

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Umzinyathi 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 5 to 24.

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 entity-specific basis of accounting, as set out in accounting policy note 1 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 in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in accounting policy note 1.

Basis for disclaimer of opinion

Municipal entity - uThukela Water (Pty) Ltd

Valuation of investment

5.1 uThukela Water (Pty) Ltd has to date not produced a set of financial statements. The municipality was therefore unable to reasonably determine the value of its investment in this company. Consequently the financial statements do not include any disclosure of the value of the investment held in uThukela Water (Pty) Ltd.

However, included under debtors and creditors are balances relating to the transfer of the water function to uThukela Water (Pty) Ltd which will eventually be taken into account in determining the value of the investment in uThukela Water (Pty) Ltd.

As a result debtors and creditors are overstated by R34,2 million and R25,1 million respectively.

Incorrect accounting of water transactions

5.2 Included in the financial statements, and as disclosed in note 23 to the financial statements, are the operating results for the water services functions for the year ended 30 June 2007 which have been incorrectly incorporated into the financial statements of Umzinyathi Municipality in the current and prior years for the following reasons:-

- a) uThukela Water (Pty) Ltd is an entity jointly controlled by three water services authorities.
- b) Transactions and balances relating to each water services authority should be accounted for in the consolidated financial statements prepared on the proportionate consolidation basis in accordance with the standards of Generally Accepted Municipal Accounting Practice, GAMAP 8 *Financial Reporting of Interests in Joint Ventures*.
- c) Any payments made to uThukela Water (Pty) Ltd in accordance with an approved budget should be accounted for as their portion of the equitable share.

As a result income and expenditure is overstated by R41 million and R38,7 million respectively and debtors is overstated by R2,3 million.

Investments

Investment overstated

6.1 An investment with New Republic Bank is under receivership and confirmation from the joint receiver, established that the expected distribution will be 35% of the remaining capital balance. Included in investments however, is the full remaining capital balance of R1,5 million. As a result, investments are overstated and accumulated surplus is understated by R1 million.

Interest not accrued for

6.2 Interest on investments was not accrued for during the year. As a result investments and income is understated by R138 000.

Valued added taxation (VAT)

7. A Vat reconciliation for the period ended 30 June 2006 includes an unreconciled difference of R241 000 between the municipality's records and the balance as per the South African Revenue Services. An amount of R13,2 million relating to assessments performed by the South African Revenue Service in respect of water income not declared by the municipality but declared by uThukela Water (Pty) Ltd which the municipality has objected to, has also not been accounted for. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the valuation and existence of the VAT debtor of R18,7 million.

Fixed assets

- 8.1 As a result of the following I was unable to carry out all the audit procedures considered necessary to satisfy myself regarding the the existence, valuation and completeness of the fixed assets balance of R3,5 million.
 - a) A fixed asset register was not maintained and a physical stock take of assets was not performed during the year.
 - b) The journal and supporting documents for an adjustment of R1.9 million increasing the total value of fixed assets could not be provided for audit.
 - c) Three airconditioners valued at R15 000 were incorrectly recorded as repairs and maintenance instead of being capitalised to assets.
 - d) The opening balance for fixed assets does not agree to the prior year closing balance, resulting in an unexplained difference of R160 000.
 - e) The journal and supporting documents for an adjustment of R296 000 could not be provided for audit.
- 8.2 Furthermore, in the absence of a proper asset register the accuracy of the funding entries and balances recorded under loans redeemed and other receipts could not be substantiated.

Creditors

Accrual incorrectly recognised

- 9.1 Included under accruals is an amount of R200 000 in respect of funding set aside for a feasibility study and business plan for a development initiative still to be undertaken by the municipality. The accrual does not meet the definition of a liability as no obligation existed at year-end. Creditors and expenditure are therefore overstated by R200 000.

No movement in creditors

- 9.2 The agreements, supporting documentation or reconciliations in respect of creditors balances totalling R1,8 million could not be provided for audit. As a result, I was unable to satisfy myself regarding the valuation and municipality's obligation to settle these balances.

Expenditure

10. Rental expenditure of R324 000 pertaining to the prior year is incorrectly included in general expenses for the current year. As a result expenditure is overstated and appropriations are understated by R324 000.

Debtors

Provison for bad debts

11.1 Although the municipality has no consumer debtors, during the year the provision for bad debts was increased from R4,5 million in the prior year to R8,3 million in the current year. Consumer debtors have been taken over and controlled by the water services provider, uThukela Water (Pty) Ltd therefore there exists no basis for recording the provision for bad debts in the books of the municipality. As a result, debtors is understated by R8,3 million, expenditure is overstated by R3,8 million and accumulated surplus is overstated by R4,5 million.

Amounts due by the Municipal Manager and Mayor

11.2 Included under staff debtors are balances totalling R82 000 relating to credit card expenditure incurred by the mayor and the suspended municipal manager. These balances have increased since the prior year and no steps or actions have been taken by the municipality to recover the outstanding debt. As a result I could not satisfy myself regarding the valuation and existence of the balance.

Debtor suspense accounts

11.3 Suspense accounts totalling R315 000 were not cleared at year end and the supporting documents and reconciliations for the balances could not be provided for audit. The municipality's records did not permit the application of alternative audit procedures. Consequently I did not obtain sufficient appropriate evidence to satisfy myself regarding the valuation and existence of these balances.

Recoverability of debtors

11.4 Debtors balances totalling R1,6 million have not been recovered since the previous year. Confirmation in respect of a balance of R1,4 million owing from Umgungundlovu district municipality revealed that no corresponding creditor is included in their financial statements. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself regarding the valuation and existence of this balance.

Accumulated surplus

12. The journal voucher and supporting documents for journal adjustments totalling R3,5 million processed against accumulated surplus could not be provided for audit. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity and accuracy of the adjustments processed.

Cash and cash equivalentents

13.1 A review of the bank reconciliation at year end revealed the following:

- The bank reconciliation is performed from the cash book to the bank statement and has not been reconciled to the general ledger.
- The cash book balance does not agree to the general ledger balance. A difference of R55 000 exists between the cash book and the general ledger.

13.2 In the absence of a properly reconciled bank balance, I could not satisfy myself regarding the valuation and completeness of the year end bank balance of R42,9 million and the accuracy and completeness of the related cash transactions.

Provisions

14. The staff leave provision is based on the total leave due to staff at year-end. As a result of the errors found with the recording and management of leave transactions and balances, I could not satisfy myself regarding the accuracy of the leave balances recorded for each staff. As a result I could not satisfy myself regarding the valuation and completeness of the provision for leave pay of R813 000.

Material losses through fruitless and wasteful expenditure

15. Interest and penalties totalling R482 000 incurred on VAT due to SARS has not been disclosed as fruitless and wasteful expenditure in the financial statements, contrary to section 125(2)(d)(i) of the MFMA.

Income

16. The unspent balance of the Municipal Systems Improvement Grant (MSIG) of R593 000 is incorrectly included in income from grants and subsidies instead of being recorded under unspent conditional grants disclosed under creditors. As a result, income is overstated and creditors are understated by R593 000.

Disclaimer of opinion

17. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Umzinyathi District Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

18. I draw attention to the following matters:

Water services provider agreement with uThukela Water (Pty) Ltd

19. In May 2004 the municipality entered into a water services provider agreement with uThukela Water (Pty) Ltd (WSP) together with two other water services authorities. Our review of the agreement revealed the following significant shortcomings which indicates that the water services function is not conducted in an efficient, equitable, cost effective and sustainable manner:-

- a) The water tariff policy was not compiled, approved and maintained by the municipality in accordance with paragraph 9.1.1 of the agreement.

- b) A detailed reconciliation of amounts received and debited to the account of the WSP was not submitted by the WSP in accordance with paragraph 9.5.4 of the agreement.
- c) Transfer of ownership of the assets in accordance with paragraph 10.1 and 25 of the agreement has not taken place.
- d) The municipality has not assisted the WSP to compile a comprehensive asset register and valuation of the water services system in accordance with paragraph 10.2 of the agreement.
- e) The water services provider business plan was not compiled and submitted to the municipality for approval in accordance with paragraph 14, 16.2 and 17.2 of the agreement.
- f) The municipality has not monitored and evaluated the performance of the WSP in accordance with paragraph 15 of the agreement.
- g) The WSP has not developed a performance management policy and performance management system in accordance with paragraph 15.3 of the agreement.
- h) The WSP has not operated an effective financial transaction system in accordance with paragraph 17.1 of the agreement.
- i) Financial statements have not been submitted by the WSP since inception in 2005 and in accordance with paragraph 17.1.2, 17.1.3 and 17.1.4 of the agreement.

The above findings indicate that there has been a material breach of the terms and conditions of the agreement which could significantly impact on the continuation of the agreement.

Grant funding

Unspent grants

20.1 Included under unspent conditional grants disclosed under creditors is grants totalling R2,8 million which recorded no movement since the prior year. This is contrary to the agreement which has been signed with the donor which requires that any unspent or uncommitted funds on completion of a project or if the grant remains uncommitted within six months of the signature of the agreement the funds must be repaid to the donor.

Reports not submitted to grantor

20.2 The municipality did not fulfill its reporting requirements to the various organs of state from which grant funding was received, contrary to the signed agreements. In this regard monthly reports on progress of the implementation of the business plan, reports on problems experienced in fulfilling obligations of the grant and detailed close out reports were not submitted to the grantor.

OTHER MATTERS

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

Non-compliance with applicable legislation

Municipal Finance Management Act (MFMA)

21. During the year under review the municipality did not develop and implement a risk management policy and a fraud prevention plan. The municipality has therefore not effectively managed its risks in accordance with section 62(1)(c) of the MFMA.

Matters of governance

Internal audit

22. A review of internal audit revealed the following weaknesses which indicates that internal audit has not been effective in fulfilling their duties in accordance with the internal audit charter and section 165(2) of the MFMA:-

- There is only 1 internal auditor and no head of internal audit to report to.
- Audit approach and methodology was compiled by the internal auditor and was not reviewed.
- No training was provided on the audit approach and methodology.
- An internal audit training and development programme has not been developed to facilitate continuous education of the staff.
- The annual internal audit plan was prepared by the internal auditor and in the absence of an audit committee, was not approved nor was it reviewed.
- The internal audit report on Mayoral projects was not signed by the internal auditor.
- The recommendations of the external quality assurance review conducted by National Treasury were not implemented.
- It was also noted that the internal auditor did not sign any declaration of independence certificates.
- A review of the Internal audit charter revealed that the following requirements were not included in the charter:
 - The requirement for the head of internal audit to attend all audit committee meetings.
 - The requirement that the appointment or dismissal of the head of internal audit should be concurred by the audit committee.

Audit Committee

23. As at the date of this report the municipality did not have an audit committee in place, as required by section 166(1) of the MFMA.

Value-for-money matters

Human Resource Management

24. The following were noted:-

- a) The organisational structure of the auditee has not been clearly defined by means of an approved and updated organisational chart.

- b) Staff vacancies exist in the finance component for extended periods and the vacancy rate is not addressed on a timeous and regular basis.

Infrastructure grants

25.1 The following information with respect to contract expenditure on infrastructure grants, totalling R2,1 million, could not be provided for audit.

- Total actual expenditure for each contract
- The formal contract signed between the municipality and the contractor
- The date on which the construction commenced or the first invoice and payment of the first invoice

25.2 Consequently I was unable to assess if the expenditure incurred was in accordance with the terms and conditions of the contract.

Supply Chain Management

26. The monthly written notification to the accounting officer or chief financial officer of all written or verbal quotations and formal written price quotations accepted by an official acting in terms of a sub delegation, as required by regulation 18(d) of the Supply chain management regulations, was not submitted,

Internal control

27. 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 exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Municipal entity – Uthukela Water	✓				✓
Investments			✓		✓
Value added taxation			✓		✓
Fixed assets	✓			✓	
Creditors			✓		✓
Expenditure			✓		✓
Debtors			✓		✓
Accumulated surpluses					✓

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Cash and cash equivalents			✓		✓
Provisions			✓		✓
Material losses through fruitless and wasteful expenditure					✓
Income					✓
Emphasis of matter					
WSP agreement – uThukela Water	✓				✓
Grant funding			✓		✓
Other matters					
Non-compliance with applicable laws and regulations		✓			
Matters of governance	✓	✓			
Value for money matters			✓		

Investigations in progress

28. An investigation commissioned by the Department of Traditional and Local Government Affairs into allegations of irregularities within the municipality has resulted in the suspension of the municipal manager and disciplinary proceedings being instituted against him. The proceedings were still ongoing at the reporting date.

Unaudited supplementary schedules

29. The supplementary information set out on pages 25 to 30 does not form part of the audited 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

30. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

31. 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

32. 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.

33. 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.

34. 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)

Non-compliance with regulatory requirements

Existence and functioning of a performance audit committee

35. The municipality did not appoint and budget for a performance audit committee as required by section 14(2) of the Local Government: Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

36. The internal audit processes and procedures did not include assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA as required by section 14(1) of the Local Government: Municipal Planning and Performance Management Regulations, 2001.

Lack of sufficient appropriate audit evidence

37. It was established that there were no documented policies and procedures to guide the recording, monitoring and reporting of performance information.

Performance information not received in time

38. The municipality did not submit the annual performance report as required by section 46 of the MSA. Consequently the annual performance information, to be included in the annual report of the municipality, was not audited.

APPRECIATION

39. The assistance rendered by the staff of the Umzinyathi District Municipality during the audit is sincerely appreciated.

Pietermaritzburg

30 November 2007



A U D I T O R - G E N E R A L