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**AUDITOR - GENERAL  
SOUTH AFRICA**

# **Sundays River Valley Municipality**

## **Audit Report**

For the year ended 30 June 2017

# Report of the auditor-general to Eastern Cape Provincial Legislature and the council Sundays River Valley local Municipality

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Sundays River Valley Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2017 and 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 to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effects of the matters described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Sundays River Valley Municipality as at 30 June 2017, 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.

### Basis for qualified opinion

#### Irregular expenditure

3. I was unable to obtain sufficient appropriate audit evidence regarding the irregular expenditure as disclosed on note 37 to the financial statements, as the disclosure was presented in the financial statements for auditing purposes without accurate and complete underlying accounting records. I was unable to audit the disclosure in the financial statements by alternative means. Consequently, I was unable to determine whether any adjustments to the irregular expenditure of R216,5 million (2015: R183,4 million) as disclosed in note 37 to the financial statements was necessary.

#### Revenue from exchange transactions

4. The municipality recognised items that did not meet the definition of revenue in accordance with GRAP 9, *Revenue from exchange transactions*, and also did not measure revenue at the fair value of the consideration received or receivable, as required by the standard. Consequently, service charges revenue was overstated by R7,1 million and other receivables was overstated by the same amount.
5. My 2015-16 report contained a modification relating to revenue from exchange transactions because I was unable to obtain sufficient appropriate evidence that revenue from exchange transactions were properly accounted for. Management did not correct the matters giving rise to the modification. As a result, I was again unable to obtain sufficient appropriate audit evidence that the corresponding figure for revenue from exchange transactions was adequately supported. I was unable to confirm this corresponding figure by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the corresponding figure for revenue from

exchange transactions disclosed at R45,1 million in the statement of financial performance.

#### Receivables from exchange and non-exchange transactions

6. Sufficient and appropriate audit evidence was not available to support receivables from non-exchange transactions and receivables from exchange transactions. This was due to a lack of systems and processes in place at the municipality. I was unable to confirm these balances by alternative means. Consequently, I was unable to determine whether any adjustments were required to receivables from non-exchange transactions and receivables from exchange transactions disclosed at R26,1 million (2016: R16,9 million) and R24,6 million (2016: R19,8 million) in the statement of financial position and note 4 and 5 to the financial statements respectively, provision for impairments of non-exchange and exchange receivables of R39,9 million (2016: R15, 8 million) and R148,7 million (2016: R150,4 million) disclosed in note 4 and 5 respectively, impairment expense of R22,2 million (2016: R11,1 million) and interest on receivables of R10,3 million disclosed in the statement of financial performance.

#### Value added tax (VAT) Payable

7. A journal to the value of R7,6 million was processed during the year under review to the VAT payable control account and accumulated surplus account in the general ledger. This journal was not supported by adequate documentation. As a result, I could not obtain sufficient appropriate evidence to confirm that this journal was correctly processed. I was unable to obtain the required evidence by alternative means. Consequently, I was unable to determine whether any adjustments were required to the VAT payable disclosed in the statement of financial position and note 13 at R3,8 million (2016: R1,9 million) and the accumulated surplus of R578 million (2016: R563,7 million) disclosed in the statement of changes in net assets and statement of financial position.

#### Corresponding figures

8. I was unable to obtain sufficient appropriate evidence for the elements below included in the 2015-16 financial statements. During the current year I was again not provided with the evidence required to substantiate these transactions and disclosures. I was unable to substantiate these transactions and disclosures by alternative means and as a result was unable to determine whether any adjustments were required to the following:
  - Revenue from non-exchange transactions of R141,5 million as disclosed in the statement of financial performance.
  - General expenditure of R42,7 million as disclosed in note 30

#### Context for the opinion

9. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
10. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa.

I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

11. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

12. I draw attention to the matters below.

### **Unauthorised expenditure**

13. As disclosed in note 36 to the financial statements, unauthorised expenditure amounting to R44,3 million (2015-16: R13,5 million) was incurred due to supply chain management transgressions that occurred in the current and prior financial years. The cumulative balance as at 30 June 2017 amounted to R94.4 million.

### **Fruitless and wasteful expenditure**

14. As disclosed in note 38 to the financial statements, fruitless and wasteful expenditure to the amount of R4 million (2015-16: R1,5 million) was incurred, due to interest charged for late payments, water and electricity losses above the norm.

### **Restatement of corresponding figures**

15. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors only corrected during the year ended 30 June 2017 that existed in the financial statements at, and for the year ended 30 June 2016.

### **Material losses**

16. As disclosed in note 43 to the financial statements electricity and water losses to the amount of R2,9 million (2015-16: R2,3 million) and R884 054 (2016-15: R275 536) respectively, were incurred. This was due to lack of processes and controls to prevent losses effectively

### **Impairment**

17. As disclosed in note 26 to the financial statements, impairment to the amount of R 22,3 million (2015-16: R11,2 million) was incurred as a result of irrecoverable trade debtors. This is due to poor debt collection processes.

### **Other matter**

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

### **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 this legislation. This disclosure requirement did not

form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

### **Responsibilities of the Accounting Officer**

20. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA standards of GRAP and the requirements of the MFMA and 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.
21. In preparing the financial statements, the accounting officer is responsible for assessing the Sundays River Valley Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

22. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
23. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

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 material findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report (APR). I performed procedures to identify findings but not to gather evidence to express assurance.
25. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

26. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2017:

| <b>Key Performance Areas</b>                          | <b>Pages in the annual performance report</b> |
|---|---|
| Basic Service Delivery and Infrastructure Development | x – x   |
| Local Economic Development                            | x – x   |

27. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

28. The material findings in respect of the usefulness and reliability of the selected objectives are as follows:

### **Basic Service Delivery and Infrastructure Development**

**Indicator: The percentage of households with earnings less than R1,100 per month with access to free basic services**

29. The source information, evidence and method of calculation for the achievement of the planned indicator were not clearly defined, as required by the Framework for Managing Programme Performance Information (FMPPI).

**Strategic objective: To ensure that the poor households access free basic services and that each household has access to a set of basic household services**

30. The strategic objective as approved on the amended service delivery and budget implementation plan (SDBIP) is not consistent with the strategic objective on the APR. This is not in line with the requirements of section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

31. The planned targets as listed in the table below; were not reported in the annual performance report, as required by section 41(c) of MSA:

| <b>Indicator</b>  | <b>Target per SDBIP</b> |
|---|-------------------------|
| The percentage of households with access to basic level of water, sanitation, electricity and solid waste removal | 70%                     |
| The percentage of households with earnings less than R1,100 per month with access to free basic services          | 80%                     |

32. The municipality did not implement adequate systems and processes to collect, collate and accurately record information relating to planned and actual performance. As a result, the reported achievements of the indicators detailed in the table below are misstated:



| Performance indicator                 | Reported achievement  | Audited value   |
|---------------------------------------|---|---|
| Kms of road in Moses Mabida surfaced  | Taxi loop: 0.370 kms<br>Moses Mabida entrance road: 1.17km surfaced | Taxi loop: 0<br>Moses Mabida entrance road 0.79205 km |
| Number of sport field turfs completed | 1   | 4   |

33. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of the indicators as per the table below. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of the following indicators:

| Performance indicator   | Reported achievement  |
|---|---|
| Kms of gravel road upgraded   | 1km - Paterson entrance road.<br>0.8km - Moses Mabida entrance<br>1.3km - Valencia storm water phase 2    |
| The percentage of households with access to basic level of water, sanitation, electricity and solid waste removal | Over 90%  |
| The percentage of households with earnings less than R1,100 per month with access to free basic services          | 100%  |
| % availability of water services to the consumers   | 84.4%   |
| Turnaround time in repairing non-functional area lights   | Municipality takes more than 5 days to repair area lights   |
| % compliance with NERSA assessment (D-form)   | 70%   |
| KMs of storm water pipes installed  | 0.32 km of storm-water pipes installed in Emsengeni<br>1.3 km storm water pipelines installed in Valencia |

## Local Economic Development

### Indicator: Number of jobs created through municipality's local economic development initiatives including capital projects

34. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 280 jobs created. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 718 jobs created.

### Indicator: Number of development initiatives conducted

35. The reported achievement for target of 8 development initiatives conducted was misstated as the evidence provided indicated 9 development initiatives, conducted and not 19 as reported.



## **Other matter**

36. I draw attention to the matter below.

## **Achievement of planned targets**

37. Refer to the annual performance report on pages xx for information on the achievement of planned targets for the year and explanations provided for the under achievement of a number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 36 of this report.

## **Report on audit of compliance with legislation**

### **Introduction and scope**

38. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

39. The material findings on compliance with specific matters in key legislations are as follows:

### **Annual Financial Statements and annual report**

40. 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.

41. The 2015-16 annual report was not published for the local community to submit representations in connection with the annual report, as required by section 127(5)(a) of the MFMA

42. The oversight report adopted by the council on the 2015-16 annual report was not made public, as required by section 129(3) of the MFMA.

### **Consequence management**

43. Unauthorised, irregular, 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)(a) of the Municipal Finance Management Act.

44. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act.

45. 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)(b) of the Municipal Finance Management Act.

## **Expenditure Management**

46. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph.
47. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R4 million, as disclosed in note 38 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.
48. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

## **Revenue Management**

49. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
50. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Conditional Grants**

51. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant, as required by section 12(5) of the Division of Revenue Act.
52. The municipality did not evaluate its performance in respect of programmes or functions funded by the Integrated National Electrification Programme, as required by section 12(5) of the Division of Revenue Act.

## **Procurement**

53. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
54. Some of the 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). Similar non-compliance was also reported in the prior year.

## **HR Management**

55. I was unable to obtain sufficient appropriate audit evidence that job descriptions were established for all posts in which appointments were made, as required by section 66(1)(b) of MSA.

## **Budgets**

56. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R44, 4 million as disclosed in note 36 to the annual financial statements, in contravention

of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by inadequate budgeting as the depreciation and impairment of receivables were not adequately budgeted for.

### Other information

57. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected objectives presented in the annual performance report that have been specifically reported on in the auditor's report.
58. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
59. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
60. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

### Internal control deficiencies

61. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. 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 has not implemented processes and controls to ensure compliance with laws and regulations, specifically in the area of supply chain management. In addition management has responded slowly in terms of addressing consequence management as the cases of unauthorised, irregular and fruitless and wasteful expenditure reported in the previous year have not been investigated.
  - Management did not design and implement daily and monthly financial controls in order to ensure the financial statements and annual performance reports are supported by accurate and complete underlying records.
  - Although the internal audit and audit committee executed their legislative mandate during the financial year under review, the municipality had recurring material findings on the annual financial statements, annual performance report and compliance. This

was as a result of leadership not responding adequately to recommendations made by the internal audit unit as well as the audit committee.

*Auditor-General*

East London

30 November 2017



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SOUTH AFRICA

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## Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

### Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:
  - Identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
  - Obtain an understanding of internal control relevant to the audit 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.
  - Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - Conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Sundays River Valley Local Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
  - Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.