

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the uMkhanyakude District Municipality set out on pages xx to xx, 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, 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 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

Revenue and Receivable from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence that management had properly charged and accounted for all service charge revenue due to inadequate internal controls in the billing and estimation thereof. I was unable to confirm the service charge revenue by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R43, 57 million in note 16 and the related receivables from exchange transactions stated at R13,57 million in note 3 to the financial statements were necessary.

Other Receivables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence for other receivables from exchange transactions due to the lack of supporting documentation in respect of agreements to support the amount recorded. I was unable to conduct alternative procedures to verify this amount. Consequently I was unable to determine whether any adjustment relating to receivables from exchange transactions stated at R2, 50 million disclosed in note 4 to the financial statements was necessary.

Water and electricity losses

8. I was unable to obtain sufficient appropriate audit evidence for the R36, 21 million (2013: R25, 12million), and R9, 33 million (2013: R3, 39 million) disclosed as water and electricity losses respectively in note 45 to the financial statements due to inadequate systems and processes for the recording and monitoring of these losses. There were no satisfactory alternative audit procedures that I could perform in this regard. Consequently, I was unable to determine whether any adjustment relating to the water and electricity losses stated at R36, 21 million (2013: R25, 12million), and R9, 33 million (2013: R3, 39 million) disclosed in note 45 to the financial statements was necessary.

Inventory

9. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for water pipe inventory, due to the status of the accounting records. I was unable to confirm the inventory by alternative means. Consequently, I was unable to determine whether any adjustment to inventory stated at R86, 84 million disclosed in note 2 to the financial statements was necessary.

Provision for leave

10. I was unable to obtain sufficient appropriate audit evidence that the provision for leave pay included all leave days taken by employees due to the municipality not having adequate procedures and systems in place to maintain records of leave. I was unable to confirm the provision for leave pay by alternative means. Consequently, I was unable to determine whether any adjustment to the provision for leave pay stated at R10, 07 million in note 10 to the financial statements was necessary.

Payables from exchange transactions

11. I was unable to obtain sufficient appropriate audit evidence that management had fully accounted for all payables from exchange transactions due to the lack of supporting documentation for the prior years' payables, as a result of a fire, which destroyed these records, stated at R5, 21 million (2013: R16, 98 million) as disclosed in note 39 to the financial statements. I was unable to confirm the payables by alternative means. Consequently, I was

unable to determine whether any adjustment to payables from exchange transactions stated at R86, 09 million (2013: R29, 09 million.) disclosed in note 10 to the financial statements was necessary.

Qualified opinion

12. In my opinion, except for the possible 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 uMkhanyakude District Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Going concern

14. As disclosed in note 48 to the financial statements the municipality has unspent conditional grants of R21, 85 million during the year ended 30 June 2014, which are not adequately cashed back, and as of that date, the municipality's current liabilities exceeded its total assets by R15, 11 million. These conditions, along with other matters as disclosed in note 48, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Restatement of corresponding figures

15. As disclosed in note 33 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 30 June 2014 in the financial statements of the uMkhanyakude District Municipality at, and for the year ended, 30 June 2013.

Unauthorised expenditure

16. As disclosed in note 34 to the financial statements, the municipality incurred unauthorised expenditure of R51, 34 million in the 2013/2014 financial year as a result of overspending of the approved budget.

Irregular expenditure

17. As disclosed in note 36 to the financial statements, the municipality incurred irregular expenditure of R556, 24 million in the 2013/2014 financial year as a result of proper supply chain management processes not being followed.

Additional matters

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

Unaudited supplementary schedules

19. 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

20. 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

21. 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 objectives 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

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

Objective 1: To provide access to quality, affordable and quality municipal service and to provide free basic service on pages 2 of 4

Objective 2: To provide free basic service on pages 2 of 4

Objective 3: Regular investment in infrastructure in order to improve on operations and maintenance pages 2 of 4

23. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
24. 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 objectives. 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 (FMPPPI)*.
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. The material findings in respect of the selected objectives are as follows:

To improve access to quality, affordable and reliable municipal services, To provide free basic service, and Regular investment in infrastructure in order to improve on operations and maintenance.

Usefulness of reported performance information

Measurability of indicators and targets

Performance indicators not well defined

27. The FMPPPI requires that 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. All of the indicators were not well defined. This was because management was not aware of and therefore did not adhere to the requirements of the FMPPPI due to a lack of proper systems and processes.

Reliability of reported performance information

Validity, accuracy and completeness

28. 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. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to a lack of frequent review of the validity of reported achievements against source documentation. There were also a lack communication and coordination between the different departments within the municipality to ensure accurate information is reported for the performance targets.

Additional matter

29. 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

30. Refer to the annual performance report on page 2 of 4 for information on the achievement of 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 objectives reported in paragraphs 26-27 of this report.

Unaudited supplementary information

31. The supplementary information set out on pages XX to XX 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

32. I performed procedures to obtain evidence that the municipality has complied with applicable legislation 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

33. The performance of Umhlozinga Development Agency against the agreed performance objectives and indicators was not monitored and annually reviewed, as part of the annual budget process, as required by section 93B(b) of the Municipal System Act of South Africa, 2000, (Act No. 32 of 2000) (MSA).

34. The annual performance report for the year under review did not include a comparison of the performance with set targets and a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1) (b) and (c) of the MSA.

Budget

35. 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.

Annual financial statements

36. 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 identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

Audit committee

37. A performance audit committee was not in place, as required by section 166(1) of the MFMA.
38. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
39. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
40. The audit committee did not review the municipality's performance management system or make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
41. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
42. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
43. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

44. The internal audit unit did not function as required by section 165(2) of the MFMA, in that, it did not report to the audit committee on the implementation of the internal plan and it did not report to the audit committee on matters relating to internal audit and internal controls accounting procedures and practices.

Procurement and contract management

45. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of supply chain management (SCM) regulation 36(1).
46. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
47. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of section 112(j) of MFMA and SCM regulation 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).

48. A list of accredited prospective providers was not in place for procuring goods and services through quotations as required by SCM regulation 14(1)(a).
49. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
50. Contracts and quotations were awarded to providers whose tax matters had not been declared to be in order, as required by SCM regulation 43.
51. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
52. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
53. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA

Human resource management

54. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of MSA.

Revenue management

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

Internal control

56. 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

57. Leadership did not exercise adequate oversight responsibility regarding financial and performance reporting and compliance with laws and regulations.

Financial and performance management

58. 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 management did not ensure that regular, accurate and complete financial and performance reports were prepared, which were supported and evidenced by reliable information.

Governance

59. The internal audit and audit committee did not promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations.

OTHER REPORTS

Investigations

60. A total of six investigations have been completed during the year in respect of procurement fraud, SCM irregularities identified and cash stolen in the bank. Disciplinary hearings have been initiated against employees. These investigations have been reported to the South African Police Service.
61. Two investigations are in progress in respect of procurement and SCM compliance, financial misconduct, the documents burnt in the fire and in respect of irregular recruitment processes.

Pietermaritzburg

28 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence