



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Auditor-General of South Africa

uMkhanyakude District
Municipality-audit report 2015-16

Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the Council on uMkhanyakude District Municipality

Report on the financial statements

Introduction

1. I audited the financial statements of the uMkhanyakude District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, statement of changes in cash flows and the statement of comparison of budget and 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 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, 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 the financial statements based on my audit. I conducted my audit in accordance with the 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 adverse audit opinion.

Basis for adverse of opinion

Property, plant and equipment

6. The municipality did not recognise all items of property, plant and equipment in accordance with GRAP 17 *Property, plant and equipment*. Completed assets were recognised as assets under construction and were not depreciated. I was unable to determine the impact of this misstatement as it was impractical for me to do so. In addition, assets under construction and movable tangible assets could not be verified. I was unable to confirm these assets by alternative means. Consequently, I was unable to determine whether any further adjustment to property, plant and equipment stated at R1,66 billion in note 8 to the financial statements was necessary.

Revenue, receivables from exchange transactions, other receivables from exchange transactions and VAT receivable

7. The municipality did not account for revenue from exchange transactions in accordance with GRAP 9 *Revenue from exchange transactions* due to inadequate internal controls in the billing and estimation thereof. I was therefore unable to determine the resultant impact of this misstatement on service charges revenue, receivables from exchange transactions, the surplus for the period and accumulated surplus as it was impractical to do so. Consequently, I was unable to determine whether any adjustment to service charges stated at R23,33 million (2015: R32,56 million) in note 16 and the related receivables from exchange transactions stated at R74,98 million (2015: R79,95 million) in note 4 to the financial statements was necessary.
8. I was unable to obtain sufficient appropriate audit evidence for other receivables from exchange transactions due to the status of accounting records. I was unable to confirm this amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to other receivables from exchange transactions stated at R3,76 million (2015: R1,35 million) as disclosed in note 5 to the financial statements was necessary.
9. The municipality did not recognise value-added taxation (VAT) on the accrual basis of accounting, as required by GRAP 1 *Presentation of financial statements*. I was unable to determine the full extent of the misstatement of VAT receivable stated at R45,74 million (2015: R18,06 million) in note 6 of the financial statements, as it was impracticable to do so. Additionally, there was a resultant impact on the accumulated surplus.

Expenditure – Prior year unresolved misstatement

10. I was unable to obtain sufficient appropriate audit evidence related to prior year expenditure due to the status of accounting records. I was unable to confirm the prior year expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to expenditure stated at R404,87 million in the financial statements comparatives figure was necessary.

Irregular expenditure

11. The municipality made payments in contravention of the supply chain management (SCM) legislation that were not included in irregular expenditure of R237,31 million (2015: R164,65 million) disclosed in note 35 to the financial statements. Adequate systems and controls were not in place to ensure that all irregular expenditure was accounted for. I was not able to determine the full extent of the irregular expenditure as it was impracticable to do so.

Water and electricity losses

12. I was unable to obtain sufficient appropriate audit evidence for the R17,75 million (2015: R36,56 million), and R7,78 million (2015: R6,1 million) disclosed as water and electricity losses, respectively in note 44 to the financial statements. This was due to inadequate systems and processes for the recording and monitoring of these losses. I could not confirm the disclosed losses through alternative means. Consequently, I was unable to determine whether any adjustment relating to the water and electricity losses disclosed in note 44 to the financial statements was necessary.

Statement of changes in cash flows

13. The municipality did not prepare the statement of cash flows in accordance with GRAP 2 *Cash flow statements*. This was due to errors in the reconciliation of cash generated from operations disclosed in note 30 to the financial statements. I was not able to determine the full extent of the errors in the cash generated from operations stated at R246,49 million, as it was impracticable to do so. Consequently, I was unable to determine whether any adjustment to the cash generated from operations stated at R246,49 million (2015: R53,75 million) in the financial statements was necessary.

Adverse opinion

14. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the uMkhanyakude District Municipality as at 30 June 2016 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

15. I draw attention to the matters below.

Material losses

16. As disclosed in note 36 to the financial statements, material losses of R27,43 million were incurred as a result of inventory losses written off.

Financial sustainability

17. As disclosed in note 46 to the financial statements, the municipality's current liabilities exceeded its current assets (excluding inventory) by R125,55 million (2015: R147,93 million).

million) and the municipality was not able to pay creditors when they became due. The inability to obtain additional funding as well as the increase in the receivables impairment allowance to 65% of receivables indicates the existence of material uncertainties that may cast significant doubt on the municipality's ability to operate in the foreseeable future.

Additional matter

18. I draw attention to the matter below.

Unaudited disclosure notes

19. 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

20. 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 objectives 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

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the basic service delivery and infrastructure investment objective presented in the annual performance report of the municipality for the year ended 30 June 2016.

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

23. I evaluated the usefulness of the reported performance information to determine whether it 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).

24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

25. The material findings in respect of the selected objective is as follows:

Basic service delivery and infrastructure investment

Usefulness of reported performance information

Measurability of indicators and targets

26. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance and be measurable. A total of 40% of targets were not specific and measurable.

27. 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 40% of indicators were not well defined.

28. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 20% of indicators were not verifiable.

Reliability of reported performance information

29. The FMPPI requires the municipality 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 performance information was not reliable when compared to the source information.

Additional matter

30. I draw attention to the following matter.

Achievement of planned targets

31. The annual performance report on pages x to x; x to x which includes information on the achievement of planned targets for the year should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 26 to 29 of this report.

Compliance with legislation

32. 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:

Strategic planning and performance management

33. The key performance indicators (KPIs) set by the municipality did not include indicators on percentage of households with access to a basic level of water, sanitation, electricity and solid waste removal as required by section 43(2) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000)(MSA) and Municipal Planning and Performance Management Regulation 10(a).

34. The performance of uMhlosinga Development Agency against the agreed performance

objectives and indicators was not monitored and annually reviewed by the municipality for the 2015-16, as required by section 93B(b) of the MSA.

Consequence management

35. Unauthorised 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) of the MFMA.
36. 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)(b) of the MFMA.
37. The accounting officer did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) of the MFMA.

Human resource management

38. 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

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

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, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

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

Annual financial statements

43. The annual 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 current assets, current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving an adverse audit opinion.

Procurement and contract management

44. 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 SCM regulation 36(1).
45. I could not obtain sufficient appropriate audit evidence that contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as certain tender documents were not provided for audit.
46. I could not obtain sufficient appropriate audit evidence that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

Internal control

47. 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 adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

48. The leadership did not exercise adequate oversight responsibility regarding financial and performance reporting and compliance with laws and regulations. Leadership did not ensure that employees had a good understanding of policies and procedures, therefore preventing the effective implementation thereof. The leadership was also slow to respond to key control deficiencies highlighted in action plans.

Financial and performance management

49. Management did not ensure that regular, accurate and complete financial and performance reports were prepared, which were supported and evidenced by reliable information, and daily controls were not always performed. Regular implementation and monitoring of controls designed to prevent, detect and address risks that impact on financial, performance and compliance reporting did not occur.

Governance

50. Regular risk assessments did not take place and the audit committee did not meet regularly.

Other reports

51. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that have been completed.

Investigations

52. Two investigations performed by a private firm, at the request of the council relating to the conduct of two senior officials at the municipality were completed during the year. The outcome of these investigations resulted in the dismissal of one senior official and a settlement agreement was reached with the other senior official.

Auditor General

Pietermaritzburg

30 November 2016



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