

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF UMZINYATHI DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the uMzinyathi District Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, 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 [xx] to [xx].

**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 Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). 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 and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on 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.

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

##### **Property, plant and equipment**

9. The following deficiencies were identified in the management of the municipality's assets:
  - Some assets did not have bar codes, consequently it could not be located in the asset register.
  - Assets that were not used and are obsolete were not removed from the asset register.
  - Certain assets recorded in the asset register could not be physically located.
  - Certain assets selected from the floor could not be traced to the asset register.
  - Assets amounting to R115 000, purchased during the year could not be traced to the asset register.

The lack of a proper asset management system was also reported on in 2007 which caused us to disclaim our audit opinion on the financial statements as at 30 June 2007. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the existence and completeness of assets amounting to R3,38 million (2007: R3.5 million).

#### **Management's Comment**

The assets that did not have barcodes are assets purchased for the new financial year 2008/2009 to be included in assets register for 2008/2009. Absolute assets will be taken out of the assets register in 08/09. The list of assets that could not be located has been found and is available for audit. Assets are on the assets register audit will be given a detailed assets register to ratify this in 08/09. A policy with regards to this fixed asset register is being developed to limit the movement of asset without proper authorizing and the asset register will be timeously updated.:-

**Responsible Person** : BB Mdletshe

**Title** : Chief Financial Officer.

**Date** : 28 February 2009

## Receivables

10. I was unable to obtain the supporting documents and reconciliations, considered necessary for my audit, for debtors balances of R2,06 million (2007: R1,6 million) which also recorded no movement since the prior year.
11. Included under debtors was a balance of R7,49 million (2007: R8,14 million) owing from uThukela Water (Pty) Ltd. This entity has not produced financial statements since inception and was therefore unable to confirm the balance
12. The debtors suspense accounts of R270 522 (2007: R315 000) were not cleared at year-end. Furthermore I was unable to obtain the supporting documents and reconciliations considered necessary for my audit to determine the effect on the financial statements had these balances been cleared.

The above issues were reported in 2007 which caused us to disclaim our audit opinion on the financial statements as at 30 June 2007. Consequently there were no satisfactory audit procedures that could be performed to obtain reasonable assurance on the valuation, existence and the municipality's rights and obligation to the outstanding balances in the current year and prior year.

## Management's Comment

An amount of R2.06 million will be investigated as per audit recommendation and necessary adjustments processed in 2008/2009 financial year.

A provision for bad debt will be raised for the amount of R7.49 million as there is no assurance that the Municipality will receive this amount from UThukela Water.

Debtors suspense amount of R270 522 will be investigated as per audit recommendation and necessary adjustments processed in 2008/2009 financial year.

Responsible Person: BB Mdletshe

Title: Chief Financial Officer.

Date: 28 February 2009

## Payables

13. I was unable to obtain the supporting documents and reconciliations considered necessary for my audit, for the creditors balance of R2,40 million (2007: R1,8 million), which also recorded no movement since the prior year. The above issues were reported in 2007 which caused us to disclaim our audit opinion on the financial statements as at 30 June 2007. Consequently, there were no satisfactory audit procedures that could be performed to obtain reasonable assurance on the

valuation, existence and the municipality's rights and obligation to these balances in the current year and prior year.

**Management's Comment**

An amount of R2.40 million will be investigated as per audit recommendation and necessary adjustments processed in 2008/2009 financial year.

**Responsible Person:** BB Mdletshe

**Title:** Chief Financial Officer.

**Date:** 28 February 2009

**Subsidiaries, associates and joint ventures**

14. uThukela Water (Pty) Ltd, the municipal entity appointed as the water services provider for the district, has since inception in 2004 not produced a set of financial statements. Due to the serious financial crisis within this entity resulting in a Provincial intervention in terms of section 139 of the MFMA the municipality was therefore unable to reasonably determine the value of its investment in the entity. Consequently, the financial statements did not include any disclosure in the current and prior year of the investment held in uThukela Water (Pty) Ltd.

**Management's Comment**

All documentation relating to the movement of the UThukela Water control account was provided for the audit.

Entries raised to UThukela Water's Control account originated from UThukela Water monthly report, which were presented for audit.

We will raise UThukela Water Investments by Debiting Uthukela Investment with ~~the~~ assets transferred to Uthukela and Crediting Re-capitalisation Reserve.

Recommendation of the MEC and Auditor General will be implemented in 2008/2009.

**Responsible Person:** BB Mdletshe

**Title:** Chief Financial Officer.

**Date:** 28 February 2009

## **Taxes and VAT**

15. An amount of R7,97 million claimed by uMzinyathi District Municipality with respect to the VAT input for the year ended 30 June 2008 is in dispute with the South African Revenue Service (SARS).
16. Output VAT to the value of R13,26 million claimed by SARS in respect of water sales not declared by the municipality (but declared by uThukela Water) for the period May 2005 to June 2006 is also in dispute. In addition, no reconciliation has been performed to support the VAT debtor of R29,48 million disclosed in the annual financial statements.

These issues were reported in 2007 which caused us to disclaim our audit opinion on the financial statements as at 30 June 2007. There were no satisfactory audit procedures that could be performed to obtain reasonable assurance regarding the valuation, existence, completeness and the municipality's rights and obligation to the receivable of R29,48 million (2007: R18,75 million).

## **Management's Comment**

Vat 201 is compiled as per input and output schedules from the general ledger.

-Vat 201 reconciliations- are available for audit purposes.

PWC has been appointed to assist with Vat objections and objection supporting documents have been launched with SARS. We await the finalisation on this matter in 2008/2009.

**Responsible Person:** BB Mdletshe

**Title:** Chief Financial Officer

**Date:** 28 February 2009

## **Government grants**

17. Included under unspent conditional grants is an amount of R874 000, for which there has no movement since the prior year. I was unable to obtain the supporting documents and agreements in respect of these grants. Consequently, there were no satisfactory audit procedures that could be performed to obtain reasonable assurance on the valuation, existence and the municipality's rights and obligation to these balances.

### **Management's Comment**

An amount of R874 000 will be investigated as per audit recommendation and necessary adjustments processed in 2008/2009 financial year.

**Responsible Person:** BB Mdletshe

**Title:** Chief Financial Officer

**Date:** 28 February 2009

### **Corresponding figures**

18. The auditor's report on the prior period included a disclaimer of opinion. The following matters, although resolved in the current year, were not adjusted in the prior year. As a consequence the affected comparative amounts and opening balances were also either misstated or could not be audited.

- Included in corresponding figures are the operating results for the water services functions for the year ended 30 June 2007 which were incorrectly incorporated into the financial statements in the prior year. As a result income and expenditure for 2007 is overstated by R41 million and R38,7 million respectively.
- Included in the corresponding figures for debtors and creditors are balances relating to the transfer of the water function to uThukela Water (Pty) Ltd which have not been written off. As a result debtors and creditors for 2007 are overstated by R34,2 million and R25,1 million respectively.
- The investment in New Republic Bank was placed under receivership and a confirmation of 45% distribution was confirmed by the joint receiver. However included in investments for 2007 is the full capital balance of R1,5 million. As a result investments are overstated and accumulated surplus is understated by R851 700 in 2007.
- 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 leave balances recorded for each staff. As a result I could not satisfy myself regarding the valuation and completeness of the 2007 leave provision of R813 000.

### **Management's Comment**

The corresponding balances changed due to audit recommendation for previous -Financial year and these balances were supported and presented to audit. We

will monitor this in 2008/2009 and implement the audit recommendations.

**Responsible Person:** BB Mdletshe

**Title:** Chief Financial Officer

**Date:** 28 February 2009

### **Qualified opinion**

19. In my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I been able to satisfy myself as to the matters described in the Basis for qualified opinion paragraphs, the financial statements of the uMzinyathi District Municipality as at 30 June 2008 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 and in the manner required by the MFMA and DoRA.

### **Emphasis of matter**

I draw attention to the following matter:

### **Significant uncertainty**

20. 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. As a result of a material breach of the terms and conditions of the agreement and the serious financial mismanagement within the entity, the MEC of the Department of Local Government has intervened in terms of section 139 of the MFMA. This has created significant uncertainty on the ability of the WSP to effectively carry out the water services function on behalf of the district. At year end the effect of the intervention on the operations of uMzinyathi District Municipality could not be determined.

### **Management Comments**

We will await recommendation of MEC intervention to resolve the issues of Uthukela Water.

### **OTHER MATTERS**

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

## Internal controls

21. 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 that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

| Reporting item                              | Control environment | Risk assessment | Control activities | Information and communication | Monitoring |
|---|---------------------|-----------------|--------------------|-------------------------------|------------|
| Property, plant and equipments              | ✓                   |                 | ✓                  | ✓                             | ✓          |
| Receivables                                 |                     |                 | ✓                  |                               | ✓          |
| Payables                                    |                     |                 | ✓                  |                               | ✓          |
| Subsidiaries, associates and joint ventures | ✓                   |                 | ✓                  |                               |            |
| Taxes and VAT                               |                     |                 | ✓                  |                               |            |
| Government grants                           |                     |                 | ✓                  |                               |            |
| Corresponding figures                       | ✓                   |                 |                    |                               | ✓          |

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within



| Reporting item | Control environment | Risk assessment | Control activities | Information and communication | Monitoring |
|----------------|---------------------|-----------------|--------------------|-------------------------------|------------|
| a process.     |                     |                 |                    |                               |            |

### Management Comments

Internal auditors appointed will assist the Municipality to improve control environment and management will implement audit recommendations.

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

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

22. The municipality did not have a risk assessment committee to develop and implement the risk assessment processes. A formal risk assessment was not undertaken during the year under review and a risk management policy and fraud prevention plan has not been developed in compliance with section 62(1)(c) of the MFMA.
23. The municipality did not have written delegations of authority in place as required by section 79 of the MFMA.

### **Matters of governance**

24. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

| Matter of governance   | Yes | No |
|--|-----|----|
| <b>Audit committee</b>   |     |    |
| • The municipality had an audit committee in operation throughout the financial year.  |     | ✓  |
| • The audit committee operates in accordance with approved, written terms of reference.  | ✓   |    |
| • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.         |     | ✓  |
| <b>Internal audit</b>  |     |    |
| • The municipality had an internal audit function in operation throughout the financial year.                                      |     | ✓  |
| • The internal audit function operates in terms of an approved internal audit plan.  |     | ✓  |
| • The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. |     | ✓  |

| Matter of governance   | Yes | No |
|--|-----|----|
| <b>Other matters of governance</b>   |     |    |
| • The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).   | ✓   |    |
| • The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.  |     | ✓  |
| • The financial statements submitted for auditing were not subject to any material amendments resulting from the audit.  |     | ✓  |
| • No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.  | ✓   |    |
| • The prior year's external audit recommendations have been substantially implemented.   |     | ✓  |
| <b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>  |     |    |
| • The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.                               |     | ✓  |
| • The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007 detailing progress towards full compliance with GRAP. |     | ✓  |
| • The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.                         |     | ✓  |

### Unaudited supplementary schedules

25. The supplementary information set out in appendices A to J did 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.

### Management Comments

Internal auditors appointed will assist the Municipality to improve control environment and management will implement audit recommendations.

### OTHER REPORTING RESPONSIBILITIES

#### REPORT ON PERFORMANCE INFORMATION

26. I have reviewed the performance information as set out on pages xx to xx.

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

23. 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**

27. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

28. 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.

29. 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**

30. Section 14 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires that the internal auditors review the quarterly and annual performance information reports as part of its annual audit plan. However, the internal auditor at uMzinyathi District Municipality did not review the performance management reports as part of its annual audit plan.

31. The municipality did not have a performance management committee as required by section 14 (1) (c) (ii) of the MSA.

#### **Measurable objectives not consistent**

32. I draw attention to the fact that the reporting of actual performance in the performance report is materially inconsistent with the targets and performance indicators included in the integrated development plan (IDP) in that the IDP records a percentage achievement for each key performance area whilst the performance report only documents the municipality's progress to date. The following table highlights the difference:

| Strategies   | Key performance indicator (General key performance indicators) (IDP)               | Target per key performance indicator (performance report) (IDP) | Actual achievement per the performance report  |
|--|--|---|--|
| 1.1 Drilling of boreholes  | Percentage decrease in communities without water                                   | 14%   | During 2007-08 UMzinyathi District Municipality implemented the MIG projects to the value of R63 956 054,26. The municipality intended reducing the current backlog of 74% in relation to water and 68% in relation to sanitation by 20%. Most of the water and sanitation schemes which were being implemented by the municipality were aimed at laying infrastructural foundation as they were new projects providing communities with access to water and sanitation. According to the backlog study prepared by Jeffares and Green (Pty) Ltd, it states that it will take approximately 28 years to address the current backlog at a cost of approximately R1,37 billion; this is in relation to the MIG allocation being received by the municipality. It must also be noted that 25% of the MIG projects undertaken by the municipality were EPWP compliant. |
| 1.2 Protecting unprotected springs                                     |  |   |  |
| 1.3 Extension of existing schemes                                      |  |   |  |
| 2.1 Connection and provision of infrastructure to the bulk water mains | A percentage Of the communities With access to standpipes not more than 200 m away | 90%   |  |

## APPRECIATION

33. The assistance rendered by the staff of the uMzinyathi District Municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008



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