

Auditor-General of South Africa

**Big 5 Hlabisa Municipality**

**Audit report 2017-18**

# Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the council on Big 5 Hlabisa Municipality

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Big 5 Hlabisa Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effect of the matter described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Big 5 Hlabisa Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended 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, 2017 (Act No. 3 of 2017) (Dora).

### Basis for qualified opinion

#### Value-added Tax Payable

3. The municipality did not record value added tax as required by the Value Added Tax Act of South Africa, 1991 (Act No.89 of 1991). Additionally, I was unable to obtain sufficient appropriate audit evidence for adjustments made to VAT payables due to the status of accounting records and I could not confirm this by alternative means. Consequently, I was unable to determine the full extent of the misstatement on VAT payable stated at R684 840 in the financial statements.

### Context for the opinion

4. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
5. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Material uncertainty relating to going concern**

7. As disclosed in note 35 to the financial statements the municipality's current liabilities exceeded its current assets by R5,69 million. These conditions, along with other matters as set forth in note 35 to the financial statements, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

### **Emphasis of matter**

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

### **Impairment of trade debtors**

9. As disclosed in note 27 to the financial statements, the municipality recognised a provision for bad debts of R2,34 million (2017: R9,50 million) on trade debtors, as the recoverability of these amounts was doubtful.

### **Other matter**

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

### **Unaudited disclosure notes**

11. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

### **Responsibilities of the accounting officer for the financial statements**

12. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and 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.
13. In preparing the financial statements, the accounting officer is responsible for assessing the Big 5 Hlabisa's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

14. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are

considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

15. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

## Report on the audit of the annual performance report

### Introduction and scope

16. 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 material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
17. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
18. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2018:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
KPA 2: Local economic development	x – x
KPA 3: Basic service delivery and infrastructure development	x – x

19. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

20. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

## **KPA 2 – Local economic development**

### **Promote poverty alleviation projects to all wards**

21. I was unable to obtain sufficient appropriate audit evidence to support the reported achievement of thirteen poverty alleviation projects by 30 June 2018. This was due to a lack of technical indicator descriptions and proper performance management systems and processes and formal standard operating procedures or documented systems descriptions that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievement of the indicator by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of zero poverty alleviation projects as reported in the annual performance report.

### **Issuing of business licence by 30 June 2018**

22. The achievement for business licences issued reported in the annual performance report was 26 business licences issued. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 32 business licences issued.

### **Number of co-operatives established and registered by 30 June 2018**

23. The reported achievement for co-operatives established and registered by 30 June 2018 is not reliable as the municipality did not have an adequate performance management system to maintain records to enable reliable reporting on achievement of target. As a result, I was unable to obtain sufficient appropriate audit evidence in some instances while in other cases the supporting evidence provided did not agree to the reported achievement. Based on the supporting evidence that was provided, the achievement was 8, but we were unable to further confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement.

### **Co-ordination of SMME's trainings**

24. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of 7 SMME trainings provided. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of 7 SMME trainings provided as reported in the annual performance report.

## **KPA 3 – Basic service delivery and infrastructure development**

### **Indicator - Development of Master plan by 31 May 2018**

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of completed roads and storm water master plan and municipal and amenities master plan. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of the master plans by 31 May 2018 as reported in the annual performance report.

## **Other matter**

26. I draw attention to the matter below.

### **Achievement of planned targets**

27. The annual performance report on pages ... to ... includes 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 20 to 24 of this report.

## **Report on the audit of compliance with legislation**

### **Introduction and scope**

28. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

29. The material findings on compliance with specific matters in key legislation are as follows:

### **Annual financial statements**

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current asset, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, 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**

31. Sufficient appropriate audit evidence could not be obtained that all contracts were awarded in accordance with the legislative requirements due to inadequate record management and registry that is not adequately fire proofed.

32. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by Suuply Chain Management (SCM) regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.

33. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by inviting competitive bids, as required by SCM regulations 19(a). Similar non-compliance was also reported in the prior year.

34. Some of the contracts were awarded through a competitive bidding processes that were not adjudicated by the bid adjudication committee.

35. Some of the contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations.
36. Some of the contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA and its regulations.
37. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the Construction Industry Development Board Act of South Africa, 2000 (Act No. 38 of 2000).
38. Bid documentation for procurement of commodities designated for local content and production, did not stipulated the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2). Similar non-compliance was also reported in the prior year.

### **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. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R9,67 million, as disclosed in note 37 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by inadequate controls to monitor spending of the budget.
41. Reasonable steps were not taken to prevent irregular expenditure amounting to R12,75 million as disclosed in note 39 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the SCM regulations as detailed in the procurement and contract management compliance findings in paragraphs 30 to 37 of this report.
42. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R796 506, as disclosed in note 38 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties as a result of late payments of suppliers and the South African Revenue Services.

### **Consequence management**

43. Unauthorised, irregular and 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) of the MFMA.

### **Strategic planning and performance management**

44. The performance management system and related controls were inadequate as it did not describe how the performance monitoring, measurement, review and reporting processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

## Other information

45. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
46. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
47. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
48. The other information I obtained prior to the date of this auditor's report is the foreword by the mayor and the foreword by the municipal manager. The audit committee's report and other related supporting schedules are expected to be made available to me after 30 November 2018.
49. If, based on the work I have performed on the other information that I obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.
50. When I do receive and read the audit committee's report and other related annual report supporting schedules, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

## Internal control deficiencies

51. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it.
52. 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.
53. The accounting officer did not exercise adequate oversight responsibility regarding financial and performance reporting and compliance with legislation. In this regard, the accounting officer did not ensure the policies and procedures are appropriately implemented to support the achievement of credible reporting and compliance with legislative requirements.



54. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information as evidenced by the material misstatements identified in the annual financial statements and material findings on the annual performance report. This was due to management not fully understanding the requirements of the financial and performance reporting frameworks and vacancies in key management positions.

*Auditor-General*

Pietermaritzburg

28 November 2018



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SOUTH AFRICA

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## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit 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
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Big 5 Hlabisa Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.