Auditor's report

Emakhazeni Local Municipality

30 June 2016

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

Report on financial statements

Introduction

1. I have audited the financial statements of the Emakhazeni Local 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 information 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 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, 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 these 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 qualified audit opinion.

Basis for qualified of opinion

Property plant and equipment

6. In terms of GRAP 17, Property, plant and equipment, an entity must measure items of property, plant and equipment that meet the recognition and measurement criteria of assets at cost in the financial statements. Contrary to this requirement, assets were valued at incorrect amounts as individual components were recognised at amounts which differed from the supporting documents provided, resulting in property, plant and equipment being misstated by R147 669 452. Furthermore, opening balances were restated without proper supporting documents as disclosed in note 41 to the financial statements. I was unable to confirm the adjustment by alternative means. Consequently, I was unable to determine whether any adjustment to property, plant and equipment amounting of R780 302 698 (2015: R771 690 517), as disclosed in note 4 to the financial statements, were necessary. Additionally, there was a resultant impact on depreciation and accumulated depreciation.

Revenue from non-exchange transactions

7. In terms of GRAP 9, Revenue from non-exchange transactions, an entity must recognise revenue from rendering of services when the transaction occurs. Contrary to the requirement, the municipality failed to bill some of the property owners included on the valuation roll. Furthermore, incorrect rates were used in calculating the property rates revenue. I was unable to determine the extent of this misstatement, as it was impracticable to do so. Consequently, property rates revenue stated at R29 065 057 (2014-15: R16 928 257) and receivables from non- exchange transaction stated at R12 921 139 (2014-15: R4 016 400), as disclosed in note 19 and note 9 to the financial statements, respectively, were misstated. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

Revenue from Exchange transaction

8. In terms GRAP 23, Revenue from exchange transaction, the municipality is required to recognise revenue from the rendering of service when it can be estimated reliably. Contrary to this requirement, some electricity meters installed during the current year were not captured on the billing system, resulting in owners of those meters not being billed for services rendered. I was unable to determine the extent of this misstatement, as it was impracticable to do so. Consequently, electricity revenue stated at R44 373 781 (2014-15: R32 894 673) in note 20 and receivables from exchange transaction stated at R20 173 284 (2014-15: R75 510 137), as disclosed in note 20 and 10 to the financial statements, respectively, were misstated. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

Cash flow statement

9. I was unable to obtain appropriate audit evidence to determine whether the cash flow was fairly stated due to numerous items contributing to the qualified opinion that affected the items in the statement of financial position and the statement of financial performance.

Receivables from exchange and non-exchange transactions

10. In terms of GRAP 104, Financial instruments, an entity is required to assess individually significant financial assets for impairment where there are indicators of impairment and collectively assess insignificant financial assets with group of assets with similar credit characteristics. Contrary to this requirement, the municipality applied a similar rate of impairment for their debtors regardless of their credit characteristics. . I was unable to determine the extent of this misstatement, as it was impracticable to do so. Consequently, receivables from exchange and non-exchange transactions were misstated by R72 197 474 (2014-15: R32 363 924) in note 28 to the financial statements and expenditure was misstated by the same amount. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

Irregular expenditure

11. In terms of section 125(2)(d)(i) of the MFMA, the notes to the financial statements of a municipality must include any material irregular expenditure incurred during the current year. Contrary to the requirement of the act, irregular expenditure amounting to R26 129 262 was not disclosed in the municipality's financial statements. Consequently, irregular expenditure amounting to R39 745 973 (2014-15: R21 950 973) disclosed in note 45 to the financial statements is understated.

Qualified opinion

12. In my opinion, except for the effect of the matters described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Emakhazeni Local 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. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

14. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 30 June 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015

Material losses

15. As disclosed in note 47 to the financial statements, material losses of R9 356 700 (2014-15: R2 677 200) were incurred as a result of electricity distribution losses, which represent 24% (2014-15: 9%) of the total electricity purchased. Material losses of R3 740 292 (2014-15: R1 828 190) were incurred as a result of water distribution losses, which represent 52% (2014-15: 22%) of the total water purchased.

Material impairments

16. As disclosed in note 10 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R78 983 795 (2014-15: R19 056 790), which represented 80% (2014-15: 20 %) of the total consumer debtors. The contribution to the provision for debt impairment was R59 927 005 (2014-15: R 35 997 071).

Additional matter paragraphs

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

Unaudited supplementary schedules

18. 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 schedule(s) and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

19. 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

20. 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 development priorities presented in the annual performance report, compliance with legislation and internal control. I performed tests 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

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:

    - Development objective 1: Service delivery and infrastructure on pages x to x.

22. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned development priorities. 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).

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

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

Service delivery and Infrastructure development

Usefulness of reported performance information

25. Section 41(c) of the Municipal Systems Act (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. Important reported objectives, indicators and targets were not consistent with those in the approved integrated development plan.

26. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance and specify the period or deadline for delivery. Important targets were not specific.

Reliability of reported performance information

27. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Additional matter

28. I draw attention to the following matter.

Achievement of planned targets

29. Refer to the annual performance report on pages x to x for information on the achievement of 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 in paragraphs 25, 26 and 27 of this report

Compliance with legislation

30. Included below are material findings on compliance with selected specific requirements of applicable legislation, as set out in the general notice issued in terms of the PAA.

Strategic planning and performance management

31. The adopted integrated development plan did not reflect and identify a financial plan, as required by sections 26 and 41 of the MSA, as well as municipal planning and performance management regulation 2(1)(c).

Annual financial statements and annual reports

32. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
33. 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 of non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

34. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
35. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
36. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

Expenditure management

37. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
38. Reasonable steps were not taken to present irregular expenditure, as required by section 62(1)(d) of the MFMA.
39. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
40. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

41. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
42. An adequate management, accounting and information system which accounts for revenue and receivables was not in place, as required by section 64(2)(e) of the MFMA.
43. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
44. Account for service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA

Asset management

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

Internal control

46. I considered internal control relevant to my audit of the financial statements, 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 the annual performance report and the findings on compliance with legislation included in this report.

Leadership

47. The accounting officer did not review the financial statements and the annual performance report before submitting them for auditing.

48. Management did not monitor adherence to the audit action plans in a timely manner.

49. The accounting officer delegated the implementation of daily and monthly controls to management. However, the monitoring tools used by the accounting officer to monitor the implementation of these controls were not effective to identify challenges facing the municipality and to allow for timely corrective action where required.

Financial and performance management

50. The staff did not fully understand the requirements of the financial reporting framework and the FMPPI.

51. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

52. Management did not ensure that daily and monthly controls were effectively and consistently implemented throughout the period.

53. Management at the appropriate level did not ensure that compliance with applicable legislation was adequately reviewed and monitored throughout the year, which resulted in non-compliance with supply chain management prescripts.

54. Supporting schedules submitted with the financial statements for auditing were not adequately reviewed for accuracy and completeness, as errors were noted in these schedules during the audit.

Governance

55. The internal audit unit and audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management on the improvements on the internal controls to ensure reliable reporting on both financial and performance information as well as compliance with legislation. This has not, however, resulted into improvement in the controls due to management's failure to implement recommendations, which in turn led to the adverse assessment on the impact of this unit and committee.

Auditor - General

Mbombela

20 December 2016

AUDITOR-GENERAL
SOUTH AFRICA

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