

REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND 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 2014, the statement of financial performance, statement of changes in net assets, the cash flow statement and the statement of comparison of budget information with actual information 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, 2013 (Act No. 2 of 2013) (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. I was unable to obtain sufficient appropriate evidence that management has accounted for all property plant and equipment, depreciation and accumulated depreciation for the current year, as the municipality did not maintain adequate records for assets. I was unable to confirm the carrying value, depreciation and accumulated depreciation by alternative means. Consequently, I was unable to determine whether any adjustment relating to depreciation of property plant and equipment stated at R2,24 billion (2013: R2 billion) in note 10 to the financial statements were appropriate.
7. The municipality recognised land that had not transferred to the municipality in accordance with GRAP 17, *Property Plant and Equipment*. Consequently property plant and equipment is overstated by R182,82 million in the current and prior years.

Revenue and Receivables from exchange transactions – Service Charges

8. I was unable to obtain sufficient appropriate audit evidence that management had properly charged and accounted for all service charges for the current and prior year, due to the status of the accounting records. I was unable to confirm the service charges and receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R 312,78 million (2013: R 276,53 million) and receivables from exchange transactions stated as R132,75 million (2013: R 101,54 million) in the financial statements was necessary.

Value Added Tax (VAT) Receivable

9. The municipality did not recognise all undeclared output VAT from receivables from exchange transactions where services have been provided in accordance with GRAP 9, *Revenue from Exchange Transactions*. The municipality has not recognised undeclared VAT output for service debtors. Consequently the VAT receivable is understated by R13,0 million. Additionally there is consequential impact on provision for doubtful debt, the surplus in the current period end and accumulated surplus.

Interest earned

10. The municipality did not discount the service debtors in accordance with GRAP 104, *Financial Instruments*. The discounting of service debtors was calculated on an incorrect basis. Consequently the service debtors are overstated by R24,22 million and impairment is understated by R42,99 million. Additionally there is consequential impact on the surplus in the period and accumulated surplus.

Capital commitments

11. The municipality did not recognise other disclosures relating to unrecognised contractual commitments in accordance with GRAP 1, *Presentation of Financial Statements*. Further I was unable to obtain sufficient appropriate audit evidence for capital commitments for restated comparative amounts due to inadequate reconciliations. I was unable to confirm the capital commitments by alternative means. Consequently I was unable to determine whether any adjustments to capital commitments stated at R483,40 million (2013: R301,04 million) as disclosed in note 46 to the financial statements was necessary.

Cash flow statement

12. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed for net cash flow from operating activities due to the inconsistencies in amounts when compared to the statement of financial position and performance. I was unable to confirm the net cash flow from operating activities by alternative means. Consequently, I was unable to determine whether any adjustments to the net cash flow from operating activities stated at R421,20 million (2013: R209,52 million) on the cash flow statements were necessary.

Qualified opinion

13. 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 2014 and their 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

14. I draw attention to the matters below.

Significant uncertainties

15. With reference to note 49 to the financial statements, the municipality is the defendant in 12 lawsuits amounting to R24,3 million. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

16. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an errors discovered during 2013/14 in the financial statements of the Ugu District Municipality at, and for the year ended, 30 June 2013.

Material losses

17. As disclosed in note 36 to the financial statements, material losses to the amount of R20,3 million (8,999,979 kl) were incurred as a result of water losses due to water leakages, tampering and faulty meters and illegal connections.

Unauthorised expenditure

18. As disclosed in note 41 to the financial statements, unauthorised expenditure of R40,06 million (2013:R10,83 million) was incurred as a result of expenditure exceeding approved budget for operating expenditure.

Irregular expenditure

19. As disclosed in note 43 to the financial statements, irregular expenditure amounting to R166,17 million (2013:R65,54 million) was incurred as a result of proper procurement processes not followed.

Fruitless and wasteful expenditure

20. As disclosed in note 42 to the financial statements, fruitless and wasteful expenditure of R2,69 million was incurred as a result of interest charges on late payments.

Additional matters

21. I draw attention to the matters below.

Unaudited supplementary schedules

22. 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

Unaudited disclosure notes

23. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

24. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Development Priority 3: Basic Service Delivery on pages x to x

26. I evaluated the reported performance information against the overall criteria of usefulness and



reliability.

27. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected development priority are as follows:

Basic service delivery

Usefulness of reported performance information

Measurability of indicators and targets

30. The FMPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

31. The measurability of planned targets and indicators could not be assessed due to lack of proper systems and processes and/or formal standard operating procedures or documented system descriptions. The portfolio of evidence maintained by management does not allow for verification of targets.

Reliability of reported performance information

Validity, accuracy and completeness

32. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the municipality not providing sufficient appropriate evidence in support of the reported performance information and the municipality's records not permitting the application of alternative audit procedures.

Additional matters

33. I draw attention to the following matters below. These matters do not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

34. Refer to the annual performance report on page(s) x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected priority reported in paragraphs 30 to 32 of this report.

Unaudited supplementary information

35. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not express a conclusion thereon.

Compliance with legislation

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

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 of the MFMA. Material misstatements of non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

38. Awards were made to providers who are in the service of other state institutions, in contravention of MFMA 112(j) and Supply Chain Management (SCM) regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

39. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).

40. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

42. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset Management

43. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Revenue Management

44. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

45. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

46. Accounts for service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.

Budget Management

47. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Internal control

48. 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 opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

49. The leadership and management did not effectively exercise oversight over policies and procedures regarding, annual financial statements, procurement and contract management, expenditure management, asset management, revenue management and budget management.

Financial and performance management

50. Management did not implement controls over the preparation, review and reconciliation of the financial statements and performance information.

51. Systems and controls were not designed in a manner to prevent, detect and address risks that impact on financial and performance management and compliance reporting. In this regard management did not ensure regular, accurate and complete financial and performance reports.

Governance

52. The outcome of the risk assessment was not adequate as it did not factor the actual risks of the municipality that resulted in the prior year audit issues. The reviews conducted by internal audit could not assist the municipality to resolve audit report issues identified in the prior year due to slow response by management in implementing internal audit recommendations.

OTHER REPORTS

Investigations

53. Internal audit is currently performing investigations for allegations of mismanagement, SCM and MFMA contravention, fruitless expenditure and theft at the request of management at the municipality. Nineteen investigations are still in progress.

Pietermaritzburg

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

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