

# REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON UMKHANYAKUDE DISTRICT MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying financial statements of the uMkhanyakude district Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information as set out on pages xx to xx.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the 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), the Division of Revenue Act of South Africa, (Act No.1 of 2010) (DORA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice No. 1111 of 2010* issued in *Government Gazette No. 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that 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 municipality'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 municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

## **Basis for adverse opinion**

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

7. The SA Standard of GRAP 17, *Property, plant and equipment* (GRAP 17), states that subsequent to initial recognition at cost, an item of property, plant and equipment should be carried at cost less accumulated depreciation and accumulated impairment losses or at a revalued amount less accumulated depreciation and accumulated impairment losses. As indicated in note 7 to the financial statements, no depreciation is provided for on property, plant and equipment. In addition the municipality did not assess assets for impairment indicators; review the residual values and the useful lives of assets at year end in accordance with GRAP 17 as evidenced by assets being included in the financial statements at a zero net carrying amount whilst still being in use, thus impacting on the valuation of these assets. There was also no indication that management conducted a revaluation on land and buildings. Furthermore, infrastructure assets were disclosed in components at a zero value. I was unable to quantify the effect of these misstatements.
8. An amount of R280, 183 million included in the property, plant and equipment balance disclosed in note 7 to the financial statements could not be reconciled to the asset register. R181,756 million has been disclosed as asset disposals in the financial statements, however, sufficient and appropriate documentation could not be provided to support this. Furthermore, assets identified during the physical verification procedures could not be reconciled to the financial statements. I was unable to quantify the effect of this misstatement due to lack of supporting documentation.

### **Accumulated Surplus**

#### **Prior year qualification item**

9. The municipality could not provide sufficient appropriate audit evidence to support prior years' expenses that affected the accumulated surplus of R3, 225 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that prior year's expenses of R3, 225 million had been properly recorded. Consequently I did not obtain sufficient appropriate evidence to satisfy myself as to completeness and valuation of amount disclosed as the accumulated surplus.
10. The municipality could not provide sufficient appropriate evidence to support automatic transfers incorrectly processed on the statement of changes in net assets totaling R1, 455 million in the prior year. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance on these automatic transfers. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of the amount disclosed as accumulated surplus.

### **Unsupported adjustment processed**

11. A transfer of R3, 004 million was credited to accumulated surplus for which no audit evidence was made available to support the transaction. The comparative amounts in the statement of changes in net assets were omitted. As a result the financial statements do not meet the requirements of SA Standards of GRAP 1 *Presentation of Financial Statements* relating to the presentation of comparative information. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that accumulated surplus was accurately recorded.

## **Electricity Sales**

### **Prior year qualification item**

12. During the prior year the municipality could not provide sufficient appropriate audit evidence to support a journal entry of R1, 909 million relating to the reversal on electricity sales. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the reversal was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence and accuracy of the electric sales reversal of R1, 909 million.

## **Unspent Conditional grants**

### **Debit amounts included in Municipal Infrastructure Grant balances**

13. The municipality could not provide sufficient appropriate audit evidence to support debit balances for the Municipal Infrastructure Grants amounting to R5, 415 million that is included in Note 13. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that unspent conditional grants had been accurately recorded.

## **Trade and other receivables**

14. The municipality could not provide sufficient appropriate evidence supporting the existence of debtors totaling R5, 727 million as disclosed in note 2 to the financial statements. It was also noted that R713 897 million of the debtors total relates to prepayments from debtors and is a negative amount that should be classified as creditors. As a result trade and other receivables is misstated. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that trade debtors disclosed exist and are accurately recorded.

## **Provision for bad debts**

15. An impairment loss has not been recognised in accordance with South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133), *Financial instruments: Recognition and measurement*. The prior year allowance for doubtful debts was not adjusted to account for current year irrecoverable and long outstanding debtors balances. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of provision for bad debts.

## **Trade and other payables**

16. Trade and other payables of R 51 486 million as disclosed in note 9 to the financial statements does not agree to the underlying accounting records. The municipality did not reconcile the difference of R2, 453 million between the financial statements and the underlying accounting records. Furthermore, an adjustment of R5,211 million was made to trade and other payables for which no supporting audit evidence was made available. In addition the municipality could not provide sufficient appropriate audit evidence to support credit balances for trade creditors amounting to R11, 772 million that is included in note 9. There were no satisfactory alternative audit procedures that I could perform to obtain

reasonable assurance that trade creditors exist and had been accurately recorded. Consequently I could not satisfy myself as to the existence and valuation of the trade and other payables balance in the financial statements.

### **Investment Property**

17. SA Standard of GRAP 16, *Investment property*, requires property held to earn rentals or for capital appreciation to be recognised as investment property. Rentals on the lease of property amounting to R167 446 had been earned for the year, however, the related properties had been included as property, plant and equipment. This resulted in investment property being understated and property, plant and equipment being overstated. The amount cannot be quantified due to lack of information provided. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of investment property.

### **Bulk purchases**

18. Bulk purchases as disclosed in note 26 to the financial statements does not include an amount of R3, 242 million that was not recorded in the financial systems of the municipality. This has resulted in bulk purchases and trade payables being understated by R3, 242 million.

### **Grant expenditure**

19. An adjustment of R2, 101 million was debited to grant expenditure for which no audit evidence was made available. This resulted in grant expenditure of R22 929 million as disclosed in note 28 to the financial statements being overstated and accumulated surplus being understated by R2, 101 million. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all grant expenditure was properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of grant expenditure.

### **General expenditure**

20. General expenditure of R14 634 million as disclosed in note 29 to the financial statements does not include an amount of R20, 828 million which was incorrectly classified as grant expenditure in the financial statements. The reason for this is still being investigated and therefore no explanations were provided for audit purposes.

### **Interest earned**

21. A difference of R1, 324 million exists between interest earned disclosed in note 19 to the financial statements and the investment register. The municipality did not reconcile this difference between the financial statements and the underlying accounting records. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that interest earned had been properly recorded. Interest earned is therefore overstated by R1, 324 million.

### **Irregular expenditure**

22. Payments amounting to R3,236 million were made in contravention of the requirements of the municipal supply chain management regulations. This has resulted in irregular expenditure being incurred and has not been disclosed in the financial statements. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure.

### **Fruitless and wasteful expenditure**

23. The municipality incurred fruitless and wasteful expenditure of R1, 086 million due to the following: Interest on late payment of accounts (R1, 036 million) and Vehicle damages (R50, 638). This was not disclosed in note 30.2 of the financial statements.

### **Commitments**

24. Commitments amounting to R58, 415 million has not been disclosed in note 38 to the financial statements. This results in commitments being understated. Consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments.

### **Cash Flow Statement**

25. Presentation of a cash flow statement, summarising the municipality's operating, investing and financing activities, is required by SA Standard of GRAP 2, *Cash flow statements*. The cash flow statement included in the financial statements of the municipality did not contain any amounts to be audited. The municipality therefore did not comply with the requirements of paragraph 8 of GRAP 1, *Presentation of Financial Statements* and GRAP 2.

### **Adverse audit opinion**

26. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the uMkhanyakude District Municipality as at 30 June 2011 and its financial performance and its cash flows for the year then ended in accordance with the SA Standards of GRAP and in the manner required by the MFMA and DORA.

### **Additional matters**

27. I draw attention to the matters below. My opinion is not modified in respect of these matters:

### **Material inconsistencies in other information included in the annual report**

28. The municipality did not make available the draft annual report that will include the financial statements and performance on predetermined objectives. As a result it could not be determined if there are any inconsistencies in the related information.

### **Unaudited supplementary schedules**

29. The supplementary information set out on pages xx to xx 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.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

30. In accordance with the PAA and in terms of *General Notice No. 1111 of 2010*, issued in *Government Gazette No. 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

### **Predetermined objectives**

#### **Presentation of information**

31. The following criterion is relevant to the finding below:

- Performance against predetermined objectives is reported using the National Treasury Guidelines.

The following audit finding relates to the above criterion:

32. Measures taken to improve performance were not provided in the performance report, as required in terms of section 46 (1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total 54% of the reported targets where improvements are required was not explained.

### **Usefulness of information**

33. The following criteria are relevant to the findings below:

- Measurability: Indicators are well defined and verifiable, and targets are specific, measurable and time bound.
- Relevance: A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets?
- Consistency: Objectives, indicators and targets are consistent between planning and reporting documents.

The following audit findings relate to the above criteria:

34. Reported performance against predetermined indicators is not consistent with the approved integrated development plan. In total 78% of all reported targets specified in the annual performance report were not included in the Integrated Development Plan IDP submitted for audit purposes.

35. Additional indicators were reported on as opposed to those approved in the IDP. These additional objectives, indicators and targets were not included in the approved or adjusted budgets.

36. For the objectives, basic service delivery and infrastructure development and financial viability and management, 26% of the planned and reported indicators were not clear, as unambiguous data definitions were not available to allow for data to be collected consistently

37. For the objectives, basic service delivery and infrastructure development and financial viability and management, valid performance management processes and systems that produce actual performance against the planned indicators do not exist for 100% of the indicators.

### **Reliability of information**

38. The following criteria are relevant to the findings below:

- Validity: Actual reported performance occurred and pertains to the entity.
- Accuracy: Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have been included in the annual performance report.

The following audit finding relates to the above criteria:

39. The municipality did not provide supporting documentation to audit the reliability of the information recorded in the annual performance report.

### **Compliance with laws and regulations**

#### **Annual financial statements, performance and annual reports**

40. The municipality did not comply with section 122(1)(a) of the MFMA as they did not produce a set of financial statements that fairly presented the state of affairs of the municipality. The financial statements that were submitted for audit were subjected to adjustments due to material misstatements identified during the audit.

### **Strategic Planning and Performance Management**

41. In contravention of section 53(1) (c) (ii) of MFMA, the service delivery and budget implementation plan was not approved by the Mayor within 28 days of the approval of the budget.
42. The annual performance report and internal management reports did not accurately reflect the progress achieved for all of the targets set for the year as required by Section 46(1).
43. Contrary to the Local Government: Municipal Planning and Performance Management Regulation 15(3), the municipality did not make its key performance indicators known to the general public.

### **Procurement and Contract Management**

44. In contravention of the requirements of section 62(1) (e) of the MFMA, it was noted that there are no disciplinary policies and procedures for contravention of the Supply Chain Management Policy.

45. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) & (c).
46. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a) and 36(1).
47. Awards were made to bidders who did not declare whether they or any person connected with them is employed by the state or if they were a legal person whether they have a relationship with persons/a person involved in the evaluation and/or adjudication of the bids as per the requirements of SCM Regulation 13(c).
48. There was no evidence that deviations from SCM regulations amounting to R150 295 had been reported to council or that they were disclosed in the Annual Financial Statements, in contravention of SCM Regulation 36(2).

#### **Internal Audit**

49. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act, in that:
  - Internal audit did not prepare a risk-based audit plan and an internal audit programme for the financial year under review;
  - Internal audit reports were submitted in draft format.

#### **Audit Committee**

50. Contrary to the requirements of section 166 of the MFMA, the municipality did not have an audit committee in operation for the full financial year as the members were only appointed in the last two months before financial year end.

#### **Expenditure Management**

51. The accounting officer did not take reasonable steps to prevent or detect irregular expenditure, as required by section 62(1) (d) of the MFMA.
52. The municipality failed to meet its financial commitments to an organ of state, in terms of Section 37(1) (c), as no payments were made during the year under review.

#### **Asset Management**

53. Contrary to the requirements of section 96 of the MSA, the municipality has not implemented a debt collection policy and has not taken steps to collect the monies due by the consumers which has resulted in consumer accounts receivables increasing by R27,823 million compared to the prior year.
54. Distributions losses are not monitored on a monthly basis as required by section 62(1) (d) of the MFMA. As a result the municipality has not reported on such distribution losses.



## **INTERNAL CONTROL**

55. In accordance with the PAA and in terms of *General Notice No. 1111 of 2010*, issued in *Government Gazette No. 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

56. The accounting officer does not exercise oversight responsibility over financial and performance reporting and compliance with related internal control.
57. The accounting officer did not develop and monitor the implementation of a corrective action plan to address the prior year internal control deficiencies.

### **Financial and performance management**

58. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting. Monthly and annual reconciliations and reviews of information are not done timely. The financial statements and performance information were subject to material amendments resulting from the audit.
59. There was a lack of review and monitoring of compliance with applicable laws and regulations.

### **Governance**

60. The accounting officer did not ensure that a risk assessment was conducted. In addition the accounting officer failed to develop and implement a fraud prevention plan.
61. The audit committee and internal auditors did not fulfil their responsibilities as set out in legislation and in accordance with accepted best practice.

Pietermaritzburg

30 November 2011



**AUDITOR - GENERAL**  
**SOUTH AFRICA**

*Auditing to build public confidence*