

King Sabata Dalindyebo Municipality

Audit Report

For the year ended 30 June 2016

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the King Sabata Dalindyebo Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2016, 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.

The 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, 2015 (Act No. 1 of 2015) (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 entity'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 entity'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 audit opinion.

Basis of qualified opinion

Irregular expenditure

6. During 2014-15 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 R599,4 million (2014-15: R497,9 million) as disclosed in note 51 to the financial statements.

Unauthorised expenditure

7. During 2014-15 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 R509,9 million (2014-15: R497,2 million) as disclosed in note 49 to the financial statements.

Qualified opinion

8. 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 2016 and 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

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

Significant uncertainty

10. As disclosed in note 46 to the financial statements, the municipality is the defendant in a number of lawsuits. The municipality is opposing the claims and the ultimate outcome of the matters cannot presently be determined and no provision for any liabilities that may result has been made in the financial statements.

Material losses and impairments

11. As disclosed in note 52 to the financial statements, material losses to the amount of R47,4 million (2014-15: R29,3 million) were incurred as a result of distribution losses in the provision of electricity. In addition, material debt impairments of R220,4 million (2014-15: R175,8 million) and R184,9 million (2014-15: R147,7 million) on receivables from exchange and non-exchange transactions respectively were disclosed in note 4 and 5 to the financial statements. These arose from the poor expected recoverability of trade debtors.

Fruitless and wasteful expenditure

12. As disclosed in note 50 to the financial statements, fruitless and wasteful expenditure amounting to R5,3 million (2014-15: R4,7 million) was incurred by the municipality during the year ended 30 June 2016.

Restatement of corresponding figures

13. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of prior year misstatements corrected in the current year.

Additional matters

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

Unaudited disclosure note

15. 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

16. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected programmes 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

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected programmes presented in the annual performance report of the King Sabata Dalindyebo for the year ended 30 June 2016:
- Programme 7: Human Settlements on pages x to x
 - Programme 8: Infrastructure on pages x to x
18. 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 programmes. 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).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected development programmes are as follows:

Programme: Human Settlements

Usefulness of reported performance information

21. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance. A total of 25% of performance targets were not specific.

Reliability of reported performance information

22. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 45% of performance indicators were not reliable when compared to the evidence provided.

Programme: Infrastructure

Usefulness of reported performance information

23. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance. A total of 36% of performance targets were not specific.

24. The FMPPI requires that performance targets should be measurable. A total of 24% of targets were not measurable.
25. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 56% of indicators were not well defined.

Reliability of reported performance information

26. FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 29% of performance indicators were not reliable when compared to the evidence provided.

Additional matter

27. I draw attention to the following matter:

Achievement of planned targets

28. Refer to the annual performance report on pages x to x for Infrastructure; pages x to x for Human Settlement 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 in paragraphs 21 to 26 of this report.

Compliance with legislation

29. 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 report and annual financial statements

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA as material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and/or the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.
31. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.

Strategic planning and performance management

32. The performance management system was not adopted by council as required by section 38(a) of the MSA or regulation 8 of the MPPMR.

Human resource management and compensation

33. 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 Municipal Systems Act, 2000 (Act No. 32 of 2000).

Consequence management

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

Expenditure management

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

Internal control

37. I considered internal control relevant to my audit of the financial 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 qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

38. The lack of stability in critical positions during the financial period has contributed to leadership not providing sufficient oversight with regard to the implementation and monitoring of internal control.
39. There have been no consequences for prior year supply chain management transgressions and there is no evidence that leadership has followed up or investigated the transgressions of these officials. The lack of appropriate action against officials undermines a culture of accountability. Leadership's inability to finalise investigations and take action by prioritising this critical area has a direct bearing on the number of compliance findings reported.
40. 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.
41. 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

42. 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 and lack of in-house skills and competencies. A proper strategy was not adopted to fill vacant positions and ensure that the necessary skills transfer from the consultants to employees took place.
43. 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

44. 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.
45. 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. Consequence management and recourse taken by oversight mechanisms to address this lack of accountability and poor performance within the municipality has not improved during the year.
46. Furthermore, capacitating the internal audit unit, audit committee and MPAC 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 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence