



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Auditor-General of South Africa

Msunduzi Municipality - Audit
report 2015-16

Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the council on Msunduzi Municipality

Report on the financial statements

Introduction

1. I audited the financial statements of the Msunduzi Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget with actual information 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 the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (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 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 opinion

Receivables

6. I was unable to obtain sufficient appropriate audit evidence that receivables from non-exchange transactions in respect of a prepayment of R93,66 million had been properly accounted for, due to the status of the accounting records. I was unable to confirm the prepayment by alternative means. Consequently, I was unable to determine whether any adjustment to receivables stated at R370,23 million and the related debt impairment provision of R244,50 million in the financial statements was necessary.

Payables from exchange transactions

7. The municipality did not recognise all payables from exchange transactions meeting the definition of a financial liability, in accordance with GRAP 104 *Financial instruments*. This was as a result of the municipality not maintaining adequate records of outstanding payments for goods and services received but not yet paid at year-end. I was therefore unable to determine the full extent of the understatement of payables from exchange transactions and the related expenditure as disclosed in note 16 of the financial statements as it was impracticable to do so.

Revenue – Fines

8. I was unable to obtain sufficient appropriate audit evidence for revenue from camera fines as disclosed in note 35 to the financial statements due to the status of the accounting records. The municipality did not have adequate systems of internal control in place for the recording of revenue from camera fines. I could not confirm revenue from camera fines by alternative means. Consequently, I was unable to determine whether any adjustment to revenue from camera fines stated at R34,50 million and the related traffic fine receivable of R30,36 million in the financial statements was necessary.

Commitments

9. The municipality did not disclose all contractual commitments, as required by GRAP 1 *Presentation of financial statements*. Contractual commitments shall be disclosed when the municipality has committed itself to future transactions which will result in the outflow of cash. Consequently, commitments of R92,48 million as disclosed in note 61 to the financial statements was understated.

Contingent liabilities

10. The municipality incorrectly disclosed contingent liabilities which did not satisfy the requirements of GRAP 19 *Provisions, contingent liabilities and contingent assets*, due to breakdowns in processes and controls. Consequently, I was unable to determine the overstatement of the contingent liabilities amounting to R102,33 million as disclosed in note 62 of financial statements, as it was impractical to do so.

Aggregation of immaterial uncorrected misstatements

11. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in revenue, receivables and investment property included in the statement of financial position, statement of financial performance and the notes to the financial statements.

Qualified opinion

12. 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 Msunduzi Municipality as at 30 June 2016 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 and DoRA.

Emphasis of matters

13. I draw attention to the matters below.

Restatement of corresponding figures

14. As disclosed in note 65 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Msunduzi Municipality at, and for the year ended, 30 June 2016.

Material losses and impairments

15. As disclosed in note 71 to the financial statements, material electricity losses of R181,96 million (208 million kilowatts) (2015: R179,28 million – 234 million kilowatts) were incurred as a result of electricity losses due to illegal connections.

16. As disclosed in note 71 to the financial statements, material water losses of R 119,72 million (21 million kilolitres) (2015: R 117,86 million - 23 million kilolitres) were incurred due to the ageing pipeline infrastructure.

17. As disclosed in note 4 to the financial statements, material allowances for impairment amounting to R244,50 million (2015: R247,79 million) were incurred as a result of an allowance for impairment of receivables from non-exchange transactions.

18. As disclosed in note 5 to the financial statements, material allowances for impairment amounting to R718,93 million (2015: R725,49 million) were incurred as a result of an allowance for impairment of receivables from exchange transactions.

Material underspending of the conditional grants

19. As disclosed in note 34 to the financial statements, the municipality underspent on the public transportation infrastructure grant and the integrated national electrification grant by R37,90 million and R25,34 million, respectively due to the delays in the implementation of the projects associated with these grants.

Additional matters

20. I draw attention to the matters below.

Unaudited supplementary schedules

21. 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.

Unaudited disclosure notes

22. 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

23. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, compliance with legislation and 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

24. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the *basic service delivery* objective presented in the annual performance report of the municipality for the year ended 30 June 2016.

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

26. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned objectives. 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).

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

28. I did not identify any material findings on the usefulness and reliability of the reported performance information for the *basic service delivery* objective.

Additional matter

29. I identified no material findings on the usefulness and reliability of the reported performance information for the selected objective; however, I draw attention to the following matter.

Achievement of planned targets

30. The annual performance report on pages x to x and x to x includes information on the achievement of the planned targets for the year.

Compliance with legislation

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

Annual financial statements

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/or the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

33. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, in contravention of supply chain management (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).
34. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
35. 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); the code of conduct for councillors, as well as the code of conduct for staff members issued in terms of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
36. Awards were made to providers who were in the service of the municipality and whose directors are in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, the provider failed to declare that they were in the service of the municipality, as required by SCM regulation 13(c).
37. Awards were made to providers who were in the service of other state institutions or whose directors were 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 previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).

38. Persons in 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, in contravention of SCM regulation 46(2) (e) and the code of conduct for staff members issued in terms of the MSA.

Expenditure management

39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.
40. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, and which also accounted for creditors and payments made, as required by section 65(2)(b) of the MFMA.
41. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1) (d) of the MFMA.

Revenue management

42. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2) (e) of the MFMA.

Liability management

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

Internal control

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

Leadership

45. Oversight over key internal controls was not adequate to ensure that the municipality's control environment prevented significant deficiencies related to financial and compliance reporting. The leadership did not act swiftly in ensuring that commitments in the action plans were monitored on a regular basis and key vacancies in key positions were not filled in good time to promote a sound control environment.

Financial management

46. Daily and monthly processes coupled with adequate records management were not adequate to ensure quality financial and compliance reporting. Management did not decisively respond to breakdowns in key control activities due to a lack of understanding of applicable financial and compliance reporting requirements.

Governance

47. The leadership and management did not create a sound and sustainable control environment by institutionalising an adequate and appropriate risk management strategy and mitigation plan. Consequently basic internal controls were not implemented to prevent, detect and respond to risks that support reliable reporting.

Other reports

48. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

Investigations

49. Internal audit performed numerous investigations at the request of the accounting officer. The investigations related to allegations of fraud, corruption, theft, mismanagement, and SCM irregularities. Twenty-two investigations were concluded during the 2015-16 financial year. Two investigations resulted in the institution of criminal charges.
50. The provincial department of Cooperative Governance and Traditional Affairs requested that an investigation be conducted after a senior staff member was suspended. The investigation commenced in May 2016 and covered the period 2012 to April 2016. The investigation was initiated based on an allegation of maladministration and is still in progress.

Pietermaritzburg

30 November 2016



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