



# Report of the auditor-general to the North West provincial legislature and the council on the Ngaka Modiri Molema District Municipality

## Report on the financial statements

### Introduction

1. I was engaged to audit the financial statements of the Ngaka Modiri Molema District Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2015, 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 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, 2014 (Act No. 10 of 2014) (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 conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

### Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment to substantiate the cost, residual values, useful lives and assessment used in calculating the carrying values of assets at year end or that all items of property, plant and equipment were recorded due to the municipality not having adequate systems in place to account and maintain records of its property, plant and equipment. In addition, I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure to rectify a prior year misstatement or that this misstatement was corrected retrospectively. The municipality's records did not permit the application of alternative audit procedures.

Consequently, I was unable to verify whether any adjustments to property, plant and equipment of R4 822 840 596 (2014: R4 923 441 715) included in note 3 or the depreciation and amortisation expense of R229 414 501 (2014: R236 971 410) as included in note 22 to the financial statements were necessary.

## Inventories

5. I was unable to obtain sufficient appropriate audit evidence for inventories as the municipality did not have an adequate system in place to account for and maintain records of inventories. In addition, I was unable to confirm the inventories by alternative means. Consequently, I was unable to determine whether any adjustments relating to inventories of R30 485 891 (2014: R23 408 683) included in note 6 to the financial statements was necessary.

## Receivables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions as the municipality do not have adequate systems in place to account for and maintain records of its receivables from exchange transactions. I was unable to confirm these receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables from exchange transactions of R10 619 195 (2014: R12 333 007) included in note 7 to the financial statements was necessary.

## VAT receivable

7. I was unable to obtain sufficient appropriate audit evidence for the VAT receivable as the municipality do not have adequate systems in place to reconcile, account and maintain records of its VAT receivable. I was unable to confirm the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustments relating to VAT receivable of R161 378 714 (2014: R155 232 919) included in note 8 to the financial statements was necessary.

## Cash and cash equivalents

8. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents as the municipality did not have adequate systems in place to reconcile cash and cash equivalents. In addition, cash and cash equivalents of R46 400 403 (2014: R34 753 565) were incorrectly disclosed in both notes 5 and 9 to the financial statements. I was unable to confirm the cash and cash equivalents by alternative means. Consequently, I was unable to determine whether any adjustments relating to cash and cash equivalents of R90 446 416 (2014: R141 186 483) in the financial statements was necessary.

## Other liability

9. The municipality did not recognise the other liability at the correct amount as required by GRAP 1 *Presentation of financial statements*, as a difference exists between the loan statement and the financial statements and the municipality do not have adequate systems in place to account for its other liability. Consequently, the other liability and VAT receivable were overstated by R12 908 360 and R1 585 237 respectively and accumulated surplus was understated by R11 323 123.

## Payables from exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions as the municipality did not have an adequate system in place to reconcile, account for and maintain records of its payables from exchange transactions. I was unable to confirm these payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments relating to payables from exchange transactions of R465 111 271 (2014: R471 850 570) included in note 14 to the financial statements was necessary.

## Unspent conditional grants and receipts

11. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts as the municipality did not have an adequate system in place to reconcile, account for and maintain records of its unspent conditional grants and receipts. I was unable to confirm these unspent conditional grants and receipts by alternative means. Consequently, I was unable to determine whether any adjustments relating to unspent conditional grants and receipts of R258 686 997 (2014: R127 923 449) disclosed in note 10 or government grants and subsidies of R658 851 886 (2014: R771 902 902) disclosed in note 17 to the financial statements was necessary.

## Revenue from non-exchange transactions

12. The district municipality did not recognise government grants and subsidies revenue at the correct amount as required by GRAP 23 *Revenue from non-exchange transactions* as the municipality do not have adequate systems in place to account for revenue from non-exchange transactions. Consequently, government grants and subsidies was understated by R20 973 000 and unspent conditional grants and receipts was overstated by the same. Additionally, there was a resultant impact on the deficit and the accumulated surplus for the period.

## Expenditure

13. I was unable to obtain sufficient appropriate audit evidence for expenditure as the municipality did not have adequate systems in place to maintain records of its expenditure. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to repairs and maintenance, contracted services, transfers and subsidies and general expenses totalling R446 406 026 (2014: R304 335 744) in the financial statements was necessary.

## Employee cost

14. I was unable to obtain sufficient appropriate audit evidence for employee cost as the municipality do not have adequate systems in place to reconcile, account for and maintain records of its employee cost. I was unable to confirm the employee cost by alternative means. Consequently, I was unable to determine whether any adjustments relating to employee related costs and remuneration of councillors totalling R289 959 086 (2014: R261 452 605) as disclosed in notes 19 and 20 to the financial statements were necessary.

## Commitments

15. I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality did not have an adequate document management system in place, to disclose its commitments. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any adjustments relating to commitments of R772 574 114 (2014: R335 182 412) as disclosed in note 28 to the financial statements was necessary.

## Contingencies

16. I was unable to obtain sufficient appropriate audit evidence for contingencies as the municipality did not have adequate systems in place to maintain records of its legal correspondence. In addition, the municipality did not have adequate systems in place to accurately record its contingencies; resulting in contingencies being overstated by R107 314 004 in the current year and understated by R22 393 924 in the prior year. I was unable to confirm the contingencies by alternative means and could not practicably determine the resulting overall misstatement. Consequently, I was unable to determine whether any further adjustments relating to contingencies as disclosed in note 29 to the financial statements was necessary.

## Prior period errors

17. I was unable to obtain sufficient appropriate audit evidence that all the prior period errors were appropriately disclosed as required by GRAP 3 *Accounting policies, changes in accounting estimates and errors*. In addition, I was unable to obtain sufficient appropriate audit evidence for a difference of R1 431 149 282 between the adjustments in the statement of changes in net assets and adjustments disclosed in note 31 to the financial statements. I was unable to confirm the disclosure relating to the prior period errors or the adjustments to the accumulated surplus by alternative means. Consequently, I was unable to determine whether any adjustment to prior period errors disclosed in note 31 or any other account balances, transactions and disclosures affected by these prior period errors to the financial statements were necessary.

## Unauthorised expenditure

18. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure disclosed in note 34 to the financial statements as no accurate comparison of budget versus actual expenditure per vote was available. In addition unauthorised expenditure of R551 772 (2014: R15 105 681) were incurred that was not disclosed by the municipality. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any further adjustment to unauthorised expenditure was necessary.

## Fruitless and wasteful expenditure

19. Section 125 of the MFMA requires the disclosure of fruitless and wasteful expenditure incurred. The municipality made payments of R15 581 811 (2014: R9 820 145) that is regarded as fruitless and wasteful expenditure which were not included in fruitless and wasteful expenditure disclosed. Consequently, fruitless and wasteful expenditure as per note 35 to the financial statements is understated by R25 401 957 (2014: R9 820 145).

## Irregular expenditure

20. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R104 698 512 (2014: R978 897 985) contrary to the supply chain management requirements which were not included in irregular expenditure disclosed. Consequently, irregular expenditure as per note 36 to the financial statements is understated by R1 083 596 497 (2014: R978 897 985). As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure as per note 36 to the financial statements.

## Financial instruments

21. The municipality did not disclose the carrying values of the different categories or details about significant financial instruments as required by GRAP 104, *Financial instruments* as the municipality did not maintain adequate records relating to the assessment of financial instruments. In addition the municipality did not disclose all the requirements relating to the exposure to credit risk, liquidity risk and interest rate risk. I was unable to determine the correct disclosure as per note 32 to the financial statements for the financial instruments as it was impracticable to do so.

## Cash flow statement

22. I was unable to obtain sufficient appropriate audit evidence for the amounts included in the cash flow statement for the current and prior period taking into account the misstatements identified in the financial statements and set out in this report. I was unable to practicably quantify the misstatements in the cash flow statement and notes thereto or verify the amounts by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement and notes thereto were necessary.

## Statement of comparison of budget and actual amounts

23. I was unable to obtain sufficient appropriate audit evidence for the amounts included in the statement of comparison of budget and actual amounts taking into account the misstatements identified in the financial statements and set out in this report. I was unable to practicably quantify the misstatements in the statement of comparison of budget and actual amounts by alternative means. Consequently, I was unable to determine whether any adjustments relating to the statement of comparison of budget and actual amounts were necessary.

## Disclaimer of opinion

24. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

## Additional matters

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

## Unaudited disclosure notes

26. In terms of section 125(2) (e) of the MFMA the district 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.



## Unaudited supplementary schedules

27. 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.

## Report on other legal and regulatory requirements

28. 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. 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

29. 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 district municipality for the year ended 30 June 2015:
- Development priority 2: Basic service delivery and infrastructure development on pages XX to XX.
  - Development priority 3: Promote financial viability on pages XX to XX.
  - Development priority 5: Good governance and public participation on pages XX to XX.
30. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
31. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance 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).
32. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
33. The material findings in respect of the selected development priorities are as follows:

## Development priority 2: Basic service delivery and infrastructure development

### Usefulness of reported performance information

34. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measurable and time bound:
- A total of 33% of performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use.
  - A total of 52% of performance targets were not specific in clearly identifying the nature and required level of performance and were not measurable

The measurability of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions and formal standard operating procedures or documented system descriptions.

### **Reliability of reported performance information**

35. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete 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 limitations placed on the scope of our work due to the absence of information systems and 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.

### **Development priority 3: Promote financial viability**

#### **Usefulness of reported performance information**

36. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. Significantly important indicators did not relate logically and directly to the aspects of the auditee's mandate and the realisation of the strategic goals and objectives. This was because proper performance planning and management practices had not been implemented to provide for the development of indicators.

#### **Reliability of reported performance information**

37. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Adequate and reliable corroborating evidence could not be provided for 33% of the targets to assess the reliability of the reported performance information. The auditee's records did not permit the application of alternative audit procedures.

### **Development priority 5: Good governance and public participation**

#### **Usefulness of reported performance information**

38. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. Significantly important indicators did not relate logically and directly to the aspects of the auditee's mandate and the realisation of the strategic goals and objectives. This was because proper performance planning and management practices had not been implemented to provide for the development of indicators.

#### **Reliability of reported performance information**

39. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete 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 limitations placed on the

scope of our work due to the absence of information systems and 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**

40. I draw attention to the following matter:

## **Achievement of planned targets**

41. Refer to the annual performance report on pages XX to XX 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 for the selected development priorities reported in paragraphs 34 to 39 of this report.

## **Compliance with legislation**

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

## **Strategic planning and performance management**

43. Key performance indicators, including input and output indicators, in respect of each of the development priorities and objectives were not set out in the integrated development plan (IDP), as required by section 41(1) (a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and regulations 1 and 9(1)(a) of the Municipal planning and performance management regulations (MPPMR).
44. Measurable performance targets for the financial year were not set in the IDP, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the MPPMR.
45. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
46. The performance management system and related controls were not maintained as it did not describe and represent the process of performance monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by section 38 of the MSA and regulation 7 of the MPPMR.

## **Budgets**

47. Expenditure was not incurred in accordance with the approved budget, contrary to section 15 of the MFMA.

## **Annual financial statements, performance and annual reports**

48. 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 the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.





49. The 2013-14 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
50. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

## **Procurement and contract management**

51. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by regulation 17(a) and (c) of the Supply Chain Management (SCM) regulations.
52. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by regulation 19(a) of the SCM regulations.
53. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by regulations 22(1) and 22(2) of the SCM regulations.
54. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
55. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by regulation 5 of the SCM regulations.
56. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2) (c) of the MFMA.
57. Awards were made to providers who are 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.
58. Awards were made to providers who are in the service of other state institutions or whose directors and principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44.

## **Human resource management and compensation**

59. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.
60. Appointment was made in a post of manager directly accountable to the municipal manager that was not advertised, in contravention of section 56(3) of the MSA.
61. A senior manager directly accountable to the municipal manager was appointed without the approval of the municipal council, in contravention of section 56(1)(a) of the MSA.

## **Expenditure management**

62. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
63. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred nor accounted for creditors as required by section 65(2)(b) of the MFMA.
64. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.



## Conditional grants received

65. Municipal Infrastructure Grant (MIG) and Municipal Systems Improvement Grant (MSIG) funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.
66. Sufficient appropriate audit evidence could not be obtained that the MSIG, Local Government Financial Management Grants (LGFMG) allocations were spent in accordance with the applicable grant framework, as required by section 17(1) of the DoRA.
67. The municipality did not evaluate its performance in respect of programmes or functions funded by the MSIG and LGFMG allocations, as required by section 12(5) of the DoRA.

## Asset management

68. An adequate management and accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
69. 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.

## Liability management

70. An adequate management and accounting system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
71. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

## Consequence management

72. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure as required by section 32(2) (a) (ii) of the MFMA.

## Environmental management

73. The district municipality did not exercise its legislative and executive authority as required by the section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

## Internal control

74. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

## Leadership

75. Management did not exercise oversight responsibility regarding accurate and complete financial and performance reporting, compliance and related internal controls to such an extent it was placed under administration. Management did not implement effective human resources management to ensure that adequate and sufficiently skilled resources were in place and that performance is monitored. Furthermore the municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall performance management system process of planning, budgeting, implementation and reporting.

## Financial and performance management

76. The municipality did not implement proper record keeping ensuring that complete, relevant and accurate information is accessible and available to support financial and performance reporting. The municipality did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

## Governance

77. Significant risks listed during the risk assessment process, were not properly managed by the municipality, resulting in significant deficiencies identified during the audit. Although the audit committee and internal audit was in place and complied with relevant legislation, their inputs were not implemented by the municipality.

## Other reports

## Investigations

78. An independent service provider, at the request of the municipality, is in the process of performing a physical head count of all staff in order to conclude on the actual staff compliment and staff recorded on the payroll, as at 30 June 2015. The outcome of the audit is expected by December 2015.

Potchefstroom

30 November 2015



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*