

Auditor's report

Victor Khanye Local Municipality

30 June 2016

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 statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and 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 my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. In terms of GRAP 17, *Property, plant and equipment*, an entity must recognise items of property, plant and equipment that meet the recognition and measurement criteria of assets in the financial statements. The municipality earmarked land for transfer to others, including RDP houses. However, this land was not accounted for as inventory at year-end, as the intention is to dispose of it in future, resulting in an overstatement of property, plant and equipment and an understatement of inventory. I was unable to determine the extent of this misstatement, as it was impracticable to do so. Furthermore, differences of R7 823 448 were noted between the general ledger and the fixed asset register. Consequently, property, plant and equipment of R1 269 375 159 (2014-15: R1 272 492 680) and inventory of R1 598 713 disclosed in notes 5 and 10 to the financial statements, respectively, were not fairly stated.

Cash and bank

7. The municipality was unable to reconcile the bank balance of R7 249 214 as per the bank confirmation to the cash book overdraft of R22 716 571. Furthermore, the municipality processed adjustments relating to prior year accrual invoices amounting to R13 979 805 in the cash book instead of the accruals and expenditure relating to the 2014-15 financial period. Consequently, cash and cash equivalent of R22 716 571, 2014-15 accruals of R31 778 833 and bulk purchases of R112 821 550 disclosed in notes 16, 22 and 45 to the financial statements, respectively, were misstated.

Payables

8. I was unable to obtain sufficient appropriate audit evidence for the debit amount included in payables. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to payables of R54 318 807 disclosed in note 22 to the financial statements.

Revenue from exchange transactions

9. In terms of GRAP 9, *Revenue from exchange transactions*, an entity must recognise revenue from the rendering of services when the transaction occurs. Contrary to this requirement, the municipality did not bill some of the customers for water and electricity, while some customers were billed incorrectly due to differences between the meter reading books and the billing report. I was unable to determine the extent of this misstatement, as it was impracticable to do so. Consequently, debtors disclosed at R80 298 320 (2014-15: R69 238 745) in note 14 to the financial statements and revenue disclosed at R201 561 340 (2014-15: R186 223 265) in note 28 to the financial statements were misstated.

Cash flow

10. I was unable to obtain appropriate audit evidence to determine whether the cash flow statement was fairly stated, due to numerous differences identified in cash flow from operating activities, net cash flow from investing activities and net cash flow from financing activities. As a result, the cash flow statement was misstated.

Irregular expenditure

11. In terms of section 125 of the MFMA, the notes to the financial statements of a municipality must include any material irregular expenditure incurred during the year. Contrary to this requirement, irregular expenditure of R3 901 909 was not disclosed in the financial statements of the municipality. The municipality also adjusted the prior year balance without providing supporting documents. I was unable to confirm the amount by any alternative means. Consequently, irregular expenditure of R28 821 896 disclosed in note 56 to the financial statements was understated.

Qualified opinion

12. In my opinion, except for the effect 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 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 51 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during the year ended 30 June 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material impairments

15. As disclosed in note 34 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R370 464 049 (2014-15: R302 853 721), which represented 83% (2014-15: 81%) of the total consumer debtors. The contribution to the provision for debt impairment was R42 294 690 (2014-15: R55 249 874).

Additional matters

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

Unaudited supplementary schedules

17. 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.

Unaudited disclosure notes

18. 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

19. 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

20. 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 priority 1: basic service delivery and infrastructure on pages ... to ...
 - Development priority 6: local economic development on pages ... to ...
21. 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).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected development priorities are as follows:

Basic service delivery and infrastructure

Usefulness of reported performance information

24. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (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. Important reported indicators and targets were not consistent with those in the approved IDP.
25. The FMPPI requires performance targets to be measurable. Important targets were not measurable.

26. The FMPPI requires performance indicators to be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. Important indicators were not well defined.
27. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. Important indicators were not verifiable.

Reliability of reported performance information

28. 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. The reported achievements against the planned targets of important indicators were not reliable when compared to the evidence provided.

Local economic development

Usefulness of reported performance information

29. 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 indicators and targets were not consistent with those in the approved IDP.

Reliability of reported performance information

30. 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. The reported achievements against the planned targets of important indicators were not reliable when compared to the evidence provided.

Additional matters

31. I draw attention to the following matters:

Achievement of planned targets

32. Refer to the annual performance report on pages ... 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 in paragraphs 24 to 30 of this report.

Adjustment of material misstatements

33. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information for basic service delivery and infrastructure and local economic development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Compliance with legislation

34. I performed procedures to obtain evidence that the municipality had 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 and annual reports

35. 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, which resulted in the financial statements receiving a qualified audit opinion.
36. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.
37. The oversight report was not adopted by the council and was not made public, as required by section 129(3) of the MFMA.

Procurement and contract management

38. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
39. 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

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

Revenue management

44. An effective system of internal control for revenue and debtors was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

45. 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.

Consequence management

46. Unauthorised 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) of the MFMA.
47. 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)(b) of the MFMA and municipal budget and reporting regulation 75(1).
48. 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)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Internal control

49. 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, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

50. The accounting officer did not adequately review monthly reports or the financial statements and annual performance report prior to their submission for auditing.
51. The municipality did not have sufficient capacity to plan, manage and report on its performance.

Financial and performance management

52. Non-compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored.

Governance

53. The audit committee did not ensure that the internal audit unit was fully equipped to perform its functions, as the unit was only fully capacitated towards the end of the financial year.
54. The internal audit unit did not perform most of the planned audits, while some of the audits were performed late.

55. The audit committee did not follow-up on their recommendations to ensure that they were fully implemented to assist the municipality to improve.

Mbombela

30 November 2016



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence