

# **Auditor's report**

Emalahleni Local Municipality

30 June 2014

# Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Emalahleni Local Municipality

## Report on the financial statements

### Introduction

1. I was engaged to audit the financial statements of the Emalahleni Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statements of financial performance, changes in net assets, cash flows and 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 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 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

#### Accumulated surplus

4. In terms of GRAP 3 *Accounting policies, changes in accounting estimates and errors*, an entity must correct material prior period errors by restating the comparative amounts at the earliest period in which the error occurred. The municipality could not provide supporting documents relating to prior period adjustments. Furthermore, the balance of the accumulated surplus as per the trial balance differed from the balance as per the statement of changes in net assets by R177 440 526. I could not confirm this by alternative means. Consequently, I could not determine whether any further adjustments were necessary to the accumulated surplus of R1 527 663 838 presented in the statement of financial position.

## **Property, plant and equipment**

5. 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, I could not obtain sufficient appropriate evidence to support unreconciled differences between the fixed asset register and the financial statements amounting to R168 468 157 and R165 982 443 relating to the cost and the accumulated depreciation of property, plant and equipment, respectively. I could not confirm these differences by alternative means, as management could not be able to reconcile these differences. Some of the assets were recorded at incorrect amounts.
6. The municipality could not provide supporting documents for some of the work in progress included in property, plant and equipment disclosed in note 4 to the financial statements.
7. Consequently, I could not determine whether adjustments were necessary relating to the property, plant and equipment amounting to R2 256 030 138 (2013: R2 191 107 378) disclosed in note 4 to the financial statements.

## **Cash and cash equivalents**

8. Included in the cash and cash equivalents of R34 394 373 disclosed in note 10 to the financial statements were invalid reconciling items amounting to R41 656 161. As a result, cash and cash equivalents presented in the financial statements were understated by R41 656 161. I could not determine whether this would have a consequential impact on the accumulated surpluses presented in the statement of financial position.

## **Trade payables and other creditors**

9. In terms of *Framework for the preparation and presentation of financial statements*, transactions shall be accounted for when they occur, not only when cash is paid. Contrary to this requirement, the municipality did not accrue invoices for which it had received goods and services at year-end. As a result, trade payables of R477 369 826 and other creditors of R170 330 928 disclosed in note 15 to the financial statements, and expenditure presented in the statement of financial performance, were understated by R178 891 536.

## **Payments received in advance and retentions**

10. The municipality could not provide evidence to support income received in advance and retentions amounting to R40 323 623 and R11 719 145, respectively, disclosed in note 15 to the financial statements. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to the payables from exchange transactions of R700 566 221 disclosed in note 15 to the financial statements.

## General expenses and bulk purchases

11. In terms of *Framework for the preparation and presentation of financial statements*, transactions should be recorded and reported in the accounting period to which they relate. Contrary to this requirement, general expenditure and bulk purchase transactions relating to the current period amounting to R14 652 747 and R870 164 774, respectively, were not recorded and accounted for in the accounting records of the municipality. As a result, general expenditure, bulk purchases and trade payables were understated.
12. GRAP 1 *Presentation of financial statements* defines expenditure as decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or increases of liabilities that result in decreases in net assets, other than those relating to distributions to owners. Some of the transactions relating to general expenses were recorded at the incorrect amount, while some were recorded inclusive of value-added tax (VAT). Furthermore, included in general expenses was departmental consumption amounting to R22 966 722. These expenses did not meet the GRAP 1 definition of expenditure, which resulted in expenditure being overstated.
13. I was unable to obtain sufficient appropriate audit evidence with regard to grants and subsidies paid included in general expenses, as the municipality did not provide supporting documents. The municipality's records did not permit the application of alternative procedures.
14. Due the significance of the matters highlighted above, general expenses and bulk purchases disclosed in note 21 to the financial statements stated at R178 435 206 (2013: R127 625 651) and note 30 to the financial statements stated at R685 217 686 (2013: R647 157 460), respectively, were misstated.

## Revenue

15. The municipality could not provide sufficient appropriate audit evidence to support prepaid electricity of R151 146 091 included in the service charges disclosed in note 16 to the financial statements. I could not confirm this by alternative means. Consequently, I could not determine whether any adjustments were necessary to service charges as per note 16 to the financial statements.

## Value-added tax

16. The VAT payable was misstated, as expenditure was recorded inclusive of VAT. Furthermore, the municipality could not provide sufficient appropriate audit evidence to support the corrections made to prior period errors on VAT as disclosed in note 36 to the financial statements. Consequently, I could not determine whether any adjustments were necessary to the VAT payable of R60 401 251 stated in the statement of financial position.

## Traffic fines

17. 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 R2 424 131 disclosed in the statement of financial performance.

## Consumer deposits

18. I was unable to obtain sufficient appropriate audit evidence regarding consumer deposits, as the municipality did not provide supporting documents to support the amount recorded in the statement of financial position. The municipality's processes did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustment was necessary relating to these consumer deposits of R105 418 529 presented in the statement of financial position.

## Cash flow statements

19. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed for the net cash flow, due to inconsistencies in the amounts between the statement of financial position and the statement of financial performance. I was unable to confirm the net cash flow from operating activities by alternative means. Consequently, I was unable to determine whether any adjustments to the cash flow statement were necessary.

## Commitments

20. GRAP 1 *Presentation of financial statements* requires entities to disclose unrecognised contractual agreements. The municipality disclosed capital commitments at incorrect amounts, resulting in an overstatement of R13 111 490. Furthermore, not all commitments were recorded in the commitment register. Consequently, I could not determine the correctness of commitments amounting to R135 468 718 (2013: R15 807 662) disclosed in note 32 to the financial statements.

## Contingencies

21. GRAP 19 *Provisions, contingent liabilities and contingent assets* requires entities to disclose all contingent liabilities at the reporting date. Contrary to this requirement, legal claims against the municipality were identified in the legal register that had not been disclosed as part of contingent liabilities. I was unable to determine the full extent of the understatement of the contingent liabilities disclosed in note 33, as it was impracticable to do so.

## Journals

22. The municipality could not submit evidence to support the journals processed in the following accounts: property, plant and equipment of R2 256 030 138, payables of R700 566 221, cash and cash equivalents of R34 394 373, VAT of R60 401 251, revenue from exchange transactions of R1 194 281 507, operating expenses of R1 664 373 263. Consequently, I could not confirm the correctness of these accounts. The municipality's records did not permit the application of alternative procedures.

## **Statement of comparison of budget and actual amounts**

23. In terms of GRAP 24 *Presentation of budget information in financial statements*, a comparison of the approved budget and the actual amounts must be presented in the financial statements and explanations given for material variances. Contrary to this requirement, the municipality presented incorrect budget amounts in its statement of comparison of budget and actual amounts, which resulted in variances being misstated. Consequently, I could not determine whether all material variances had been explained.

## **Unauthorised expenditure**

24. The municipality incurred unauthorised expenditure of R63 034 584, due to the expenditure of some of the votes exceeding the approved budget of those votes. This unauthorised expenditure was not disclosed, as required by section 125(2)(d) of the MFMA.

## **Irregular expenditure**

25. I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure amounting to R46 471 425 (2013: R22 891 863) disclosed in note 40 to the financial statements, as internal controls had not been established to identify irregular expenditure. In addition, a limitation was placed on my audit of procurement due to supporting documentation that could not be submitted.

## **Fruitless and wasteful expenditure**

26. I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of fruitless and wasteful expenditure amounting to R47 595 060 (2013: R1 882 409) disclosed in note 39 to the financial statements, as internal controls had not been established to identify fruitless and wasteful expenditure.

## **Distribution losses**

27. Section 125(2)(d) of the MFMA states that the notes to the financial statements of a municipality must disclose particulars of material losses. The municipality could not provide documents to support distribution losses with regard to water and electricity. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that material losses had been properly recorded.

## **Disclaimer of opinion**

28. 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 these financial statements.

## **Emphasis of matters**

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

## **Significant uncertainties**

30. With reference to note 33 to the financial statements, the municipality is the defendant in lawsuits. The municipality is opposing the claims, as it believes the claims to be prejudiced. The ultimate outcome of these matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

## **Restatement of corresponding figures**

31. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered in 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

## **Material impairments**

32. As disclosed in note 9 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R896 289 799 (2013: R788 620 650), which represented 66% (2013: 76%) of the total consumer debtors. The contribution to the provision for debt impairment was R115 843 379 (2013: R197 985 507).

## **Additional matters**

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

## **Unaudited supplementary schedules**

34. The supplementary information set out on pages ... to ... 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.

## **Withdrawal from the audit engagement**

35. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the International Standards on Auditing.

## **Unaudited disclosure notes**

36. 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

37. 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 development priorities 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**

38. The annual performance report was not presented for auditing and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents for the following selected development objectives:

- Solid waste management on pages ... to ...
- Electrical section on pages ... to ...
- Water and sanitation services on pages ... to ...
- Roads and storm water on pages ... to ...
- Waste water management on pages ... to ...

39. I assessed the information to determine whether the performance indicators and targets were well defined, verifiable, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

40. The material findings in respect of the selected development priorities are as follows:

### **Solid waste management**

### **Usefulness of performance information**

### **Measurability of indicators and targets**

41. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, while the period or deadline for delivery of targets must be specified.
- Performance indicators or measures 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 or measures must also be verifiable.

The measurability of planned targets and indicators could not be assessed, due to a lack of technical indicator descriptions as well as proper systems and processes.

## **Electrical section**

### **Usefulness of performance information**

### **Measurability of indicators and targets**

42. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, while the period or deadline for delivery of targets must be specified.
- Performance indicators or measures 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 or measures must also be verifiable.

The measurability of planned targets and indicators could not be assessed, due to a lack of technical indicator descriptions, proper systems and processes, and documented system descriptions.

## **Water and sanitation services**

### **Usefulness of performance information**

### **Measurability of indicators and targets**

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, while the period or deadline for delivery of targets must be specified.
- Performance indicators or measures 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 or measures must also be verifiable.

The measurability of planned targets and indicators could not be assessed, due to a lack of technical indicator descriptions as well as proper systems and processes.

## **Roads and storm water**

### **Usefulness of performance information**

### **Measurability of indicators and targets**

44. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, while the period or deadline for delivery of targets must be specified.
- Performance indicators or measures 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 or measures must also be verifiable.

The measurability of planned targets and indicators could not be assessed, due to a lack of technical indicator descriptions as well as proper systems and processes.

## **Waste water management**

### **Usefulness of performance information**

#### **Measurability of indicators and targets**

45. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance and must be measurable, while the period or deadline for delivery of targets must be specified.
- Performance indicators or measures 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 or measures must also be verifiable.

The measurability of planned targets and indicators could not be assessed, due to a lack of technical indicator descriptions, proper systems and processes, and documented system descriptions.

### **Compliance with legislation**

46. 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**

47. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustment budget, as required by section 54(1)(c) of the MFMA.
48. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
49. The annual performance report for the financial year under review was not prepared, as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

## **Budgets**

50. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of sections 15 and 87(8) of the MFMA.
51. Expenditure was approved as unforeseen and unavoidable, which was considered by the council and the mayor of the parent municipality but not included in the approved annual budget, in contravention of municipal budget and reporting regulation (MBRR) 71(2).
52. The total unforeseen and unavoidable expenditure incurred exceeded 5% of own revenue, in contravention of MBRR 72.

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

53. 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 supporting records could not subsequently be provided, which resulted in the financial statements receiving a disclaimed audit opinion.

## **Audit committee**

54. The audit committee did not advise the council 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.
55. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
56. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
57. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.
58. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by municipal planning and performance management regulation (MPPMR) 14(4)(a)(ii).
59. The performance audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).
60. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

## **Procurement and contract management**

61. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations had been awarded in accordance with the legislative requirements and a procurement process that was fair, equitable, transparent and competitive, as bid documents could not be provided for auditing.
62. 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).
63. Bid specifications for the procurement of goods and services through competitive bids were drafted in a biased manner that did not allow all potential suppliers to offer their goods or services, in contravention of SCM regulation 27(2)(a).
64. Bid specifications were not always drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM regulation 27(3).
65. Sufficient appropriate audit evidence could not be obtained that bids had been evaluated by bid evaluation committees composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
66. Sufficient appropriate audit evidence could not be obtained that contracts had been awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA).
67. Sufficient appropriate audit evidence could not be obtained that contracts had been awarded to suppliers based on preference points allocated and calculated in accordance with the requirements of the PPPFA and its regulations.

68. Sufficient appropriate audit evidence could not be obtained that contracts had been awarded only to bidders who submitted 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).
69. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
70. Contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
71. Awards were made to providers who are in the service of the municipality or whose directors or principal shareholders are in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, providers failed to declare that they were in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality had not taken disciplinary action against the suppliers and officials involved.
72. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the MSA.
73. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps had been taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
74. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the codes of conduct for councillors and staff members issued in terms of the MSA.
75. Contracts were awarded to providers listed on the National Treasury's database as persons prohibited from doing business with the public sector, in contravention of SCM regulation 38(1)(c).
76. Contracts and 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**

77. Job descriptions were not established for all posts in which appointments had been made in the current year, in contravention of section 66(1)(b) of the MSA.
78. An acting director of development and planning and a director of public safety were appointed for a period of more than three months without the approval of the member of the executive council for local government, in contravention of section 54A(2A) of the MSA.
79. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
80. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

## **Expenditure management**

81. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
82. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
83. An effective system of expenditure control was not in place, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
- 84.
85. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors, as required by section 65(2)(b) of the MFMA.

## **Conditional grants received**

86. The municipality did not evaluate its performance in respect of programmes or functions funded by the allocation of the municipal systems improvement grant, as required by section 12(5) of DoRA.

## **Revenue management**

87. An adequate management, accounting and information system was not in place to account for revenue, debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.
88. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Asset management and liability management**

89. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
90. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
91. The municipality did not establish an investment policy that was adopted by the council, as required by section 13(2) of the MFMA and municipal investment regulation 3(1)(a).

## **Consequence management**

92. Unauthorised, irregular as well as fruitless and wasteful 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**

93. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

94. Senior management did not ensure that the municipality has implemented robust internal controls supported by strong capable governance structures to address the significant weaknesses in the control environment that were previously reported.

## **Financial and performance management**

95. The municipality does not have an effective records keeping management process to ensure that information reported in the annual financial statements, annual performance report and compliance with supply chain management are fully supported.

96. The municipality does not adequately monitor the implementation of internal controls designed to ensure complete and accurate information is reported in the annual financial statement and annual performance report.

97. Compliance with laws and regulations was not adequately monitored throughout the year.

## **Governance**

98. The internal audit plan was only implemented later in the year. The poor quality of reports submitted to the audit committee had a negative impact on the committee's ability to make meaningful and value adding recommendations to improve the control environment.

*Auditor-General*

Mbombela

30 November 2014



**AUDITOR - GENERAL**  
**SOUTH AFRICA**

*Auditing to build public confidence*