

REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON UPHONGOLO MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the uPhongolo Municipality set out on pages 3 to 45 which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, statement of changes in net assets and cash flows for the year then ended, and 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, 2011 (Act No. 6 of 2011) (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 conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. An amount of R1,172 million included in the property, plant and equipment balance disclosed in note 3 to the financial statements could not be reconciled to the fixed asset register. Certain assets included in the fixed asset register could not be physically verified and certain movable assets physically verified could not be traced to the fixed asset register. There was no evidence provided to support the useful life of all assets had been assessed, as required by SA Standards of GRAP, GRAP 17 *Property, plant and equipment*. I was unable to quantify the effect of this misstatement due to lack of supporting documentation. There were no alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence; therefore, I could not satisfy myself as to the rights, existence, valuation and completeness of the property, plant and equipment disclosed to the financial statements.

Restatement of corresponding figures

5. As disclosed in note 3 to the financial statements, the corresponding figure for prior year property, plant and equipment was reclassified by an amount of R9,481 million and restated by R6,740 million, due to correction of adjustments. The municipality has not provided the effect of this restatement in note 32. Sufficient and appropriate documentation could not be provided to support this. There were no alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence, I could

not satisfy myself as to the existence, valuation and completeness of and rights to property, plant and equipment as disclosed in the financial statements.

Statement of changes in net assets

6. The municipality did not provide sufficient appropriate audit evidence to support the validity of the additional amount of R3,249 million in the restated balances as at 30 June 2010 in the Statement of changes in net assets. There was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, valuation and obligation of the restated prior year adjustments.

Loss on sale on disposal of fixed asset

7. As disclosed in statement of financial performance, municipality has incurred a loss on disposal of fixed assets amounting to R1,333 million. However the amount has been overstated by R1,010 million and there was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, occurrence and accuracy on amount disclosed.

Commitments

8. The municipality could not provide sufficient appropriate audit evidence to support journals processed for an amount of R31,657 million. The municipality did not have adequate processes and proper record management systems in place to identify commitments and provide appropriate assurance that the entire population had been appropriately reviewed and that the total misstatement had been identified and adjusted accordingly. There were no satisfactory alternative audit procedures that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness and valuation of and obligations pertaining to the amount disclosed in note 31 to the annual financial statements.

Revenue

9. The municipality did not provide an updated agreement to support the rental of golf club lease stated at R1, which is below market rate. This has resulted in an estimated loss of income of R1,569 million per annum, based on the tariff structure of the municipality. The amount cannot be accurately quantified due to a lack of information provided. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of revenue received from investment property.

Value-added tax

10. As disclosed in note 37 of the annual financial statements, the municipality has value-added tax (VAT) payable amounting to R4,528 million. However, as the municipality did not maintain proper and complete records, schedules and documentation to support the VAT amount, I could not perform alternative procedures to obtain reasonable assurance on the completeness and valuation of and obligations pertaining of VAT.

Unauthorised expenditure

11. The municipality incurred unauthorised expenditure of R10,796 million due to actual exceeding budgeted expenditure for employee costs, councillor remuneration, finance charges, material and bulk purchases and other expenditure. However, this

misstatement was not adequately disclosed in note 33 to the annual financial statements and, consequently, I could not obtain reasonable assurance of the completeness and valuation of unauthorised expenditure disclosed.

Irregular expenditure

12. I could not satisfy myself as to the completeness of irregular expenditure amounting to R7,694 million disclosed in note 35 to the financial statements as the misstatements that were identified during the audit were not adequately adjusted and no appropriate evidence was provided that the entire population had been evaluated.

Trade and other payables

13. I was unable to satisfy myself as to the completeness and valuation of trade and other payables amounting to R7,524 million as disclosed in note 17 to the financial statements as the municipality only addressed and disclosed the unrecorded creditors noted through the audit process. No evidence was provided that the entire population had been evaluated and the misstatement adjusted accordingly.
14. Disclosed in note 17 to the financial statements is an eskom liability of R1,245 million, which will be settled after 12 months; however, it was not classified as non-current liability as required by SA standards of GRAP, GRAP 1 *Presentation of the financial statements*. Consequently, current liabilities are overstated and non-current liabilities are understated by R1,245 million. As the adjustment to correct misclassification was not processed to the financial statements, I was unable to satisfy myself as to the presentation and disclosure of liabilities in the financial statements.
15. The municipality could not provide sufficient appropriate audit evidence to support a journal entries adjustment totalling R1,941 million for revenue received in advance for land sales. There was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of and obligations pertaining to payables disclosed in note 17 to the financial statements.
16. The municipality could not provide sufficient appropriate audit evidence to support the validity of consumer deposits journals processed of R3,108 million. There was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and valuation of and obligations pertaining to payables disclosed in note 17 to the financial statements.
17. Due to a lack of appropriate systems in place for the recording and maintenance of retentions on the municipal infrastructure grant (MIG) projects, it was noted that based on the budget information, the MIG retention liability was overstated by R948 132.
18. The accuracy and completeness of the leave pay provision amount of R1,869 million could not be confirmed due to the errors noted in the manual and electronic leave records, where the differences could not be reconciled. There was no satisfactory alternative audit procedure that I could perform to obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of and obligations pertaining to accrued leave pay disclosed in note 17 to the financial statements.

Provisions

19. The valuation, existence and completeness of and obligations pertaining to the provision for landfill site totalling R1,927 million as disclosed in note 15 to the financial statements

could not be confirmed. The municipality had not obtained the obligation value as at year-end and no reliance could be placed on the assumptions used to calculate the provision. The municipality's records did not permit the application of alternative audit procedures; consequently, I could not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of and obligations pertaining to the provision disclosed.

Disclaimer of opinion

20. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

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

Fruitless and wasteful expenditure

22. As disclosed in note 34 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R1,306 million as a result of payments made without corresponding benefits.

Material losses

23. As disclosed in note 36 to the financial statements, material losses to the amount of R432 581 were incurred as a result of electricity distribution losses.

Material impairment

24. As disclosed in note 11 to the financial statements, material impairment to the amount of R54,643 million were incurred as a results of impairment of debtors due to poor collection practices.

Additional matter

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

Unaudited supplementary schedules

25. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

27. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

28. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information*.

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

29. The material findings are as follows:

Usefulness of annual performance report

Presentation

30. Contrary to section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), improvement measures in the annual performance report. A total of 100% of the planned targets not achieved were not disclosed. This was due to inadequate internal policies and procedures to address reporting processes and events pertaining to performance management and reporting and limited review of the presentation of the annual performance report by the management/ audit committee.

Consistency

31. Section 41(c) of the MSA requires that the actual achievements against all planned indicators and targets be reported annually. The annual performance report submitted for audit purposes did not include actual performance of 53% of all planned objectives specified in the integrated development plan for the year under review. This was due to lack of review and monitoring of the performance objectives set to ensure that there was a link between the planned objectives and reported outcomes.

Reliability

Validity

32. The National Treasury *Framework for managing programme performance information* (FMPPi) requires that processes and systems which produce the indicator should be verifiable. A total of 89% and 23%, respectively of actual reported performance relevant local economic development and basic service delivery and infrastructure objectives were not valid when compared to the evidence provided. This was due to a lack of standard operating procedures for the recording, monitoring and reporting of actual achievements and accountability in this regard by senior management.

Completeness

33. The National Treasury FMPPi requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 43% of the actual reported performance for the selected basic service delivery and infrastructure objectives was not completely recorded. This was due to a lack of documentation and a document management system with regard to collation of information to support the actual performance achievements. A further contributing factor was that this information was not recorded,

reported and reviewed by management and the governance structures on a quarterly basis.

Additional matter

34. Of the total number of planned targets, only eight were achieved during the year under review. This represents 95% of total planned targets that were not achieved during the year under review. This was mainly because indicators and targets were not suitably developed during the strategic planning process.

Compliance with laws and regulations

35. I performed procedures to obtain evidence that the municipality had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the *General Notice* issued in terms of the PAA, are as follows:

Annual financial statements

36. 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 were not adequately corrected, which resulted in the financial statements receiving a disclaimer opinion.

Audit committees

37. An audit committee was not in place as required by section 166(1) of the MFMA, hence the governance oversight roles and responsibilities were not fulfilled.

Internal Audit

38. The internal audit unit did not assess the functionality of the performance management system and whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b) [(i) / (ii) / (iii)].

Procurement and contract management

39. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of supply chain management (SCM) regulation 17(a) and (c).
40. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulations 19(a) and 36(1).
41. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
42. 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.

Asset management

43. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

Expenditure management

44. The accounting officer did not take reasonable steps to prevent unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Internal control

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

Leadership

46. The accounting officer did not adequately exercise oversight responsibility over compliance with MFMA and the SCM processes. In addition, the accounting officer did not ensure that the reporting requirements on predetermined objectives are adhered to, as required by the MSA.

Financial and performance management

47. The accounting officer has not developed processes to ensure that all requirements of laws and regulations are complied with timeously. In addition, management did not develop, implement and monitor the necessary controls to ensure that all the processes relating to financial and performance management are adhered to at all times.

48. The chief financial officer did not adequately review the financial statements before submission for audit and did not implement controls over daily and monthly processing and reconciling of transactions.

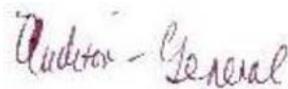
Governance

49. The audit committee was not in place during the year to ensure that the required oversight as per their audit charter was effected; however, a new committee was appointed at year-end. Furthermore, the risk assessment, while completed, has not been adequately effected within the municipality and the internal audit oversight functions are also compromised due to lack of the required information.

OTHER REPORTS

Investigations

50. An investigation into financial misconduct by an employee was completed during the year. The employee was found guilty and dismissed.



Pietermaritzburg

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence