

# **REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND COUNCIL ON HLABISA MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Hlabisa Municipality set out on pages ... to ..., which comprise, the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement 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 Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the 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. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified audit opinion**

#### **Property, plant and equipment**

6. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for property, plant and equipment. As described in note 8 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement amounting to R7,44 million by alternative means. Consequently I was unable to determine whether any adjustment to the property, plant and equipment corresponding figure stated at R72,39 million in the financial statements was necessary.

7. The municipality did not estimate the recoverable service amount of the assets that were impaired in accordance with Standard of GRAP 21, *Impairment of assets*. Impairment amounting to R4,25 million was included in the financial statements. I was unable to determine the correct amount of impairment as it was impracticable to do so. Consequently I was unable to determine whether any adjustment relating to property, plant and equipment stated at R72,39 million, in the financial statements was necessary.
8. The municipality reviewed the residual values and useful lives of infrastructure assets at each reporting date in accordance with Standard of GRAP 17, *Property, plant and equipment*. The change was not correctly accounted for as a change in an accounting estimate in accordance with the Standard of GRAP 3, *Accounting policies, changes in accounting estimates and errors*. Consequently, the infrastructure assets and accumulated depreciation were overstated by R594 860 (2012:R1,62 million).

#### **Accumulated surplus**

9. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for accumulated surplus. As described in note 41 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently I was unable to determine whether any adjustment to the accumulated surplus corresponding figure stated at R70,58 million in the financial statements was necessary.

#### **Cash flow**

10. Presentation of a cash flow statement, summarising the entity's operating, investing and financing activities, is required by Standard of GRAP 2, *Cash flow statements*. The net cash flows from operating activities and the cash and cash equivalents are overstated by R1,73 million in the cash flow statement.

#### **Receivables**

11. The account receivable balance of R1,10 million as disclosed in note 3 and 5 to the financial statements, does not agree to the balance of R1,82 million as per the age analysis. The municipality did not reconcile the difference of R721 399 between the financial statements and the underlying accounting records. Consequently, the account receivable balance is overstated and provision understated by R721 399.
12. Included in accounts receivable is an impairment balance of R247 621 as disclosed in note 3 and 5 to the financial statements, which does not agree to the balance as per the source document amounting to R1,10 million. The municipality did not reconcile the difference of R856 852 between the financial statements and the underlying accounting records. Consequently, debt impairment is understated and the accounts receivable balance is overstated by R856 852.

#### **Opinion**

13. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Hlabisa Municipality as at 30 June 2013 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.

#### **Emphasis of matters**

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

#### **Irregular expenditure**

15. As disclosed in note 29 to the financial statements, irregular expenditure amounting to R7,71 million was incurred during the year, as a result of contravention of Municipal Supply Chain Management Regulations.

### **Unauthorised expenditure**

16. As disclosed in note 30 to the financial statements, unauthorised expenditure amounting to R18,47 million was incurred during the year, as a result of utilisation of the conditional grants for municipal operations and over expenditure within the municipal votes.

### **Restatement of corresponding figures**

17. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of an error discovered during 30 June 2013 in the financial statements of the Hlabisa Municipality at, and for the year ended, 30 June 2012.

### **Additional matter**

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

### **Unaudited supplementary schedules**

19. 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**

20. 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**

21. The annual performance report included in the annual report was not presented in time for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.
22. The information was assessed to determine whether performance 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 (FMPP)*.
23. The material findings are as follows:

### **Usefulness of information**

#### **Measurability**

#### **Performance targets not specific**

24. The *FMPP* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 49% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the *FMPP* but did not receive the necessary training to enable application of the principles.

#### **Performance targets not measurable**

25. The *FMPP* requires that performance targets be measurable. The required performance could not be measured for a total of 54% of the targets. This was due to the fact that management was aware of the requirements of the *FMPP* but did not receive the necessary training to enable application of the principles.

#### **Performance targets not time bound**

26. The *FMPP* requires that the time period or deadline for delivery be specified. A total of 97% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the *FMPP* but did not receive the necessary training to enable application of the principles.

### **Performance indicators not well defined**

27. The *FMPPI* requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 36% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the *FMPPI* but did not receive the necessary training to enable application of the principles.

### **Compliance with laws and regulations**

28. I performed procedures to obtain evidence that the entity 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:

### **Strategic planning and performance management**

29. The annual performance report for the year under review does not include the performance of the municipality, performance of each external service provider, a comparison of the performance with set targets, a comparison with the previous financial year, and measures taken to improve performance, as required by section 46(1) of the Municipal Systems Act (MSA).
30. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by Municipal Planning and Performance Management Regulation 15(3).

### **Budgets**

31. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

### **Annual financial statements, performance and annual reports**

32. 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.

### **Audit committees**

33. The audit committee did not advise the council on matters relating to performance management and performance evaluation as required by section 166(2)(a) of the MFMA.

### **Procurement and contract management**

34. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
35. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
36. Quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
37. Quotations 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.

### **Human resource management and compensation**

38. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements by 31 July 2012, as required by section 57(2)(a) of the MSA.
39. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the Regulations on Minimum Competency Levels regulation 14(2)(b).

### **Expenditure management**

40. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Revenue management**

41. A credit control and debt collection policy was not adopted and implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.

### **Asset management**

42. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

### **Liability management**

43. Short-term debt was not repaid within the financial year, as required by section 45(4)(a) and (b) of the MFMA.

### **Consequences management**

44. Unauthorised, irregular, Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2)(a)(ii) and (b) of the MFMA.

### **Internal control**

45. I considered internal control relevant to my audit of the financial statements, 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 qualified opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

46. The vacancies in leadership positions impacted on the effectiveness of leadership at the municipality. Leadership did not ensure that personnel have an in-depth understanding of the requirements and therefore the policies and procedures were not effectively applied or monitored.

### **Financial and performance management**

47. The monitoring of compliance with laws and regulations and with municipal policies and procedures was ineffective during the year under review. This resulted in errors in daily and monthly processing, and in the preparation of the financial statements. These errors were not detected and corrected on a timely basis. In addition, compliance with laws and regulations was not adequately monitored.
48. Performance report was not prepared and submitted in time for auditing.

## **Governance**

49. Municipality did not effectively implement the recommendation of the internal audit resulting in the misstatement risks not being mitigated. Furthermore, the audit committee could not effectively discharge their responsibility in the performance evaluation and management due to the limitation imposed by management.

Pietermaritzburg

30 November 2013



**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*