

# **REPORT OF THE AUDITOR-GENERAL TO KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF ILEMBE 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 Ilembe District Municipality which comprise the balance sheet as at 30 June 2008, 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 66 to 81.

### **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) 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**

#### **Revenue - water service charges**

9. A major part of the municipality's revenue comprises water service charges. The existing system of control over the billing of water service charges could not be relied upon for the purpose of my audit as detailed testing revealed incorrect meter readings and billing, unreasonable estimates, negative estimates, incorrect tariffs utilised on certain accounts and significant adjustments to consumers' accounts. The entity's records did not permit the application of alternate audit procedures and it was not possible to quantify the error in water service charges.

Consequently, I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy and completeness of water service charges and the valuation and completeness of accounts receivable.

### **Qualified opinion**

10. 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 matter described in the Basis for qualified opinion paragraph, the financial statements of the Ilembe 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:

#### **Unauthorised expenditure**

11. As disclosed in note 25 to the financial statements, unauthorised expenditure amounting to R18,2 million was incurred, as a result of lack of monitoring of the expenditure on infrastructure projects.

### **OTHER MATTERS**

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

## Internal controls

12. 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
Water service charges			✓	✓	

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 a process.

## Non-compliance with applicable legislation

### Municipal Finance Management Act

13. An effective, efficient and transparent systems of financial and risk management and internal controls, as required by section 62(1)(c) of the MFMA, did not exist during the year under review.
14. An effective revenue collection systems, as required by section 64(2)(a) of the MFMA, did not exist during the year under review.
15. The municipality did not take all reasonable steps to ensure that the municipality's supply chain management policy is implemented in a way that is fair, equitable, transparent, competitive and cost effective, as required by section 65(2)(i) of the MFMA.

### Matters of governance

16. 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:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA.</li> </ul>		✓
<b>Internal audit</b>		
<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA.</li> </ul>		✓
<b>Other matters of governance</b>		
<ul style="list-style-type: none"> <li>The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.</li> </ul>		✓
<ul style="list-style-type: none"> <li>The financial statements submitted for audit were not subject to any material amendments resulting from the audit.</li> </ul>		✓
<ul style="list-style-type: none"> <li>No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The prior year's external audit recommendations have been substantially implemented.</li> </ul>		✓
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
<ul style="list-style-type: none"> <li>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.</li> </ul>	✓	
<ul style="list-style-type: none"> <li>The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.</li> </ul>		✓
<ul style="list-style-type: none"> <li>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.</li> </ul>		✓

## **Unaudited supplementary schedules**

17. The supplementary information set out on pages 82 to 87 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 thereon.

## **OTHER REPORTING RESPONSIBILITIES**

### **REPORT ON PERFORMANCE INFORMATION**

18. I have reviewed the performance information as set out on pages 13 to 19

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

19. 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**

20. 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.
21. 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.
22. 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**

Internal auditing of performance information

23. The internal auditors of the Ilembe District Municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by section 45 of the MSA.

## **OTHER REPORTS**

### **Investigations**

24. The investigations against the former municipal manager and former information technology manager are still pending before the courts, awaiting trial dates. Additional charges (damages/irregular payments) have been filed against one of these employees and attempts are made to consolidate these charges into the original charges which is currently being processed.

25. The first report on the investigation commissioned by the MEC dealt with the payment of bonuses to managers. Managers have declared a dispute on the matter and referred the matter to the Bargaining Council for Arbitration. The outcome of the arbitration is awaited.
26. The second report on the investigation commissioned by the MEC dealt largely with irregular awarding of contracts involving both councillors and managers. The municipality has sought legal advice on some of the contents of the report regarding procedures for implementing them.
27. An investigation was conducted on various matters in respect of annual leave ranging from leave days not captured on the VIP system to mis-capturing of leave entries on the VIP system. A forensic investigation confirmed the discrepancies and the official responsible for the discrepancies has been charged. Her disciplinary proceedings are in progress.
28. An investigation is being conducted to probe the manner in which cheques were stolen/ forged after year-end and three cheques were processed through the municipality's bank account amounting to approximately R1,03 million. The municipality has appointed a consultant to undertake both the normal and forensic investigation. A report on the matter is still outstanding.
29. An investigation into the payments to a company performing inspection services on behalf of the municipality has not yet been finalised.

## **APPRECIATION**

30. The assistance rendered by the staff of the Ilembe 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**

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

No.	Draft Response
1.	<b>Introduction</b> Noted.
2.	<b>Responsibility of the accounting officer for the financial statements</b> Noted.
3-7.	<b>Responsibility of the Auditor-General</b> Noted.
8.	<b>Basis of accounting</b> Noted.
9.	<p><b>Basis for qualified opinion</b></p> <p><b>Revenue – water service charges</b></p> <p>The Auditor General's reasons for qualifying their report are as follows:</p> <ul style="list-style-type: none"> <li>• Incorrect meter readings and billing.</li> <li>• Unreasonable and negative estimates.</li> <li>• Incorrect tariffs utilised on certain accounts.</li> <li>• Significant adjustments to consumer accounts.</li> </ul> <p>Set out below is a summary of how each of the above matters will be dealt with.</p> <p><u><i>Incorrect meter readings and billing</i></u></p> <p>A service provider has been appointed to undertake a meter and data audit. The debtors' data will be uploaded to the debtors system while additional resources will be employed to ensure all data is correct on the debtors system. The vacant position of Accountant Billing/Deviations will also be filled.</p> <p><u><i>Unreasonable and negative estimates</i></u></p> <p>The meter audit mentioned above will assist in resolving this problem. In addition meters that are unable to be read will either be replaced, uncovered or moved to outside the property. In addition the Munsoft Debtors Programme will be changed to allow for the system to calculate the average consumption in line with the bylaws, credit control policy and accounting policy.</p> <p><u><i>Incorrect tariffs utilised on certain accounts</i></u></p> <p>As part of the data cleansing exercise the zoning and area fields on the debtors' database are being corrected. A review of all tariffs as a whole will be</p>

	<p>undertaken with the view to reduce the number of tariff codes. Thereafter a review of the tariffs on each account will be done.</p> <p><i>Significant adjustments to consumer accounts</i></p> <p>Reviews are being done and corrective measures are being taken where an error has escaped the deviation net. This is being done on a monthly basis to ensure that any errors are adjusted timeously to avoid any errors at year end.</p>
10.	<p><b>Qualified opinion</b></p> <p>Noted. Please see above in item 9. how each of the matters that resulted in the qualification will be dealt with.</p>
11.	<p><b>Emphasis of matter</b> <b>Unauthorised expenditure</b></p> <p>The Capital Budget for 2007/08 was adjusted as part of the 2007/08 Adjustment Budget process. The Capital Budget is particularly difficult to predict due to the following:</p> <ul style="list-style-type: none"> <li>• The lengthy bid process.</li> <li>• Delays in completing the projects due to factors out of the control of the Municipality e.g. bulk water supply, supply of electricity etc.</li> <li>• Identification of new projects that can be commenced or completed after finalisation of the adjustment budget.</li> <li>• Changes to the funding available – additional grants are given at the end of the Central and Provincial Governments’ financial year in March after the adjustment budget has been completed.</li> <li>• The urgency to spend the MIG allocation for the year.</li> </ul> <p>A Capital Projects Monitoring Task Team has been set up comprising Finance and Technical Services staff to monitor the capital projects on a monthly basis.</p> <p>A monthly report on capital expenditure is submitted to Councillors for their information.</p> <p>It should be noted that neither the MIG nor the external loans amounts allocated for the 2007/08 financial year were exceeded in total.</p>
12.	<p><b>OTHER MATTERS</b> <b>Internal controls</b></p> <p>The components of internal control are noted and will be taken cognisance of in addressing the different issues as explained in our detailed responses to the audit report.</p>
13-15.	<p><b>Non-compliance with applicable legislation</b> <b>Municipal Finance Management Act</b></p> <p><i>Financial and risk management and internal controls</i></p> <ul style="list-style-type: none"> <li>• Business Continuity Plan:</li> </ul> <p>There was no adopted Business Continuity Plan during the year under review since the Plan is still work in progress. It will be finalised during the current financial year (2008/2009). The delay is due to a number of factors.</p>



- Risk Management Strategy:

It is agreed that there was no such strategy during the year under review due to technical and financial constraints. However a lot of ground has been covered towards such a strategy. At the beginning of June 2008 at a session facilitated by the Provincial Treasury through Price Waterhouse and Coopers we had a two day session on the Strategic Risk Assessment. The session was preceded by a workshop on the notion and concept of Risk Management and how such risks are managed. We now have a final Strategic Risk Assessment Report which spells out a catalogue of risks and the requisite controls to manage such risks.

This report specifies risks and necessary controls on one hand and the necessary actions to manage the risk on the other, including timeframes for such actions. We are already implementing these actions for all intended purposes. The report has been structured in such a way that it is able to fulfil the role of a strategy. From June 2008 onwards we had a strategy in the form of a Final Risk and Control Assessment Report, which is available on request.

- Fraud Prevention Plan

It has been considered that there has been some delay since the adoption of this plan, but now the process is underway to implement both the spirit and letter of the plan. An Anti-Fraud and Corruption Committee is being formed; but already other mechanisms such as a whistle-blowing mechanism have been implemented.

- Tariff Policy

It was considered that there was no Tariff Policy for the year under review, but the Council has adopted such a policy at a workshop on 24 July 2008. To date we have such a policy.

- **Performance Management and Review Policy**

There was a Performance Management Policy during the period under review. This was adopted in late 2004. However, in June 2008 the Council reviewed the Policy and adopted a new one (Performance Management Policy and User Manual for Section 57 Employees).

*Revenue collection systems*

Revenue collection measures have been implemented. However due the Rand for Rand campaign which allowed for an amnesty period for consumers to register for the campaign and during the amnesty no disconnection took place at domestic properties. Revenue collection will be escalated in the 2008/09 financial year.

	<p><i>Supply chain management policy</i></p> <p>While there are the Supply Chain Management Regulations/Policy there are times when these cannot be fully adhered to. Cognisance should be taken as regards the balance between the regulations and service delivery which must always be borne in mind.</p> <p>The understaffing of the Supply Chain Management Unit will receive priority from management and the introduction of the DIMS SCM computer module will go a long way in improving compliance with the Regulations/Policy.</p>
<p>16.</p>	<p><b>Matters of governance</b></p> <p><b>Audit committee</b></p> <p>It is considered that there was no Audit Committee at the start of the Financial Year. The Audit Committee was appointed by Exco in January 2008 and forwarded to the Council for confirmation in February 2008. The history behind the delay in the appointment of the Audit Committee is that sometime in July 2006 Exco resolved to defer the appointment of the Audit Committee until there was an agreement on the concept of Shared Services, which according to the Provincial Department of Local Government and Traditional Affairs would include a Shared Audit Committee, between all Municipalities in the District.</p> <p>The idea behind this was that it would be in the interests of the Municipalities in the District, to have a Shared Audit Committee in the District for all five municipalities and a shared Internal Audit Section. Several meetings were held between the Municipal Manager and the Province to try and implement this concept. On realising that the delay was persisting we decided to go ahead with the Audit Committee towards the end of July 2007 through a report tabled at an Exco meeting on 11 December 2007.</p> <p><b>Internal audit</b></p> <p>The Risk-based Audit Plan, including the internal audit programme has been completed. The Audit Committee was established in 2007 and had two meetings on 19 and 29 August 2008 respectively. The chairperson of the Audit Committee also served on the External Panel responsible for the Annual Performance Management review.</p> <p><b>Other matters of governance</b></p> <p><i>Financial Statements</i></p> <p>The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA. Certain amendments were made to the financial statements after this deadline, with the consent of the Auditor-General.</p> <p><i>Annual Report</i></p> <p>A decision was taken to withhold the draft Annual Report until the Audit report has been received, in order to incorporate and address any resulting queries from said Audit Report. The Annual Performance Report data was however</p>

	<p>submitted prior to the completion of the Audit Report.</p> <p><b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b></p> <p>A GRAP Implementation Plan was submitted to National Treasury. The Municipality only needs to comply with GRAP standards for the 2009/10 financial year.</p>
17.	<p><b>Unaudited supplementary schedules</b></p> <p>Noted.</p>
18-23.	<p><b>OTHER REPORTING RESPONSIBILITIES</b></p> <p><b>REPORT ON PERFORMANCE INFORMATION</b></p> <p><b>Responsibility of the accounting officer for the performance information</b></p> <p>Noted.</p> <p><b>Responsibility of the Auditor-General</b></p> <p>Noted.</p> <p><b>Audit findings (performance information)</b></p> <p><b>Non-compliance with regulatory requirements</b></p> <p>Quarterly performance was not audited in the 2007/2008 financial year due to the following:</p> <ol style="list-style-type: none"> <li>1. It was not part of the audit plan and</li> <li>2. There were no available resources to conduct the required audit.</li> </ol> <p>Due to capacity constraints, it was impossible to audit the performance information quarterly. However we have planned for two audits in the 2008/09 financial year. Our plan for 2008/09 is also dependent on the availability of resources.</p>
24-29.	<p><b>OTHER REPORTS</b></p> <p><b>Investigations</b></p> <ul style="list-style-type: none"> <li>• <u>Re. Additional Charges against former Municipal Manager.</u> Ongoing matter which has not been concluded as yet.</li> <li>• <u>Re. Outcome of Managers' Bonuses dispute.</u> The findings and recommendations of the Bargaining Council is currently being negotiated.</li> <li>• <u>Re. Irregular awarding of contracts.</u> A forensic audit into the matter is currently underway.</li> <li>• <u>Re. Annual leave discrepancies.</u> The responsible staff member has been suspended.</li> </ul>

	<ul style="list-style-type: none"><li>• <u>Re. Forged cheque payments report.</u> The draft report has been received by Management and is currently under review.</li><li>• <u>Re. Payments to company performing inspection services.</u> Investigating into the matter has not been concluded as yet.</li></ul>
30.	<b>APPRECIATION</b> Noted.