Auditor's report

Victor Khanye Local Municipality

30 June 2014

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Victor Khanye Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Victor Khanye Local Municipality set out on pages ... to ..., which comprise the appropriation statement, the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and cash flow statement 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 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

Property, plant and equipment

6. In terms of GRAP 17 *Property, plant and equipment*, an entity shall recognise items of property, plant and equipment that qualify for recognition as assets in the financial statements. Contrary to this requirement, the municipality did not have adequate systems to maintain the acquisition records of its assets, thus I was unable to determine whether property, plant and equipment had been correctly valued. I was unable to confirm the balances by alternative means.
7. Furthermore, property, plant and equipment was understated, as not all assets were accounted for in the financial statements. I was unable to determine the full extent of the understatement, as it was impracticable to do so.
8. Assets that met the definition of intangible assets and investment property of R544 931 and R1 516 450, respectively, were incorrectly classified as property, plant and equipment.
9. Consequently, I was unable to determine whether any further adjustments were necessary relating to the property, plant and equipment of R1 340 271 419 (2013: R1 339 297 623) disclosed in note 5 to the financial statements and the statement of financial position as well as the depreciation expense of R52 055 166 (2013: R50 118 059) disclosed in note 31 to the financial statements and the statement of financial performance.

Investment property

10. In terms of GRAP 16 *Investment property*, an entity that chooses the cost model shall measure all its investment properties in accordance with the standard of GRAP 17. I was unable to obtain sufficient appropriate audit evidence for the values of investment property, as the municipality did not have adequate systems to maintain acquisition records of its assets. I was unable to confirm investment property by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the investment properties of R32 363 732 (2013: R35 059 315) disclosed in the statement of financial position and note 4 to the financial statements as well as the depreciation expense of R52 055 166 (2013: R50 118 059) disclosed in note 31 to the financial statements and the statement of financial performance.

Intangible assets

11. In terms of GRAP 31 *Intangible assets*, an entity shall recognise items of property, plant and equipment that qualify for recognition as assets in the financial statements. I was unable to obtain sufficient appropriate audit evidence to determine whether the municipality had accounted for all of its intangible assets – servitudes, as the municipality did not have an adequate document management system to account for intangible assets in accordance with GRAP 31. I was unable to confirm intangible assets by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the intangible assets of R5 603 350 disclosed in note 6 to the financial statements and the statement of financial position.

Cash flow statement

12. I was unable to obtain sufficient appropriate audit evidence for the undefined differences in amounts included in the cash flow from operating activities of R8 622 928 (2013: R90 859 235) and other cash items included in cash flows from financing activities amounting to R23 683 371 (2013: R55 224 862) in the cash flow statement. The municipality could not provide sufficient calculations to substantiate these amounts. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments to the cash flow statement were necessary.

Traffic fines

13. The municipality did not recognise traffic fine revenue on the accrual basis in accordance with iGRAP 1 *applying the probability test on initial recognition of exchange revenue*. The municipality recognised traffic fine revenue on the cash basis. I was unable to determine the full extent of the understatement of revenue from traffic fines and trade receivables. Consequently, I was unable to determine whether any adjustments were necessary to the revenue from fines of R123 962 disclosed in the statement of financial performance.

Prior period errors

14. I was unable to obtain sufficient appropriate audit evidence to determine whether a prior period error had been correctly accounted for. I was unable to confirm the prior period error by alternative means, due to unexplained differences of R7 328 199 between the general ledger and the financial statements. Consequently, I was unable to determine whether any further adjustments were necessary relating to the prior period errors of R659 374 080 as well as the accumulated surplus for the year ended 30 June 2012 of R1 350 484 170 disclosed in the statement of changes in net assets and note 41 to the financial statements.

Qualified opinion

15. In my opinion, except for the 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 Victor Khanye Local Municipality as at 30 June 2014 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

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

Restatement of corresponding figures

17. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during the year ended 30 June 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

Material impairments

18. As disclosed in note 11 to the financial statements, the municipality raised a provision for debt impairment amounting to R329,78 million (2013: R144,20 million) on trade receivables, as the recoverability of these amounts is doubtful.

Additional matter

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

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. 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

21. 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 the selected development priority 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

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

    - Development priority 1: infrastructure and basic service delivery on pages x to x

23. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

24. 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 development priority. 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).
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. The material findings in respect of the selected development priority are as follows:

Infrastructure and basic service delivery

Usefulness of reported performance information

Consistency of objectives, indicators and targets

27. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 39% of the reported objectives, 23% of the reported indicators and 45% of the reported targets were not consistent with those in the approved integrated development plan. This was due to a lack of review of the completeness of reporting documents by management, the audit committee and the internal audit unit.

Measurability of indicators and targets

28. The FMPPI requires the following:

    - 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. A total of 41% of the indicators were not well defined.

    - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 26% of the indicators were not verifiable.

    This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes that were monitored by senior management and technical indicator descriptions that were accurate and complete.

Reliability of reported performance information

29. 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. Overall, 43% of the targets were not reliable. I was unable to obtain sufficient appropriate audit evidence for 20% of the significantly important targets, while 23% of the significantly important targets were not valid, accurate and complete when compared to the source information or evidence provided. This was due to limitations placed on the scope of my work by the auditee and a lack of monitoring oversight by senior management.

Additional matter

30. I draw attention to the following matter:

Achievement of planned targets

31. Refer to the annual performance report on pages ... to ... and ... to ... 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 development priority reported in paragraphs 25 to 27 of this report.

Compliance with legislation

32. 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:

Budgets

33. 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 report and annual report

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Some material misstatements of non-current assets, revenue and expenditure identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Internal audit

35. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not advise the accounting officer and report to the audit committee on matters relating to accounting procedures and practices as well as loss control.

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

Procurement and contract management

37. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
38. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
39. Contracts 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).
40. Sufficient appropriate audit evidence could not be obtained that contracts were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Expenditure management

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

Asset management

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

Consequence management

43. 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)(a)(ii) of the MFMA.

Internal control

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

Leadership

45. The accounting officer did not adequately review the monthly reports or the financial statements and annual performance report prior to their submission for auditing.

46. The municipality did not have sufficient capacity to plan, manage and report on its performance.

47. The human resource plan did not adequately determine the gap between the existing and the required human resources and the actions necessary to address the gap.

Financial and performance management

48. The municipality did not have a proper record management system to maintain information that supported the reported performance in the annual performance report. This included information that related to the collection, collation, verification, storing and reporting of actual performance information.

49. Management did not implement the following daily and monthly controls as designed for the municipality's business processes:

    - Monthly fixed asset reconciliations
    - Reconciliations of performance targets

Governance

50. The internal audit unit did not conduct internal audits or reviews of performance information systems and management that focused on compliance aspects as well as the usefulness and reliability of the reported performance information.

51. The internal audit unit did not review financial and performance reports to confirm the reliability of the reports before their submission to the audit committee or external auditors.

Auditor - General

Mbombela

30 November 2014

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence