

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL  
LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE  
INFORMATION OF UTHUKELA DISTRICT MUNICIPALITY FOR THE YEAR  
ENDED 30 JUNE 2007**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of Uthukela District Municipality which comprise the balance sheet as at 30 June 2007, income statement, and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 8 to 28.

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting as set out in accounting policy note 1.1 to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

6. An audit also includes evaluating the:

- appropriateness of accounting policies used
- reasonableness of accounting estimates made by management
- overall presentation of the financial statements.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis of accounting**

8. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in accounting policy note 1.1.

#### **Basis for qualified opinion**

##### **9. Receivables (debtors)**

9.1 Debtors amounting to R53,2 million had been outstanding for more than 120 days at 30 June 2007 and there was an increase of 62% in the debtors over 120 days from 30 June 2007 to 31 October 2007. However, the provision for bad debts amounted to only R38 million. Due to the council not having a policy on provision for doubtful debts, it was not possible to assess whether the provision of R38 million was adequate with respect to the long-outstanding debtor balances.

##### **10 Revenue (income)**

###### **10.1 Water sales**

I was unable to verify the completeness and accuracy of revenue amounting to R40 million, as the controls implemented to read meters, register new applications and update records pertaining to existing water debtors were not adequate due to the following:

- It could not be ascertained if the billable customers who were taken over from the local municipalities were a complete list and that all customers receiving water were being billed.
- Completeness of application forms could not be determined as they were not prenumbered.
- Some debtor files did not contain application forms and other supporting documentation to verify the accuracy and completeness of the information used for the billing process.
- Opening readings could not be verified due to a lack of supporting documentation.
- The size of water pipes was not documented and therefore it could not be established if the correct tariff had been utilised in the billing process.
- There was no evidence that all meters were being read on a monthly basis.
- No estimates were used for billing when no readings were taken.

## 10.2 Interest on overdue accounts

In terms of section 64(1)(g) of the MFMA the accounting officer must take all reasonable steps to ensure that the municipality charges interest on arrear accounts unless the council has granted exemptions in accordance with its budget-related policies and within a prescribed framework. In addition, according to paragraph 6.9 of the credit control and debt collection policy of the municipality, interest should be levied on all overdue accounts using the interest rate of prime plus 1%.

The penalty interest charged on a monthly basis could not be verified due to the unavailability of a monthly debtors age analysis. It could not be ascertained if the interest was levied in accordance with the credit control and debt collection policy. Consequently, interest recorded of R4,9 million and the related debtors' account balance could not be verified.

### Qualified opinion

11. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of Uthukela District Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1.1 and in the manner required by the MFMA.

### Emphasis of matter

12. I draw attention to the following matter:

#### Highlighting a matter affecting the financial statements

##### Going concern

Although the executive director's report on page 3 of the financial statements highlights the extreme financial challenges facing the municipality, the following further matters relating thereto were noted at year-end:

- The municipality was still facing a severe negative cash flow situation.
- The history of accumulated losses during the past financial years.
- The Metropolitan Life investment policies of R9,8 million were ceded as security for the bank overdraft facility as per note 8 to the financial statements.
- Statutory funds, provisions and reserves totalling R17 million at year-end were not fully supported by investments and cash. External investments and cash excluding investments that were ceded amounted to R1,3 million, causing a shortfall of R15,7 million.
- A drastic rise in current debtors by R21,8 million (30%) from R70 million to R91,8 million.
- Revenue recorded for the year under review was substantially below the budget.

Council did not have an adequate comprehensive plan in place to address the matters raised above. As there was no evidence that a turnaround strategy had been developed, approved and implemented by management, there is significant uncertainty with respect to the municipality's ability to meet both short- and long-term debt in the near future.

## **OTHER MATTERS**

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

### **13. Non-compliance with applicable legislation**

#### **Municipal Finance Management Act**

No formal risk management policy or process has been established and incorporated into the municipality's system to assess, manage and control risk on a continuous basis as required by section 62(1)(c) of the MFMA.

The municipality was in a net overdraft position during certain months of the year, for which no evidence could be produced that the municipality informed the treasury as required by section 70(2) of the MFMA.

### **14. Matters of governance**

#### **Internal audit and audit committee**

Section 165 of the MFMA requires the municipality to establish an internal audit function. The following shortcomings in respect of the internal audit function were noted during the audit:

- There was no approved internal audit charter.
- The internal audit plan for the year under review had not been approved.
- The audit committee was not established for the major duration of the year.

### **15. Material corrections made to the financial statements submitted for auditing**

The financial statements, approved by the accounting officer and submitted for auditing on 31 August 2007, have been significantly revised in respect of the following material misstatement identified during the audit:

Credit balances included in debtors resulted in the understatement of debtors and creditors by R2,8 million. This error was corrected.

### **16. Internal control**

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies existed in more than one internal control component.

Reporting Item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for qualification of opinion</b>					
Debtors			X		X
Water sales and sanitations			X		X
Interest on overdue accounts					X
<b>Emphasis of matter</b>					
Going concern		X			X
<b>Other matters</b>					
Non-compliance with applicable laws and regulations		X			X
Matters of governance	X				X
Material corrections to the financial statements			X		X

**17. Investigations in progress or completed**

With reference to paragraph 7 of the directors' report in the financial statements, an investigation is in progress to probe the manner in which investments to the value of R5,2 million, included in debtors that matured during the year under review, were made.

**18. Unaudited supplementary schedules**

The supplementary information set out on pages 28 to 34 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 on them.

## **OTHER REPORTING RESPONSIBILITIES**

### **Reporting on performance information**

19. I was engaged to audit the performance information.

### **Responsibility of the accounting officer for the performance information**

20. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **Responsibility of the Auditor-General**

21. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 646 of 25 May 2007* and section 45 of the MSA.

22. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

23. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### **Audit findings (performance information)**

#### **24. Non-compliance with regulatory requirements**

##### **No reporting of performance information**

In terms of section 41(e) of the MSA the municipality must establish a process of regular reporting of performance to the council, political structures, other political office-bearers, municipal staff, public and other organs of state. However, the municipality did not issue any monthly, quarterly or annual performance reports as a means of creating this regular reporting to the said persons.

##### **Existence and functioning of a performance audit committee**

The municipality did not appoint and budget for a performance audit committee, neither was the audit committee utilised as the performance audit committee.

##### **Internal auditing of performance measurements**

The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes as required in terms of section 45 of the MSA.

**Existence and functioning of a performance audit committee**

The municipality did not appoint and budget for a performance audit committee, neither was the audit committee utilised as the performance audit committee.

**Internal auditing of performance measurements**

The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes as required in terms of section 45 of the MSA.

**Integrated development plan (IDP) and key performance indicators (KPIs)**

The KPIs for the performance management system (PMS) were not aligned with the KPIs as per the IDP as required by the PMS framework and the IDP.

**APPRECIATION**

26. The assistance rendered by the staff of Uthukela District Municipality during the audit is sincerely appreciated.

*Auditor-General*  
13 December 2007

Pietermaritzburg



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