

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mtubatuba Municipality, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, changes in net assets and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx.

Accounting Officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with 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 matter(s) 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. The municipality did not reconcile the fixed asset register to the financial statements. The fixed asset register carrying balance is R207,697 million while the financial statement carrying balance is R101,326 million. Consequently, property, plant and equipment is understated by R106,371 million. In addition, the general ledger is showing a different carrying value of R107,652 million. I was unable to perform alternative procedures to reconcile the amounts as no journals and reconciliations were available for auditing purposes.

Assets, Liabilities, Income and Expenditure

5. I was unable to obtain sufficient appropriate audit evidence for the journals affecting VAT, expenditure, revenue, property, plant and equipment, payables, receivables and employee costs. I was unable to confirm the journals by performing alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut-off and classification of VAT of R9,555 million, expenditure of R1,806 million, revenue of R1,280 million, property, plant and equipment of R23,379 million, payables of R409 545, receivables of R1,991 million, provision for bad debts of R7,374 million and employee costs of R180 624.

Furthermore, I was unable to obtain the journals that were passed in the preparation of the financial statements. I was not able to perform alternative procedures to ascertain what year-end journals were processed in the drawing up of the financial statements and consequently I was unable to determine which figures were affected in the financial statements.

Grant expenditure and revenue

6. The municipality did not provide evidence or supporting documentation to substantiate grant expenditure totalling R23,033 million. No alternative procedures could be performed as the supporting documentation and payment vouchers were not made available for auditing purposes. Consequently I was unable to verify the accuracy, completeness, occurrence, cut-off and classification of expenditure and revenue.

Furthermore, I was not able to perform alternative procedures to verify the amount that should have been retained as unspent conditional grant as well as the amount that needed to be transferred to the retention project account under trade and other payables from exchange transactions. Consequently I was unable to verify the completeness of unspent conditional grants and retention project account.

Other income

7. I was unable to obtain sufficient appropriate audit evidence to substantiate occurrence, accuracy and completeness of other income totalling R622 521. I was not able to perform alternative procedures and consequently I was unable to verify occurrence, accuracy and completeness of other income.

Expenditure

8. The municipality did not have adequate systems in place to maintain records of expenditure as supporting documentation to substantiate expenditure totaling to R16,598 million was not made available for audit. No alternative procedures could be performed to verify the occurrence, accuracy, and completeness of the expenditure and consequently I could not determine whether any adjustments were necessary to the amounts disclosed for expenditure.

Trade payables

9. The municipality did not have adequate systems in place to maintain records of trade payables for goods and services received totalling R9,784 million. Per alternative procedures performed, documentation totalling R8,154 million were received for auditing but sufficient appropriate audit evidence was not available to substantiate the remaining R1,630 million as no journals and not all the creditors' reconciliations were available. Consequently I was unable to verify existence, valuation, and completeness of the trade payables.

VAT receivables

10. The municipality did not reconcile the VAT receivables per the financial statements of R4,236 million to VAT returns totalling to R2,566 million. I was not able to perform alternative procedures as the documents to support the difference totalling to R1,670 million limited documentation available totalled R1,670 million. Consequently I was not able to verify existence, valuation and completeness of the VAT receivable balance in the financial statements.

Finance leases

11. The municipality did not have adequate systems in place to maintain records for finance leases totalling R3,924 million. Alternative procedures were performed, however, insufficient evidence was obtained to support the amount in the financial statements and consequently I was unable to verify existence, valuation, and completeness of the finance leases balance in the financial statements.

Cash flow statement

12. The municipality did not correctly reflect the cash flow for the year in the cash flow statement as required by GRAP 2, as the property, plant and equipment acquired was overstated by R7,393 million and suppliers overstated by R325 000, and consequently the net decrease in cash and cash equivalents was also misstated.

Statement of changes in net assets

13. The municipality did not provide workings and the journal to substantiate the amendments made to the amounts in the statement of changes in net assets in respect of other adjustments. I was unable to perform alternative procedures to verify the amount of R2,400 million. Consequently I was unable to determine the necessary adjustment to correct the amount in the statement of changes in net asset.

Disclaimer of opinion

14. 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

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

Irregular expenditure

16. As disclosed in note 33 to the financial statements the municipality incurred irregular expenditure of R15,270 million, being expenditure incurred in contravention of DoRA where grant funding was used for daily operating expenditure and procuring done with suppliers whose members were in the service of the state, contrary to paragraph 44 of the Supply Chain Management (SCM) regulations.

Unauthorised expenditure

17. As disclosed in note 35 and the appendix to the financial statements the municipality incurred unauthorised expenditure of R13,943 million as a result of overspending of the budgets for repairs and maintenance, grants and subsidies expenditure and general expenses.

Fruitless and wasteful expenditure

18. As disclosed in note 32 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R487 072 as a result of interest and penalties raised by creditors and the South African Revenue Services (SARS) for the late payment and/or submission of PAYE and/or VAT returns.

Going concern

19. As at 30 June 2012 the municipality's current liabilities exceeded its current assets by R11,613 million (2011: R8,383 million) and a number of creditors had not been paid within the stipulated 30 days with conditional grant funding being utilised for daily operating expenditure as a result of cash flow problems. Irregular expenditure of R11,749 million (2011: R6,707 million) to that effect was disclosed in note 33 to the financial statements.

Material underspending of conditional grants

20. The municipality has materially underspent its grant funding allocation for the year. At the date of this report, underspending amounted to R11,749 million as a result of grant funding being utilised to pay for daily operating expenses.

Additional matter

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

Unaudited supplementary schedules

22. 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 these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. 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

24. I performed procedures to obtain evidence about the usefulness and reliability of the information in the Mtubatuba Municipality annual performance report as set out on pages xx to xx of the annual report.
25. 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).

The material findings are as follows:

Usefulness of annual performance report

Presentation

26. The National Treasury *Guide for the preparation of the annual report* requires that explanations for major variances between the planned and reported (actual) targets should be provided in all instances and should be supported by adequate and reliable corroborating evidence.

The performance information was not presented in the format prescribed in the guide, with no variances being detailed. Furthermore, adequate and reliable corroborating evidence could not be provided for all information that was disclosed in the annual performance report. The institution's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as completeness, accuracy and validity of the information presented.

Consistency

27. The Municipal Systems Act, section 41(c) requires that the integrated delivery plan and service delivery and budget implementation plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. All of the reported objectives are not consistent with the objectives as per the approved integrated development plan and service developed and budget implementation plan. This is due to the annual performance report not being presented in the form prescribed in the National Treasury *guide for the preparation of the annual report*, with no alignment between the documents as well as no evidence being provided to verify information that was detailed in narrative form in the annual performance report contained in the annual report.

Validity

28. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain any information and explanations I considered

necessary to satisfy myself as to the validity of the actual performance relevant to all the objectives. This was due to the limitations placed on the scope of my work due to the absence of information systems and the lack of an adequate filing system of the institution's records which did not permit the application of alternative audit procedures.

Completeness

29. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. The municipality could not provide sufficient appropriate evidence to support any of the selected objectives.
30. The municipality's records did not permit the application of alternative audit procedures regarding the validity, accuracy and completeness of the reported performance information.

Additional matter

31. I draw attention to the following matter below. This matter do not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

32. The annual performance report did not reflect the achievement or non achievement of targets and no evidence was provided to substantiate targets reflected in the integrated development plan and service delivery and budget implementation plan.

Compliance with laws and regulations

33. I performed procedures to obtain evidence that the municipality has 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:

Budgets

34. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

Strategic planning and performance management

35. The approved Integrated Development Plan (IDP) was not submitted within 10 days of the adoption of the plan to the Member of the Executive Committee (MEC) for Local Government as required by section 32 of the Municipal Systems Act (MSA).

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(1) of the MFMA. Material misstatements identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer opinion.

Audit committee

37. The audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information as required by section 166(2)(a)(iv) of the MFMA.

Furthermore, the audit committee only met twice during the year under review contrary to the requirements of section 166(4)(b) of the MFMA.

Procurement and contract management

38. Goods and services totalling R3, 520 million were awarded to prohibited suppliers, being suppliers whose members were in the employ of the State contrary to the requirements of paragraph 44 of the Supply Chain Management (SCM) regulations.

Expenditure management

39. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
40. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.
41. The municipality could not provide evidence or supporting documentation that VAT records for the prior five years were safely filed as required by section 55 of the VAT Act.

Transfer of conditional grants

42. The allocations for Library Assistance, Finance Management, Governance Support, Municipal Systems Improvement, Municipal Infrastructure, Sports Field and Small Town Rehabilitation grants were utilised for purposes other than those stipulated in their respective schedules or Gazetted Division of Revenue Act framework in contravention of the requirements of section 15(1) of the Division of Revenue Act.

Revenue management

43. The accounting officer did not take effective and appropriate steps to timeously collect all money due to the municipality as per the requirements of Treasury Regulation (TR) 11.2.1.
44. The accounting officer did not notify National Treasury in writing of the Organs of State whose accounts were long outstanding as required by section 64 of the MFMA.

Asset management

45. 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.

Liability management

46. The accounting officer did not ensure that the short term debt, being the bank overdraft, was repaid at year end as required by section 45(4)(a) of the MFMA.

Internal control

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

Leadership

- 48. The Council and Management had not reviewed the financial statements presented for auditing purposes for accuracy and compliance with the Standards of GRAP.
- 49. Management had not reviewed the performance information report to ensure that the report submitted for auditing purposes met the legislated requirements.

Financial and performance management

- 50. The financial statements presented for auditing purposes were not accurate and required a number of changes.
- 51. The performance information report was not per the legislated requirements and the information contained in the report was not supported by reliable information.

Governance

- 52. The audit committee did not perform their legislated duties during the year under review, meeting only twice and not providing the necessary guidance to Council and Management.

Pietermaritzburg
30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence