

King Sabata Dalindyebo

Municipality

Audit Report

For the year ended 30 June 2014

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND COUNCIL ON KING SABATA DALINDYEBO LOCAL
MUNICIPALITY**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the King Sabata Dalindyebo Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, the cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as 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 these 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, 2013 (Act No. 2 of 2013) (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 these 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 entity'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 entity'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 opinion

Receivables from exchange and non-exchange transactions

6. Sufficient appropriate audit evidence was not available to support receivables from exchange and non-exchange transactions as documentation in support of the amounts was either not submitted for audit purposes or that which was submitted was not adequate. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts for receivables from exchange and non-exchange transactions of R41,9 million and R21,3 million respectively, as disclosed on the statement of financial position and in notes 8 and 9 to the financial statements.
7. Due to the inherent limitation on receivables from exchange and non-exchange transactions detailed above, it was impracticable to recalculate the impairment allowance raised. Consequently I am unable to determine whether any adjustments were necessary to the R143,9 million and R114,6 million recognised as the impairment allowance on receivables from exchange and non-exchange transactions respectively, as disclosed in notes 8 and 9 to the financial statements. Furthermore, it was also impracticable to determine the effect on interest revenue as described in paragraph 11 below.
8. During the 2012-13 financial year, sufficient appropriate audit evidence was not available to support receivables from exchange and non-exchange transactions as documentation in support of the amounts was either not submitted for audit purposes or that which was submitted was not adequate. I was unable to confirm the balances by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the comparative amounts for receivables from exchange and non-exchange transactions of R74,4 million and R14,6 million respectively, as disclosed on the statement of financial position and in notes 8 and 9 to the financial statements. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures for receivables from exchange and non-exchange transactions.

Revenue from exchange and non-exchange transactions

9. The municipality did not have adequate controls in place to ensure that all revenue owed to the municipality was billed accurately. Revenue from exchange transactions, receivables from exchange transactions and output VAT are overstated by R35,6 million, R40,6 million and R5 million respectively, as a result of:

- service and refuse charges which were calculated at incorrect tariffs
- service and refuse charges which did not agree to supporting readings

Consequently, there was a resultant impact on the deficit for the period and the accumulated surplus.

10. Sufficient and appropriate audit evidence was not available to support revenue recognised from rental agreements as management were unable to provide rental agreements to corroborate rentals billed, or where rental agreements were provided, these were incomplete and outdated. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the R14,6 million recognised as revenue from rental agreements and disclosed in note 39 to the financial statements or the corresponding receivable disclosed in note 8.

11. Weaknesses identified in the municipality's systems for the recording and monitoring of receivables from exchange and non-exchange transactions made it impracticable to recalculate interest revenue charged on these outstanding balances at 30 June 2014. Consequently I am unable to determine whether any adjustments were necessary to the R20,7 million recognised as interest income in note 32 to the financial statements or the corresponding receivable from exchange and non-exchange transactions raised.

Accumulated surplus

12. During 2012-13, I was unable to obtain sufficient appropriate audit evidence for accumulated surplus and to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to accumulated surplus stated at R1,7 billion (2012-13: R1,8 billion) as disclosed in the statement of changes in net assets and statement of financial position.

Irregular expenditure

13. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 53 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R47,5 million (2012-13: R154,8 million). It was impracticable for me to determine the full extent of this understatement.
14. During 2012-13, I was unable to obtain sufficient appropriate audit evidence for irregular expenditure and to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the irregular expenditure stated at R365,7 million (2012-13: R154,9 million) as disclosed in note 53 to the financial statements.

Contingent liabilities

15. The municipality did not have adequate systems in place to identify and disclose all contingent liabilities in the financial statements. Adequate supporting documentation was not provided to support the amount disclosed. I was unable to confirm these values by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the contingent liabilities of R14,7 million as disclosed in note 45 to the financial statements.

Commitments

16. The municipality did not have adequate systems in place to identify and disclose all commitments in the financial statements. Adequate supporting documentation was not provided to support the amount disclosed. I was unable to confirm these values by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amount of R153,3 million (2012-13: R144,6 million) as disclosed in note 44 to the financial statements.

Unauthorised expenditure

17. During 2012-13, I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure and to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the unauthorised expenditure stated at R354,4 million (2012-13: R102,9 million) as disclosed in note 51 to the financial statements.

Corresponding figures

18. During 2012-13, I identified the following misstatements which are still included in the corresponding figures disclosed in the current period's financial statements and for which I was unable to obtain sufficient appropriate audit evidence:

- Revenue of R314,7 million as disclosed in the statement of financial performance.
- Unspent conditional grants and receipts of R48,4 million as disclosed in note 14 of the financial statements.
- GRAP 2: *Cash flow statement* requires the presentation of a cash flow statement, summarising the entity's operating, investing and financing activities. Re-performance of the comparative figures in the cash flow statement identified fundamental errors in the calculation of cash flows and discrepancies between the figures presented on the cash flow statement, cash generated from operations in note 43 and notes to the financial statements totalling R121,1 million.

19. I was unable to obtain sufficient appropriate audit evidence for the corresponding figures of the above items or to confirm them by alternative means. Consequently, I was unable to determine whether any adjustments to these amounts were necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of these matters on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements

20. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, performance and the notes to the financial statements:

- A finance lease liability of a possible R19,1 million was not disclosed.
- Expenditure reflected as R1,05 billion is understated by R14,7 million (2012-13: R12,4 million).
- Inventories reflected as R9,5 million is overstated by R6,6 million.
- Property, plant and equipment reflected as R2,2 billion is understated by R5,6 million.
- VAT payable reflected as R39,1 million is overstated by R3,6 million.

21. I was unable to obtain sufficient appropriate audit evidence regarding the following items making up the statement of financial position and the statement of financial performance to the financial statements, which had a cumulative effect on the financial statements:

- Personnel costs of R8,1 million (2012-13: R39,2 million).
- VAT payable of R4,6 million.

22. During 2012-13, I identified an uncorrected immaterial misstatement relating to a fair value adjustment of R12 million which is still included in the corresponding figures disclosed in the current period's financial statements for which I was unable to obtain sufficient appropriate audit evidence.

Qualified opinion

23. 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 King Sabata Dalindyebo Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA.

Emphasis of matters

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

Corresponding figures

25. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the King Sabata Dalindyebo Municipality at, and for the year ended, 30 June 2014.

Distribution losses

26. As disclosed in note 54 to the financial statements, the electricity losses have exceeded the acceptable range and therefore are deemed material. This could indicate that the municipality is facing one or more of the following challenges:

- a. Deteriorating electricity infrastructure
- b. Poor management of the networks

Unauthorised, fruitless and wasteful and irregular expenditure

27. As disclosed in notes 51 and 52, unauthorised and fruitless and wasteful expenditure has been incurred by the municipality. Furthermore, included in the disclosed amount as per note 53 is irregular expenditure of R8,4 million which relates to incorrect procurement processes followed for the state funeral expenditure.

Additional matters

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

Unaudited supplementary information

29. The supplementary information set out on pages XX to XX does not form part of the financial statements and are presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

30. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

31. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected programmes presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

32. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected programmes presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Programme: Infrastructure on pages XX to XX
- Programme: Human Settlements on pages XX to XX

33. I evaluated the reported performance information against the overall criteria of

usefulness and reliability.

34. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).

35. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

36. The material findings in respect of the selected programmes are as follows:

Programme: Infrastructure

Usefulness of reported performance information

37. Section 41(c) of the Municipal Systems Act (MSA) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 67% of the reported objectives were not consistent with those in the approved IDP. A total of 71% of the reported indicators were not consistent with those in the approved IDP. A total of 86% of the reported targets were not consistent with those in the approved IDP. This was due to:

- No formal documented performance management system.
- No consequence management for poor reporting.
- No proper review to ensure that all information from the IDP is consistent with the Service Delivery Budget Implementation Plan (SDBIP) and Annual Performance Report.

38. Section 54(1)(c) of the MFMA determines that the SDBIP adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the SDBIP in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the annual performance report, without adoption by the municipal council. This was due to no proper review to ensure that all information from the IDP is consistent with the SDBIP and Annual Performance Report.

13. The FMPPi requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable and the period or deadline for delivery of targets must be specified.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

39. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures.

Reliability of reported performance information

40. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and

store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems; the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information; the auditee's records not permitting the application of alternative audit procedures and the auditee not ensuring that there are registers in place to monitor the progress of the various reported targets.

Programme: Human Settlements

Usefulness of reported performance information

41. Section 41(c) of the MSA requires the IDP to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 50% of the reported objectives were not consistent with those in the approved IDP. A total of 53% of the reported indicators were not consistent with those in the approved IDP. A total of 100% of the reported targets were not consistent with those in the approved IDP. This was due to:

- No formal documented performance management system.
- No consequence management for poor reporting.
- No proper review to ensure that all information from the IDP is consistent with the SDBIP and Annual Performance Report.

42. Section 54(1)(c) of the MFMA determines that the SDBIP adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the SDBIP in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the annual performance report, without adoption by the municipal council. This was due to no proper review to ensure that all information from the IDP is consistent with the SDBIP and Annual Performance Report.

43. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable and the period or deadline for delivery of targets must be specified.
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. Performance indicators must also be verifiable.

44. The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes and formal standard operating procedures.

Reliability of reported performance information

45. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems; the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information; the auditee's records not permitting the application of

alternative audit procedures and the auditee not ensuring that there are registers in place to monitor the progress of the various reported targets.

Additional matter

46. I draw attention to the following matter:

Achievement of planned targets

47. Refer to the annual performance report on pages XX to XX and XX to XX for information on the achievement of the 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 for the selected programmes reported in paragraphs XX to XX of this report.

Compliance with legislation

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

Strategic planning and performance management

49. Sufficient appropriate evidence could not be obtained that:

- The local community was consulted by means of a municipal wide structure for community participation/ through a forum that enhances community participation in drafting and implementing the IDP, as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
- The municipality established a performance management system, as required by section 38(a) of the MSA.
- The performance management system provided for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the MSA.
- The performance management system provided for steps of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.
- The municipality established mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
- Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
- The performance management system and related controls were in place/ were maintained/ were inadequate to describe and represent the processes of performance planning/ monitoring/ measurement/ review/ reporting/ improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.
- The performance management system
 - was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan and
 - did not clarify the roles and responsibilities of each role-player and
 - did not determine the frequency of reporting and the lines of accountability and

- did not relate to the employee's performance management processes and
 - did not link to the integrated development planning processes,
- as required by section 38(a) of the MSA and Municipal planning and performance management regulation 7(2)(c/e/f/g).

50. The local community was not afforded the opportunity to comment on the final draft of the IDP before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).
51. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
52. The annual performance report for the year under review did not include:
- The performance of the municipality and name of external service providers/ each external service provider and
 - A comparison of the performance with set targets and a comparison with the previous financial year and
 - Measures taken to improve performance, as required by section 46(1)(a),(b) and (c) of the MSA.

Budget

53. 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.
54. The total unforeseen and unavoidable expenditure incurred exceeded R15 million, in contravention of Municipal Budget and Reporting Regulation 72.

Financial Statements, performance and annual reports

55. 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 in non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit Committee

56. The audit committee was not constituted, in the manner required by section 166(4)(a) of the MFMA as the audit committee did not consist of at least 3 persons with the appropriate experience for the full financial year.
57. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
58. The audit committee did not advise the council/ accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
59. The audit committee did not review the financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.

Internal Audit

60. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.