

# REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON HIBISCUS COAST MUNICIPALITY

## REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

### Introduction

1. I have audited the consolidated and separate financial statements of the Hibiscus Coast Municipality and its subsidiary set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2012, the consolidated and separate statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate 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, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate 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 consolidated and separate financial statements based on my audit. I conducted my 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. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

### Opinion

6. In my opinion, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Hibiscus Coast Municipality and its subsidiary as at 30 June 2012, and their 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**

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

### **Irregular expenditure**

8. As disclosed in note 52 to the consolidated financial statements, irregular expenditure of R7,2 million was incurred in the current year due to non-compliance with the municipal supply chain management regulations.

### **Unauthorised expenditure**

9. As disclosed in note 50 to the consolidated financial statements, unauthorised expenditure of R50,9 million was incurred due to overspending of the employee costs, debt impairment, finance charges, bulk purchases and general expenses budgets.

### **Material losses**

10. As disclosed in note 54 to the consolidated financial statements, material losses to the amount of R1,8 million were incurred as a result of electricity distribution losses.

### **Material impairment**

11. As disclosed in note 12 to the consolidated financial statements, the municipality had a provision for debt impairment amounting to R25,8 million at year-end.

### **Restatement of corresponding figures**

12. As disclosed in note 45 to the consolidated financial statements the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during 2012 in the financial statements of the Hibiscus Coast Municipality, at and for the year ended, 30 June 2011.

### **Going concern**

13. As disclosed in note 48 to the consolidated financial statements the ability of the municipal entity to continue as a going concern is dependent on continued financial support from the parent municipality and IDC.

### **Additional matter**

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

### **Unaudited supplementary schedules**

15. 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 this schedule and, accordingly, I do not express an opinion thereon.

### **Material inconsistencies in other information included in the draft annual report**

16. I have not obtained the other information included in the draft annual report for my review and as such have not been able to identify any material inconsistencies with the

consolidated financial statements.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

17. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

### **Predetermined objectives**

18. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
19. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development priorities or objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMPPI).
20. The reliability of the information in respect of the selected development priorities or objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
21. The material findings are as follows:

### **Usefulness of information**

#### **Presentation**

22. Section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 79% of the measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity and accuracy of the measures taken to improve performance.

#### **Consistency**

23. The MSA, section 41(1)(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 41% of objectives and 25% of targets reported in the annual performance report were not consistent with the objectives and targets as per the approved integrated development plan. This is due to the staff involved in the compilation of the predetermined objectives and reporting not having a full, clear understanding of the performance reporting framework and guidelines.

24. Section 54(1)(c) of the MFMA requires changes to the service delivery and budget implementation plan to be approved by council following the approval of an adjustments budget. A total of 95% of targets reported in the annual performance report were changed without being approved. This is due to the staff involved in the compilation of the predetermined objectives and reporting not having a full, clear understanding of the performance reporting framework and guidelines.

### **Measurability**

25. The National Treasury FMPPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 50% of the indicators were not verifiable in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. The root cause is that the directors of the respective departments involved in the compilation of the predetermined objectives and reporting do not have a full, clear understanding of the performance reporting framework and guidelines.

### **Reliability of information**

#### **Accuracy**

26. The National Treasury FMPPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 77% of the actual reported performance relevant to Local Economic Development objective were not accurate when compared to source information. This was due to a lack of monitoring operating procedures for the recording of actual achievements as there was no formal process in place to facilitate the implementation of Local Economic Development initiatives to allow for data to be collected consistently.

#### **Completeness**

27. The National Treasury FMPPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 77% of the actual reported performance for the selected objectives was not completely recorded. This was due to lack of a document management system with regard to actual performance achievements.

### **Compliance with laws and regulations**

28. I performed procedures to obtain evidence that the municipality and municipal entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the *General Notice* issued in terms of the PAA, are as follows:

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

29. The parent municipality with effective control of a municipal entity did not ensure that the annual performance objectives and indicators for the municipal entity are established by

agreement with the municipal entity and are included in the municipal entity's multi-year business plan, as required by section 93B(a) of the MSA.

30. The performance of the Hibiscus Coast Development Agency was not monitored and annually reviewed as part of the annual budget process, as required by section 93B(b) of the MSA.

### **Consolidated annual financial statements, annual performance report and annual reports**

31. The consolidated 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 property, plant and equipment, investment property, irregular expenditure, unauthorised expenditure, accumulated surplus and disclosure notes identified by the auditors were subsequently corrected, resulting in the consolidated financial statements receiving an unqualified audit opinion.
32. The annual performance report for the year under review does not include the performance of the municipality and external service providers, as required by section 46(1)(a) of the MSA.

### **Internal audit**

33. The internal audit unit did not function as required by section 165(2) of the MFMA. Internal audit did not prepare a risk-based audit plan and an internal audit programme for the municipal entity for the financial year under review.

### **Budget**

34. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.
35. Monthly budget statements were not submitted to the accounting officer of the parent municipality, as required by section 87(11) of the MFMA.

### **Expenditure management**

36. The accounting officer did not take effective steps to prevent irregular and unauthorised expenditure, as required by section 62(1)(d) of the MFMA.

### **Procurement and contract management**

37. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(1)(a) and (c).
38. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
39. Awards were made to providers who are persons in the service of the municipality and/or whose directors/ principal shareholders are persons in service of the municipality, in contravention of SCM regulation 44. Furthermore the provider failed to

declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

40. Awards were made to providers who are persons in service of other state institutions or whose directors/ principal shareholders are persons in service of other state institutions, in contravention of SCM regulation 44.
41. 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).
42. 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, as required by SCM regulation 46(2)(e).

#### **Internal control**

43. I considered internal control relevant to my audit of the consolidated financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

44. The accounting officers did not exercise oversight responsibility over procurement of goods and services to ensure that they comply with the requirements of the municipal SCM regulations. The accounting officers did not develop strategic planning documents for the municipal entity as required by the MSA.

#### **Financial and performance management**

45. The accounting officers did not ensure that regular accurate and complete financial and performance reports that are supported and evidenced by reliable information were prepared. This resulted in material amendments being made to the financial statements submitted for audit. Action plans to address internal control deficiencies were not adequately monitored, resulting in non-compliance with applicable laws and regulations.

#### **Governance**

46. There was no risk assessments performed for the municipal entity and its internal audit was not functional for the year under review.

*Auditor General*

Pietermaritzburg

21 December 2012



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

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