000)(MSA) and the Municipal planning and performance management (MPPM) regulation 1 and 9(1) (a).

37. Annual performance objectives and indicators were not established by agreement with uMhloosinga Development Agency, as required by section 93B (a) of the MSA.
38. The performance of uMhloosinga Development Agency against the agreed performance objectives and indicators was not monitored and annually reviewed, as part of the annual budget process, as required by section 93B(b) of the MSA.
39. Effective, efficient and transparent systems of risk management and internal controls with respect to performance information and management was not in place in the entity as required by section 95(c) (i) of the MFMA.

## Annual financial statements, performance and annual reports

40. The annual performance report of the municipality did not include the performance of uMhloosinga Development Agency, 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) (c) of the MSA.
41. The performance management system and related controls for the municipality were not maintained as it did not describe and represent the processes of performance measurement, review, reporting and how it is conducted, organised and managed as required by sections 38 of the MSA and MPPM regulation 7.
42. The consolidated and separate 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 identified by the auditors in the submitted consolidated and separate financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the consolidated and separate financial statements receiving a disclaimer audit opinion.

## Audit committee

43. The audit committee of the municipality did not meet at least four times a year, as required by section 166(4) (b) of the MFMA.
44. The audit committee of the municipality did not review the municipality's performance management system and make recommendations to the council, as required by MPPM regulation 14(4) (a) (ii).

## Budgets

45. The 2014-15 annual budget for the entity was not approved by the council before the start of the financial year, as required by section 87(4) of the MFMA.

## Procurement and contract management

46. Sufficient appropriate audit evidence could not be obtained from the municipality that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as contracts were not submitted for audit.



47. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
48. Sufficient appropriate audit evidence could not be obtained from the municipality that contracts and quotations were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
49. Goods and services of a transaction value above R200 000 were procured by the entity without inviting competitive bids, as required by SCM regulation 19(a).
50. Goods and services with a transaction value of below R200 000 were procured by the entity without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
51. The preference point system at the entity 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).
52. Sufficient appropriate audit evidence could not be obtained from the entity that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

## Expenditure management

53. Sufficient appropriate audit evidence could not be obtained that money owed by the municipality had always been paid within 30 days, as required by section 65(2) (e) of the MFMA.
54. Money owed by the municipal entity was not always paid within 30 days, as required by section 99(2) (b) of the MFMA.
55. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) and 95(d) of the MFMA.

## Conditional grants

56. Municipal Systems Improvement Grant funds of the municipality were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by section 22(1) of the DoRA.

## Revenue management

57. An adequate management, accounting and information system which accounts for revenue, and debtors was not in place at the municipality, as required by section 64(2) (e) of the MFMA.
58. Interest was not charged on all accounts in arrears at the municipality, as required by

section 64(2) (g) of the MFMA.

59. An effective system of internal control for debtors and revenue was not in place at the municipality, as required by section 64(2) (f) of the MFMA.

### Internal audit

60. An internal audit unit was not established in the entity, as required by section 165(1) of the MFMA.

### Consequence management

61. Unauthorised, irregular, and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure in the municipality, as required by section 32(2) (a) (ii) of the MFMA.
62. Irregular expenditure incurred by the entity was not investigated to determine if any person is liable for the expenditure, as required by section 102(1) of the MFMA
63. Unauthorised, irregular and fruitless and wasteful expenditure was not always recovered from the liable person in the municipality, as required by section 32(2) of the MFMA.

### Internal control

64. I considered internal control relevant to my audit of the consolidated and separate 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 basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

### Leadership

65. The leadership did not exercise adequate oversight responsibility regarding financial and performance reporting and compliance with laws and regulations. Leadership did not ensure that a proper action plan is established and monitored to address prior year issues and that employees have a better understanding of the requirements in respect of policies and procedures. Therefore the policies and procedures were not effectively applied and monitored due to the slow response by leadership.

### Financial and performance management

66. Systems and controls were not designed in a manner to prevent, detect and address risks that impact on financial; performance and compliance reporting. In this regard, management did not ensure that regular, accurate and complete financial and performance reports were prepared, which were supported and evidenced by reliable information, and daily controls were not always performed. Senior management did not implement proper record keeping to ensure that the information was accessible and available to support financial and performance reporting.

## Governance

67. There was a lack of regular risk assessment and response and the audit committee has not been meeting regularly. This also includes the lack of review of key reports such as the annual performance report.

## Other reports

### Investigations

68. We were informed that an independent firm performed an investigation at the municipality at the request of the treasury, which covered the current and prior period.
69. The entity performed an investigation which covered the period 01/01/2013 to 01/06/2014. The investigation was initiated based on an allegation of possible misappropriation of the entity's assets. The investigation concluded in February 2015 and resulted in criminal proceedings being instituted against a former employee. These proceedings are currently in progress.

*Auditor - General*  
Pietermaritzburg

18 December 2015



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