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AUDITOR - GENERAL
SOUTH AFRICA

**King Sabata Dalindyebo
Municipality
Audit Report**

For the year ended 30 June 2015



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting Officer
King Sabata Dalindyebo Local Municipality
Munitata Building
Sutherland Street
Mthatha
5099

30 November 2015

Reference: 60081REG14/15

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of King Sabata Dalindyebo Local Municipality for the year ended 30 June 2015

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when

preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



Dereck Ollsson: ECBU ELO2

Enquiries:	Grant Howard
Telephone:	(043) 709 7200
Fax:	(043) 709 7300
Email:	granth@agsa.co.za

Report of the auditor-general to the Eastern Cape provincial legislature and the council on the King Sabata Dalindyebo Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the King Sabata Dalindyebo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as 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 these financial statements in accordance with 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, 2014 (Act No. 10 of 2014) (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 these financial statements based on my audit. I conducted my audit in accordance with 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 of qualified opinion

Receivables from exchange and non-exchange transactions

6. I was unable to assess the estimates and assumptions used in the computation of the impairment allowance on receivables from exchange and non-exchange transactions respectively due to unexplained discrepancies between the schedules provided for auditing and the underlying records that support the financial statements. Consequently I was unable to determine whether any adjustments were necessary to the R164,1 million (2013-14: R144 million) and R117,7 million (2013-14: R112,1 million) recognised as the impairment allowance on receivables from exchange and non-exchange transactions respectively, as disclosed in notes 8 and 9 to the financial statements, as well as the debt impairment allowance of R25,6 million (2013-14: R42,1 million) as disclosed in note 34 to the financial statements.

Contingencies

7. The municipality did not have adequate systems in place to identify and disclose all contingencies in the financial statements. Adequate supporting documentation was not provided to support the amount disclosed. I was unable to confirm these values by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the contingencies of R55,1 million (2013-14: R24,2 million) as disclosed in note 44 to the financial statements.

Commitments

8. An adequate record of commitments was not maintained and reviewed for accuracy by the municipality for the year under review. The commitments schedules prepared were found to have numerous deficiencies as commitment invoices were duplicated and incorrectly recorded inclusive of VAT. Consequently, commitments as disclosed in note 43 to the financial statements is understated by R41,9 million.
9. During 2013-14, I was unable to determine whether any adjustments were necessary to the corresponding commitments figure of R292,3 million disclosed in note 43 to the financial statements. During the year under review management was unable to provide supporting documents for this amount. Consequently, I was unable to determine whether any further adjustments were necessary to the amounts disclosed in note 43. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of possible effects of this matter on the comparability of the current period's figures.

Distribution losses

10. I was unable to obtain sufficient appropriate audit evidence for distribution losses relating to electricity. It was not possible to confirm the additional disclosure by alternative means. Consequently, I was unable to determine if any adjustments were required to the loss disclosed in note 50 to the financial statements.

Irregular expenditure

11. During 2013-14 the municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. I was unable to obtain sufficient appropriate evidence for irregular expenditure disclosed in the prior year and to confirm the irregular expenditure by alternative means. Consequently, due to the impact of this on the opening and closing balances in the current year, I was unable to determine whether any further adjustments were necessary to the amount of R497,9 million (2013-14: R365,7 million) as disclosed in note 49 to the financial statements.

Unauthorised expenditure

12. During 2013-14 the municipality did not have adequate systems in place to identify all unauthorised expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. I was unable to obtain sufficient appropriate evidence for unauthorised expenditure disclosed in the prior year and to confirm the unauthorised expenditure by alternative means. Consequently, due to the impact of this on the opening and closing balances in the current year, I was unable to determine whether any further adjustments were necessary to the amount of R497,2 million (2013-14: R354,4 million) as disclosed in note 47 to the financial statements.

Revenue

13. During 2013-14 I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements and for which I was unable to obtain sufficient appropriate audit evidence:
 - Revenue from exchange transactions of R326,2 million as disclosed in the statement of financial performance.
 - Revenue from non-exchange transactions of R575 million as disclosed in the statement of financial performance.
14. Consequently, I was unable to determine whether any further adjustments were necessary to the amounts disclosed in the statement of financial performance. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of possible effects of these matters on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements

15. The financial statements are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements:

Cumulatively and as disclosed in the statement of financial performance:

- Revenue is understated by R16,7 million (2013-14: R4,8 million)
- Expenditure is overstated by R11 million (2013-14: understated by R14,7 million)

Cumulatively and as disclosed in the statement of financial position:

- Current assets are overstated by R16,7 million (2013-14: R6,7 million)
- Non-current assets are understated by R11 million (2013-14: R5,6 million)

16. In addition, I was unable to obtain sufficient appropriate audit evidence due to individually immaterial amounts that were unsubstantiated and I was unable to confirm by alternative means, or determine whether adjustments were required to:
- Interest received revenue for the current figures as per note 24 and as disclosed in the statement of financial performance;
 - Property, plant and equipment for the current and corresponding figures as per note 4 and as disclosed in the statement of financial position; and
 - Inventories as per note 7 disclosed in the statement of financial position.

Qualified opinion

17. 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 King Sabata Dalindyebo Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Fruitless and wasteful expenditure

19. As disclosed in note 48 to the financial statements, fruitless and wasteful expenditure amounting to R4,7 million (2013-14: R7,2 million) was incurred by the municipality during the year ended 30 June 2015.

Restatement of corresponding figures

20. As disclosed in note 46 to the financial statements, the comparative figures for 30 June 2015 have been restated due to the reclassification of finance and operating leases, property, plant and equipment and the recalculation of depreciation.

Additional matter

21. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary information

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 this schedule and, accordingly, I do not express an opinion thereon.

Unaudited disclosure note

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 Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and 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 2015:

- Development priority 8: Infrastructure on pages xx to xx

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:

Development priority: Infrastructure

Usefulness of reported performance information

30. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the Integrated Development Plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. In total, 33% of the reported objectives were not consistent with those in the approved IDP. In total, 39% of the reported indicators were not consistent with those in the approved IDP. In total, 28% of the reported targets were not consistent with those in the approved IDP. This was due to:

- A lack of a formally documented performance management system,

- A lack of controls to ensure that the planned development priority/objectives per the IDP were aligned with the service delivery budget and integrated plan (SDBIP) and annual performance report, and
 - A lack of controls to ensure that the key performance indicators as per the SDBIP were aligned with the key performance indicators in the annual performance report.
31. Performance targets were not specific in clearly identifying the nature and required level of performance, were not measurable, and the period or deadline for delivery of targets was not specified, as required by the FMPPI.
32. Performance indicators were not clearly defined so that data could be collected consistently and was easy to understand and use. Performance indicators were also not verifiable.
33. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes, formal standard operating procedures and documented system descriptions.

Reliability of reported performance information

34. 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 limitations placed on the scope of my work due to the absence of information systems, the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information, the auditee's records which did not permit the application of alternative audit procedures and the fact that the auditee did not ensure that there were registers in place to monitor the progress of the reported targets.

Additional matter

35. I draw attention to the following matter:

Achievement of planned targets

36. Refer to the annual performance report on pages XX to XX for information on the achievement of planned targets for the year. This information should be considered in the context of the findings on the usefulness and reliability of the reported performance information in paragraphs 29 to 34 of this report.

Compliance with legislation

37. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on 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

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
39. Material misstatements of non-current assets, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified opinion.

Expenditure management

40. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
41. Reasonable steps were not taken to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

42. An adequate management, accounting and information system which accounted for assets was not in place, as required by section 63(2)(a) of the MFMA.
43. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Audit committee

44. An audit committee was not in place for most of the year, as required by section 166(1) of the MFMA.

Internal audit

45. 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 audit plan.
 - it did not advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, and loss control.

Consequence management

46. Unauthorised, irregular, and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Human resource management

47. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
48. 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.
49. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
50. The competencies of the senior managers were not assessed in a timely manner in order to identify and address gaps in competency levels as required by Municipal Regulations on Minimum Competency Levels, 2007 (Government Gazette 29967 of 2007) (MRMCL) 13.
51. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the MRMCL 14(2)(a).
52. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the MRMCL 14(2)(b).
53. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.
54. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Procurement and contract management

55. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
56. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

Strategic planning and performance management

57. Sufficient appropriate evidence could not be obtained that:
 - The municipality established a performance management system, as required by section 38(a) of the MSA.
 - Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
 - The performance management system and related controls were in place and represented the processes of performance planning, monitoring, measurement,

review, reporting, improvement and how they were conducted, organised and managed, including determining the roles of the different role-players, as required by section 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

- The SDBIP was submitted to National Treasury, as required by section 54(1)(c) of the MFMA and Regulation 27(2)(b) of the Municipal budget and reporting regulations GN 393 of 2009.
- The performance agreement for the municipal manager was linked to the measurable performance objectives approved with the budget and to the SDBIP, as required by section 57(1)(b) of the MSA and section 53(1)(c)(iii)(bb) of the MFMA.

Internal control

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

Leadership

59. The lack of stability in critical positions has contributed to leadership not providing sufficient oversight with regard to the implementation and monitoring of internal controls.
60. There have been no consequences for wrongdoers of prior-year supply chain management transgressions and there is no evidence that leadership has followed up or investigated these officials. The lack of appropriate action against officials undermines a culture of accountability. Leadership's inability to address and prioritise this critical area had a direct bearing on the number of compliance findings reported.
61. Management established a formal code of conduct which addressed appropriate ethical and moral behaviour, but the code was not communicated to all staff. The municipality did not produce monthly reports on performance information and compliance that were reviewed by the accounting officer.
62. The slow response in addressing prior-year audit findings and the lack of skills and competencies have contributed to a weak control environment resulting in repeat findings in the financial statements, performance reporting and compliance-related findings.

Financial and performance management

63. Non-compliance with legislation as reported above could have been prevented had compliance been properly reviewed and monitored. The financial statements contained material misstatements, this was mainly due to staff members not preparing and reviewing monthly financial statements. The municipality still had to appoint consultants for the preparation of financial statements due to a shortage or lack of in-house skills and competencies. A proper strategy was not adopted to fill vacant positions and to ensure that the necessary skills transfer from the consultants to employees took place.

64. The accounting officer did not develop and implement effective daily and monthly financial management disciplines and performance management systems that promote transparent, accurate and credible financial information and performance reports.

Governance

65. Action was not taken by the governance structures in the municipality during the year under review to ensure that risks relating to the monitoring and reporting of financial and performance information as well as the achievement of performance objectives were addressed.
66. The internal control deficiencies identified during prior-year external audits and by internal audit with recommended actions were not addressed by management during the period. The audit committee was not constituted for most of the financial year and did not report to council on the performance management system or on compliance with legislation during the period, with the result that limited assurance was provided to the mayor and the council as to the functioning of internal controls at the municipality and the credibility of information produced by the service delivery departments during the current year. Consequence management and recourse taken by oversight mechanisms to address this lack of accountability and poor performance within the municipality was not improved during the year.
67. Furthermore, capacitating the oversight structures with the required resources, skills and competence to ensure stability at that level is critical for effective governance to be achieved, which can then hold management accountable for achieving the financial and performance objectives of the municipality.

AUDITOR-GENERAL

East London

30 November 2015



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Auditing to build public confidence