

Auditor-General of South Africa

Umzinyathi District Municipality

Audit report 2019-20

Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the council on the Umzinyathi District Municipality

Report on the audit of the financial statements

Disclaimer of opinion

1. I was engaged to audit the financial statements of the Umzinyathi District Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2020, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment due to the status of the accounting records. I was unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment stated at R2,25 billion (2018-19: 2,09 billion) in note 9 to the financial statements.

Receivable from exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions due to the status of the accounting records. I could not confirm the receivables from exchange transactions by alternative means. In addition, the municipality did not calculate the provision for impairment of debtors in accordance with the South African Standard of Generally Recognised Accounting Practice (SA Standard of GRAP) 104, *Financial Instruments*. The municipality applied a uniform rate in calculating the impairment provision without considering objective indicators of impairment as well as risk profiling of the debtors. Consequently, I was unable to determine whether any further adjustment was necessary to the net carrying amount of receivables stated at R111,36 million (2018-19: R84,14 million) in note 6 to the financial statements.

Receivables from non-exchange transactions

5. The municipality did not assess at the end of each reporting period whether there was any objective evidence that the receivables from non-exchange transactions were impaired, as required by SA Standard of GRAP 104, *Financial Instruments*. Consequently, the net carrying amount of receivables from non-exchange transaction stated at R9,77 million in note 4 to the financial statements was overstated and bad debt expenditure understated by R8,65 million, respectively. There was a resultant impact on the reported surplus for the period and on the accumulated surplus.

Prior-year adjustments

6. I was unable to obtain sufficient appropriate audit evidence for the corrections of prior period errors relating to inventories, receivables from exchange transactions, property, plant and equipment, trade and other payables and the accumulated surplus due to the status of accounting records. I was unable to confirm these corrections by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the previous period errors stated at R377,12 million in note 40 to the financial statements.

Trade payables

7. I was unable to obtain sufficient appropriate audit evidence for trade payables due to the status of the accounting records, I was unable to confirm the trade payables by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to trade payables stated at R251,83 million in note 14 to the financial statements.

Finance lease obligation

8. I was unable to obtain sufficient appropriate audit evidence for the finance lease obligation due to the status of the accounting records. I was unable to confirm the finance lease obligation by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the finance lease obligation stated at R22,23 million in note 13 and the related finance cost stated at R6,39 million in note 30 to the financial statements.

Service charges

9. I was unable to obtain sufficient appropriate audit evidence for service charges due to the status of the accounting records. I was unable to confirm service charges by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to service charges stated at R82,15 million (2018-19: R70,85 million) in note 21 to the financial statements.

Other income

10. Other income was not properly accounted for as required by SA Standard of GRAP 23, *Revenue from non-exchange transactions*. Assets donated to the municipality were not recorded at fair value, as required. Consequently, I was unable to determine whether any further adjustments were necessary to other income and property, plant and equipment as it was impracticable to do so.

General expenditure

11. I was unable to obtain sufficient appropriate audit evidence for general expenditure due to the status of accounting records. I was unable to confirm general expenses by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to general expenditure stated at R171,69 million (2018-19: R161,61 million) in note 37 to the financial statements.

Contracted services

12. I was unable to obtain sufficient appropriate audit evidence for contracted services due to the status of accounting records. I was unable to confirm contracted services by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to contracted services stated at R135,42 million (2018-19: R104,63 million) in note 36 to the financial statements.

Bad debts written-off

13. During 2019, I was unable to obtain sufficient appropriate audit evidence for bad debts written-off due to the status of accounting records. I was unable to confirm bad debts written-off by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to bad debts written-off stated at R93,55 million in note 34 to the financial statements. My audit opinion on the financial statements for the period ended 30 June 2019 was modified accordingly. My opinion on the current year financial statements is also modified because of the possible effect of this matter on the comparability of the bad debts written-off for the current period.

Net cash flows from operating activities

14. The municipality did not correctly prepare and disclose the net cash flows from operating activities for the current and previous years, as required by SA Standard of GRAP 2, *Cash flow statements*. This was due to multiple errors in determining cash flows from operating activities. I was unable to determine the full extent of the errors in the net cash flows from operating activities, as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustments to net cash flows from operating activities stated at R220,21 million (2018-19: R217,66 million) in the financial statements were necessary.

Net cash flows from investing activities

15. The municipality did not correctly prepare and disclose the net cash flows from investing activities, as required by Standard of GRAP 2, *Cash flow statements*. This was due to multiple errors in determining cash flows from investing activities. I was unable able to determine the full extent of the errors in the net cash flows from investing activities, as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustments to net cash flows from investing activities stated at R262,95 million in the financial statements were necessary.

Irregular expenditure

16. I was unable to obtain sufficient appropriate audit evidence as the municipality did not have adequate internal controls to maintain records of transactions for irregular expenditure written-off. I was unable to confirm the irregular expenditure written-off by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to irregular expenditure stated at R1,39 billion in note 45 to the financial statements.

Unauthorised expenditure

17. The municipality omitted to disclose unauthorised expenditure that had been incurred during the year, as required by section 125(2)(d)(i) of the MFMA. I was unable to determine the extent of the unauthorised expenditure, as it was impracticable to do so.

Water distribution losses

18. I was unable to obtain sufficient appropriate audit evidence for water distribution losses for due to the status of the accounting records. I was unable to confirm water distribution losses by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to water distribution losses stated at R23,79 million (2018-19: R26,18 million) in note 47 to the financial statements.

Contingent liabilities

19. During 2019, I was unable to obtain sufficient appropriate audit evidence for contingent liabilities due to the status of accounting records. I was unable to confirm contingent liabilities by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to contingent liabilities stated at R86,48 million in note 53.2 to the financial statements. My audit opinion on the financial statements for the period ended 30 June 2019 was modified accordingly. My opinion on the current year financial statements is also modified because of the possible effect of this matter on the comparability of the contingent liabilities for the current period.

Material uncertainty relating to financial viability

20. I draw attention to the matter below. My opinion is not modified in respect of this matter.
21. As disclosed in note 56 to the financial statements, the adverse liquidity risks, low debt collection levels, as well as the implications of Covid-19 places significant pressure on the financial viability of the municipality. These conditions indicate that a material uncertainty exists that may cast significant doubt on the ability of the municipality to manage cash flows and settle future debts that become due.

Other matter

22. I draw attention to the matter below.

Unaudited disclosure note

23. In terms of section 125(2)(e) of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the financial statements

24. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and the Division of Revenue Act of South Africa, 2019 (Act No. 16 of 2019) (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.
25. In preparing the financial statements, the accounting officer is responsible for assessing the 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 appropriate governance structure either 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

26. My responsibility is to conduct an audit of the financial statements in accordance with the International Standards on Auditing and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.
27. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code), as well as the other ethical requirements that relevant to my audit of the financial statements in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

Introduction and scope

28. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report on the usefulness and reliability of the reported performance information against predetermined objectives for the selected key performance area presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.
29. My procedures address the usefulness and reliability of the reported performance information, which must be based on the municipality's approved performance planning documents. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures do not examine whether the actions taken by the municipality enabled service delivery. My procedures also do not extend to any disclosures or assertions relating to the 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.
30. 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 selected key performance area (KPA), KPA 2 – basic service delivery and infrastructure development, presented in the municipality's annual performance report on pages x to x for the year ended 30 June 2020.
31. I performed procedures to determine whether the reported performance information was properly presented and whether performance 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.
32. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

Key performance area (KPA) 2 – Basic service delivery and infrastructure development

Various indicators

33. Two planned indicators in the approved organisational scorecard, were not reported upon in the annual performance report. In this regard, the municipality removed the following indicators during their mid-year review:

Indicator description	Target
KPI 2.7 Number of water treatment works operations and maintenance undertaken	13

Indicator description	Target
KPI 2.8 Number of waste water treatment works operations and maintenance undertaken	5

KPI 2.1: Total number of water and sanitation projects under construction

34. The achievement of 28 for “KPI 2.1: Total number of water and sanitation projects under construction” was reported against the target of 36 in the annual performance report. However, the supporting evidence provided materially differed from the reported achievement.

Other matters

35. I draw attention to the matters below.

Achievement of planned targets

36. The annual performance report on pages xx to xx sets out 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 in paragraphs 33 to 34 of this report.

Adjustment of material misstatements

37. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the basic service delivery and infrastructure development key performance area. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the 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 municipality’s compliance 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 legislation are as follows:

Annual financial statements

40. The annual financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of related parties, commitments, the investment in associate, the employee benefit obligation and the long term liability identified by the auditors in the submitted annual financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the annual financial statements receiving a disclaimer of audit opinion.

Expenditure management

41. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The extent of the unauthorised expenditure was not disclosed by the municipality and could not be quantified as indicated in the basis for disclaimer of opinion paragraph.

42. Reasonable steps were not taken to prevent irregular expenditure of R298,37 million, as disclosed in note 45 to the annual financial statements, 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 disclaimer of opinion paragraph.

43. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R4,29 million, as disclosed in note 43 to the annual financial statements, as required by section 62(1)(d) of the MFMA.

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

45. Unforeseen and unavoidable expenditure incurred by the municipality was not approved by the mayor, as required by section 29(1) of the MFMA.

Revenue management

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

47. Interest was not charged on accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

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

Conditional grants

49. The Municipal Infrastructure Grant was not spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of Dora.

50. Performance in respect of programmes funded by the Municipal Infrastructure Grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of Dora.

Consequence management

51. Unauthorised 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 MFMA.
52. Some of the irregular 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 MFMA.
53. 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 MFMA.

Procurement and contract management

54. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted in an unbiased manner and allowed all potential suppliers to offer their goods or services, as required by supply chain management (SCM) regulation 27(2)(a).
55. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2). Similar non-compliance was also reported in the prior year.
56. Some of the competitive bids were adjudicated by a bid adjudication committee that was not duly composed, as required by SCM regulation 29(2).
57. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
58. Some of the prices of the goods or services were not reasonable, as required by section 62(1)(a) of the MFMA.
59. In some instances, sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract, as required by section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
60. Some of the bid documentation for procurement of commodities designated for local content and production, did not stipulated the minimum threshold for local production and content, as required by regulation 8(2) of the 2017 preferential procurement regulations.

61. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
62. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
63. Awards were made to providers whose directors were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44.

Other information

64. 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 and the selected development key performance area presented in the annual performance report that has been specifically reported in this auditor's report.
65. 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.
66. 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 key performance area presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
67. As a result of the disclaimer of opinion expressed on the financial statements, I do not conclude on material misstatements of the other information relating to the financial statements. If, based on the work I have performed relating to the audit of performance information and compliance with legislation, I conclude that there is a material misstatement of this other information, I am required to report that fact.
68. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, and 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

69. 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 on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
70. Leadership did not set the tone at the top and drive a culture of accountability, commitment to competence, along with effective and independent assurance and oversight over the operations of the municipality. Although policies and procedures were in place, these were not designed, implemented, maintained and monitored with vigour by management and leadership. As a result, risks and action plans to address these were not managed effectively, in that officials failed to diligently execute key control activities such as proper and complete record keeping, reconciliations and supervisory checks over daily operations. This contributed towards unreliable reporting of financial and performance information coupled with a repetitive breakdown on compliance matters and was exacerbated by a lack of consequence management.

Material irregularities

71. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

Material irregularity in progress

72. I identified a material irregularity during the audit and notified the accounting officer of this, as required by material irregularity regulation 3(2). By the date of this auditor's report, the response of the accounting officer was not yet due. This material irregularity will be included in the next year's auditor's report.

Other reports

73. I draw attention to the following engagements conducted which had, or could have, an impact on the matters reported on the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters.

Investigations

74. An investigation was conducted by an independent consulting firm, on behalf of the Department of Cooperative Governance and Traditional Affairs. The investigation covered the period 1 July 2015 to 30 June 2017 and related to expenditure for boreholes and debt collection that was not supported by adequate documentary evidence. The final report was tabled to council during the year and the recommendations of the investigation are currently being implemented.

75. An investigation covering the period 1 July 2014 to 30 June 2018 was conducted by an independent consulting firm on supply chain management irregularities relating to the construction of the disaster management centre. The final report on the outcome of the investigation was tabled to council during the year and the recommendations of the investigation are currently being implemented.

Pietermaritzburg

23 April 2021



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence