

REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON UGU DISTRICT MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Ugu District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

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) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is 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. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. 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.

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

Basis for qualified opinion

Property, plant and equipment

6. As disclosed in note 31 to the annual financial statements, depreciation amounted to R52,4 million and as disclosed in note 10 accumulated depreciation amounted to R1 billion for property plant and equipment. The municipality calculated depreciation by dividing the carry amount by the remaining useful life of each asset. However, the calculation of depreciation for the current year was incorrectly calculated since accumulated depreciation was incorrectly calculated in the prior year. Therefore I could not perform any alternative audit procedures to verify the accuracy of depreciation. Consequently, I was unable to obtain reasonable assurance on the accuracy of the property plant and equipment.

Payables

7. As disclosed in note 16 to the financial statements, the municipality had accrued for the staff leave provision amounting to R11,9 million. The salary system report generated by management to calculate the provision for staff leave did not provide sufficient detail for me to perform alternative audit procedures to verify the accuracy of the amount disclosed in the annual financial statements. Consequently, I was unable to obtain reasonable assurance with regard to the valuation of the provision for staff leave.

Revenue from exchange transaction

8. As disclosed in note 25 to the annual financial statements, the municipality disclosed revenue for service charges of R297 million. Various errors were detected relating to the billing of customers, accuracy of meter readings and the estimation of revenue on a month-to-month basis. The municipality could not provide sufficient appropriate audit evidence to substantiate the value disclosed in order to perform alternative audit procedure to verify the accuracy of revenue. Consequently, I was unable to obtain reasonable assurance with regard to the accuracy, completeness and occurrence of service charge revenue and the valuation, completeness and existence of receivables.

Opinion

9. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ugu District Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Significant uncertainties

11. With reference to note 52 to the financial statements, the municipality is the defendant in 13 lawsuits amounting to R30,3 million. The ultimate outcome of the matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

12. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an errors discovered during 2012 in the financial statements of the Ugu District Municipality at, and for the year ended, 30 June 2011.

Financial sustainability

13. Although the municipality has prepared financial statements on a going concern basis, there are indicators reflected in note 58 to the financial statements that suggest that the financial sustainability of the municipality is under threat due to the current liabilities exceeding current assets and unspent conditional grants not being cash-backed. Management has adopted a plan of action, setting out clear targets to ensure that the municipality continues to operate as a going concern for the foreseeable future.

Material losses

14. As disclosed in note 37.1 to the financial statements, material losses to the amount of R18 million were incurred as a result of water losses.

Material impairment losses

15. As disclosed in note 4 to the financial statements, provision for impairment to the amount of R117 million was raised on the collection of receivables.

Unauthorised expenditure

16. As disclosed in note 46.1 to the financial statements, unauthorised expenditure of R45,2 million was incurred as a result of expenditure exceeding approved budget for operating expenditure.

Irregular expenditure

17. As disclosed in note 46.3 to the financial statements, irregular expenditure totalling R18,4 million was incurred as a result of contraventions of the Local Government: Municipal Supply Chain Management Regulations (MSCMR)

Additional matters

18. 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

19. I have not obtained all other information included in the annual report for my review and therefore have not been able to identify any material inconsistencies with the financial statements.

Unaudited supplementary schedules

20. The supplementary information set out on pages XX to XX do 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

21. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

22. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
23. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*. The reliability of the information in respect of the selected objective is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

24. The material findings are as follows :

Usefulness of information

Presentation

25. Measures taken to improve performance are required to be disclosed in the annual performance report of municipalities as per section 46 of the Municipal Systems Act No. 32 of 2000 (MSA). Improvement measures in the annual performance report for a total of 41% of the planned targets not achieved were not disclosed as required by section 46 of the MSA. This was due to not all indicators being reported in an annual report as per annual plan.
26. Section 46 of the MSA requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. At least 63% of measures taken to improve performance were not supported by adequate and reliable corroborating evidence. This was due to the performance manager not evaluating the measures against the supporting documents.

Consistency

27. Section 41(c) of the MSA requires that the integrated development plan/service delivery budget implementation plan should form the basis for the annual performance report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 48% of objectives, 61% of indicators and 61% of targets reported in the integrated development plan were inconsistent with the objectives/indicators/targets as per the approved annual performance plan. The root cause of the inconsistency is due to inadequate review of the report before submission.

Measurability

28. The National Treasury *Framework for managing programme performance information* (FMPPPI) requires that it must be possible to validate the processes and systems that produce the indicator. A total of 63% of the indicators/measures were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection and verification of actual performance information.

Reliability

29. The National Treasury FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 66% of the actual reported performance relevant to the local development programme was not accurately reported on based on supporting documentation. This was due to a lack of monitoring operating procedures for the recording of actual achievements.
30. The National Treasury FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 66% of the actual reported performance for the selected indicators as stipulated was not completely recorded. This was due to a lack of documented management system with regard to actual performance achievements.

Additional matters

31. I draw attention to the matters below. My conclusion is not modified in respect of these matters.

Achievement of planned targets

32. Of the total number of planned targets, 44 targets were not achieved during the year under review. This represents 27% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that budget constraints were not taken into account when developing indicators.

Material adjustments to the annual performance report

33. Material audit adjustments in the annual performance report were identified during the audit, of which 35.7% were corrected by management and those that were not corrected have been reported on accordingly.

Compliance with laws and regulations

34. I performed procedures to obtain evidence that the municipality had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the *General Notice* issued in terms of the PAA, are as follows:

Strategic planning and performance management

35. The integrated development plan did not include the key performance indicators and performance targets set in accordance with its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (MPPMR).
36. The accounting officer did not prepare and include an assessment of performance against any measurable performance objectives set in terms of the service delivery agreement or other agreement between the entity and its parent municipality, as required by section 46 of the MSA, read with section 121(4)(d) of the MFMA.

Annual financial statements

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of disclosure and expenditure identified by the auditors were subsequently corrected. However, the material misstatement of capital assets, current liabilities and revenue identified by the auditors were not adequately corrected, resulting in the financial statements receiving a qualified audit opinion.

Procurement and contract management

38. Awards were made to providers who are persons in service of other state institutions, in contravention of the requirements of MSCMR 44. Furthermore, the providers failed to declare that they were in the service of the state, as required by MSCMR 13(c).
39. Payments were made in excess of the award resulting in non-compliance with section 116 of the MFMA.

Expenditure management

40. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
41. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Assets

42. The accounting officer did not take all reasonable steps to ensure that the municipality's assets are valued in accordance with SA Standards of GRAP, as required by section 63(2)(b) of the MFMA.

Internal control

43. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

44. The accounting officer did not exercise adequate oversight responsibility over compliance with laws and regulations relating to procurement and contract management and reported performance information.

Financial and performance management

45. Systems and controls were not designed in a manner to prevent, detect and address risks that impact on financial, performance and compliance reporting. In this regard, the accounting officer did not ensure that regular, accurate and complete financial and performance reports were prepared, which were supported and evidenced by reliable information. This resulted in material misstatements in the financial statements and annual performance report.

Auditor-General

Pietermaritzburg

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence