



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

# Report of the auditor-general to the North West provincial legislature and the council on the Naledi Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Naledi Local Municipality set out on pages XX to XX, 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 with actual amounts 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 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 entity'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 entity'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 audit opinion.



## Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Naledi 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 the DoRA.

## Emphasis of matters

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

## Unauthorised, irregular and fruitless and wasteful expenditure

8. As disclosed in note 35.1 to the financial statements, unauthorised expenditure of R60 158 320 was incurred in the current year.
9. As disclosed in note 35.2 to the financial statements, fruitless and wasteful expenditure of R 29 515 344 was incurred in the current year and fruitless and wasteful expenditure from prior years of R32 316 980 had not yet been dealt with in accordance with section 32 of the MFMA.
10. As disclosed in note 35.3 to the financial statements, irregular expenditure of R3 163 057 was incurred in the current year and irregular expenditure from prior years of R153 735 253 had not yet been dealt with in accordance with section 32 of the MFMA.

## Material losses

11. As disclosed in note 23 to the financial statements, material losses to the amount of R41 050 411 (2015: R30 068 238) were incurred as a result of significant impairment of debtors.
12. As disclosed in note 27 to the financial statements, material distribution losses of R6 373 649 (2015: R11 218 757) and R8 135 879 (2015: R6 455 566) were incurred as a result of electricity and water losses respectively.

## Going concern

13. Note 45 to the financial statements indicates that the Naledi Local Municipality incurred a net loss of R43 368 892 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R350 945 925. These conditions, along with other matters as set forth in note 45, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

## Restatement of corresponding figures

14. As disclosed in note 34 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Naledi Local Municipality as at, and for the year ended, 30 June 2015.

## Significant uncertainties

15. With reference to note 40 to the financial statements, the municipality is the defendant in a number of legal matters. The municipality is contesting these claims. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.



## **Additional matters**

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

## **Unaudited disclosure notes**

17. 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.

## **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 schedules 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 key performance areas (KPA) 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**

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

- KPA 2: Basic service delivery and infrastructure development on pages x to x
- KPA 5: Local economic development on pages x to x

21. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned objectives. 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 objectives are as follows:

## **KPA 2: Basic service delivery and infrastructure development**

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

24. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (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. A total of 95% of the reported objectives, 98% of the reported indicators and 99% of the reported targets were not consistent with those in the approved integrated development plan.

25. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation



plan adopted by the municipal council may be amended only if the council approves an adjustment budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to important indicators and targets reported in the annual performance report, without adoption by the municipal council.

26. The FMPPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- Significantly important indicators were not well defined.
  - A total of 59% of the indicators were not verifiable.
  - Significantly important targets were not specific.
  - Significantly important targets could not be measured.
27. A total of 75% of indicators did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the service delivery and budget implementation plan, as required by the FMPPPI.

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

28. The FMPPPI 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work 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.

## **KPA 5: Local economic development**

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

29. The FMPPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:
- Significantly important targets were not specific.
  - Significantly important targets could not be measured.

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

30. The FMPPPI 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 performance information was 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 XX to XX and 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 key performance areas reported in paragraphs XX to XX of this report.

### **Unaudited supplementary schedules**

33. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

### **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 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**

35. The performance management system and related controls were inadequate for the processes of performance planning, monitoring, reporting, improvement and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

### **Annual financial Statements**

36. 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, current assets, current liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, which resulted in the financial statements receiving an unqualified audit opinion.

### **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 prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Procurement and contract management**

39. Thresholds for local content on designated sectors procurement were not properly applied in accordance with the requirements of regulation 9 of the Preferential Procurement Regulations.

### **Consequence management**

40. 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) and (b) of the MFMA.
41. Allegations were not always investigated, as required by regulation 5(3) of the Disciplinary regulations for senior managers and section 171(4) of the MFMA.
42. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the MFMA.

**Comment [A1]:** Continue from procurement on ASMIS



## **Budget**

43. The total unforeseen and unavoidable expenditure incurred exceeded R5 million, in contravention of regulation 72 of the Municipal Budget and Reporting Regulations.
44. Unforeseen and unavoidable expenditure incurred by the municipality was not approved by the mayor as required by section 29(1) of the MFMA.

## **Environmental management**

45. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.
46. The municipality operated its wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
47. The municipality's operational activities at its waste disposals sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license or the norms and standards as required by sections 67(1)(f) and (h) of the NEMWA and sections 151(1)(c) and (i) of the NWA.
48. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

## **Internal control**

49. 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 material adjustments to the financial statements, findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

50. The municipality's leadership did not exercise adequate oversight over financial and performance reporting, compliance monitoring and related internal controls. Policies and procedures did not adequately guide financial, performance and compliance activities as consequence management measures were not fully implemented.

## **Financial and performance management**

51. Management's internal controls and processes over the preparation and presentation of financial statements, performance reports and compliance monitoring were not able to ensure that the reports were free from material misstatements and material deviations from legislation. Numerous financial registers submitted by management did not agree to amounts as per the annual financial statement, and management did not adequately ensure the collection, collation, verification, storing and reporting of actual performance information.

## **Governance**

52. The audit committee and internal audit fulfilled their functions, however, management did not adequately respond to the concerns raised by the audit committee, and did not implement all



recommendations made by internal audit resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective.

### Other reports

53. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are in progress.

### Investigations

54. An independent consulting firm is performing an investigation at the request of the municipality, which covers the 2015-16 financial year. The investigation was initiated based on an allegation of the possible misappropriation of the municipality's assets due to suspicious transactions in the debtors system. The investigation was still in progress on the date of this report.
55. The Hawks investigative unit of the South African Police Service is currently investigating Naledi traffic officers accused of taking bribes. The investigation was still in progress on the date of this report.

Rustenburg

30 November 2016



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