



# 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 2016, 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, 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 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 movable assets included in 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 projects in progress were recorded due to the municipality not having adequate systems in place to account for 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 for immovable assets to rectify prior year misstatements or that these misstatements were 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 R3 647 684 293 (2015: R4 818 683 767) included in note 3 or the depreciation and amortisation expense of R323 478 136 (2015: R229 414 501) included in note 23 to the financial statements were necessary.

5. The district municipality recognised land and roads it has no right to, as property, plant and equipment contrary to the requirements of GRAP 17 *Property, plant and equipment* as a result of incorrect interpretation of the recognition criteria in the standard. Consequently, property, plant and equipment and accumulated surplus were overstated by R1 504 592 742. Additionally, there was a resultant impact on the depreciation and amortisation expense and the deficit for the period.

## **Inventories**

6. 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. I was unable to confirm the inventories by alternative means. Consequently, I was unable to determine whether any adjustments relating to inventories of R29 663 324 (2015: R30 485 891) included in note 7 to the financial statements was necessary.

## **Receivables from exchange transactions**

7. 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 R6 445 525 (2015: R8 188 456) included in note 8 to the financial statements was necessary.

## **VAT receivable**

8. 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 for 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 R156 432 804 (2015: R161 378 714) included in note 9 to the financial statements was necessary.

## **Cash and cash equivalents**

9. During 2015, 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. I was unable to determine whether any adjustment to cash and cash equivalents of R82 539 578 in the prior period was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm cash and cash equivalents by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

## **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. In addition, liabilities



of R8 839 898 (2015: R14 776 505) were not recorded as payables from exchange transactions. Consequently, I was unable to determine whether any further adjustments relating to payables from exchange transactions of R488 585 068 (2015: R315 915 797) included in note 15 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 R106 423 058 (2015: R146 075 826) disclosed in note 11, government grants and subsidies revenue of R688 321 305 (2015: R658 851 886) disclosed in note 18 to the financial statements or any related expenditure were necessary.

## Revenue from non-exchange transactions

12. I was unable to obtain sufficient appropriate audit evidence for a receipt of R73 474 000 included in government grants and subsidies as the municipality did not have adequate systems in place to maintain records of its revenue from non-exchange transactions. I was unable to confirm revenue from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments relating to government grants and subsidies of R688 321 305 in note 18 to the financial statements was necessary.
13. During 2015, the municipality did not account for all government grants and subsidies as required by GRAP 23 *Revenue from non-exchange transactions*, as the municipality do not have adequate systems in place to reconcile and record government grants and subsidies. Consequently, government grants and subsidies was understated by R20 973 000 and unspent conditional grants and receipts was overstated by the same. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the current period's financial statements is also modified because of the effect of this matter on the comparability of the current period's figures.

## Expenditure

14. I was unable to obtain sufficient appropriate audit evidence for expenditure as the district municipality did not have adequate systems to maintain records for adjustments or reconcile differences between the financial statements and the general ledger. In addition, expenditure relating to contracted services was overstated by R161 314 145 as expenditure of prior periods was again recorded in the current year. I could not confirm this expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to repairs and maintenance, contracted services, transfer and subsidies and general expenses totalling R532 210 586 (2015: R446 406 026) in the financial statements was necessary.

## Employee related costs

15. During 2015, I was unable to obtain sufficient appropriate audit evidence for employee related costs as the municipality do not have adequate systems in place to reconcile, account for and maintain records of its employee related costs. I was unable to determine whether any adjustment to employee related costs of R304 687 735 was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm employee related costs by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.



## Commitments

16. I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality did not have an adequate contract management system in place to disclose its capital commitments. I was unable to confirm the commitments by alternative means. Consequently, I was unable to determine whether any adjustments relating to commitments of R209 411 004 (2015: R772 574 114) as disclosed in note 30 to the financial statements was necessary.

## Contingencies

17. 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 regarding contingencies. In addition, the contingencies are understated by R308 905 920 in the current year and prior year as the municipality did not have adequate systems in place to accurately record its contingencies. I was unable to confirm the contingencies by alternative means. Consequently, I was unable to determine whether any further adjustments relating to contingencies as disclosed in note 31 to the financial statements was necessary.

## Prior period errors

18. I was unable to obtain sufficient appropriate audit evidence for the differences between the correction of errors disclosed in the statement of changes in net assets and the amounts disclosed in note 33 to the financial statements and between the prior period balance of the accumulated surplus in the statement of changes in net assets and the statement of financial position. In addition, an unexplained difference for accumulated surplus exists between the financial statements and the general ledger. I was unable to confirm the accumulated surplus by alternative means. Consequently, I was unable to determine whether any adjustments to the accumulated surplus of R3 201 105 266 (2015: R4 471 473 088) as disclosed in the statement of financial position.
19. 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*. I was unable to confirm the disclosure relating to the prior period errors by alternative means. Consequently, I was unable to determine whether any adjustment to prior period errors disclosed in note 33 or any other account balances, transactions and disclosures affected by these prior period errors to the financial statements were necessary.

## Risk management

20. The municipality did not disclose the carrying values of the different categories or details about the significance of the financial instruments as required by GRAP 104 *Financial instruments*. In addition, the municipality did not disclose all the requirements relating to the exposure to credit and liquidity risk. I was unable to determine the correct disclosure as per notes 16 and 35 to the financial statements for the financial instruments as it was impracticable to do so.

## Unauthorised expenditure

21. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure as an accurate comparison of budget to the actual expenditure per vote was not available. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to unauthorised expenditure of R725 635 614 (2015: R473 582 958) as disclosed in note 37 to the financial statements was necessary.



## **Fruitless and wasteful expenditure**

22. Section 125 of the MFMA requires the disclosure of fruitless and wasteful expenditure incurred. The district municipality made payments of R3 305 076 in the current year and R20 486 965 in prior periods that is regarded as fruitless and wasteful expenditure in terms of the definition in section 1 of the MFMA, which were not included in fruitless and wasteful expenditure disclosed. Consequently, fruitless and wasteful expenditure as per note 38 to the financial statements is understated by R23 792 041 (2015: R20 486 965). As the district municipality did not quantify the full extent of the fruitless and wasteful expenditure, it was impracticable to determine the resultant understatement of fruitless and wasteful expenditure.

## **Irregular expenditure**

23. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The district municipality made payments of R22 279 970 (2015: R90 220 079) in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. Consequently, irregular expenditure as per note 39 to the financial statements is understated by R112 500 049 (2015: R90 220 079). As the district municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure.

## **Cash flow statement**

24. I was unable to obtain sufficient appropriate audit evidence for the amounts included in the cash flow statement for the current and prior period as the municipality did not adequately review the movements on the cash flow statement. 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**

25. I was unable to obtain sufficient appropriate audit evidence for differences between the amounts disclosed as the approved budget and the municipality's original budget and the amounts disclosed as the final budget and the municipality's adjustment budget, included in the statement of comparison of budget and actual amounts. As a result of these differences the amounts disclosed as difference between budget and actuals will also be misstated.

## **Disclaimer of opinion**

26. 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.

## **Emphasis of matter**

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

## **Going concern**

28. Note 36 to the financial statements indicates that the Ngaka Modiri Molema District Municipality incurred a net loss of R446 874 620 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R205 718 486. These conditions, along with other matters as set forth in note 36, indicate the existence of a



material uncertainty that may cast significant doubt on the district municipality's ability to operate as a going concern.

## **Additional matter**

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

## **Unaudited disclosure notes**

30. 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.

## **Report on other legal and regulatory requirements**

31. 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 (KPAs) 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**

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

- KPA 2: Basic service delivery and infrastructure development on pages X and X
- KPA 3: Promote financial viability on pages X to X
- KPA 4: Promote local economic development on pages X to X

33. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned programmes. 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).

34. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

35. The material findings in respect of the selected key performance areas are as follows:

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

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

36. Important 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 five year service delivery and budget implementation plan, as required by the FMPPI.

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



37. 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 planned targets of important indicators were not reliable when compared to the source information or evidence provided.

### **KPA 3: Promote financial viability**

38. I did not identify any material findings on the usefulness and reliability of the reported performance information for this development priority.

### **KPA 4: Promote local economic development**

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

39. 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 planned targets of important indicators were not reliable when compared to the source information or evidence provided.

#### **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 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.

#### **Compliance with legislation**

42. I performed procedures to obtain evidence that the district 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. The annual performance report for the year under review did not include the performance of the local municipalities and Sedibeng Water that performed services on behalf of the district municipality as required by section 46(1)(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

#### **Financial statements, performance and annual reports**

44. 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.



45. The oversight report adopted by the council on the 2014-15 annual report was not made public, as required by section 129(3) of the MFMA.

## **Procurement and contract management**

46. I could not obtain sufficient appropriate audit evidence that goods and services of a transaction value above R200 000 were procured by inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulations 19(a) and 36(1).
47. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of SCM regulations 22(1) and 22(2).
48. I could not obtain sufficient appropriate audit evidence 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.
49. I could not obtain sufficient appropriate audit evidence that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
50. 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.
51. Awards were made to providers whose directors / principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
52. 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, in contravention of SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the MSA.
53. I was unable to obtain sufficient appropriate audit evidence that measures to combat the abuse of the SCM system were implemented as per the requirements of SCM regulation 38(1).

## **Expenditure management**

54. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
55. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 65(2)(b) of the MFMA.
56. Reasonable steps were not taken to prevent unauthorised, irregular or fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Asset management**

57. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
58. 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**

59. 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) and (b) of the MFMA.

## **Environmental management**

60. The district municipality did not fulfil all the assigned powers and co-operative functions to support its local municipalities in terms of sections 152, 156 and 229 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and sections 83(1) and (2) and 88(1) of the Municipal Structures Act, 1998 (Act No. 117 of 1998) towards a healthy, safe and sustainable environment.

## **Internal control**

61. 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**

62. 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. In addition the municipality's monitoring controls to ensure the proper implementation of the overall performance management system process of planning, budgeting, implementation and reporting were not sufficient.

## **Financial and performance management**

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

## **Governance**

64. Significant risks were not identified as no risk assessment were not performed, 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**

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



## Investigations

66. An independent consulting firm is currently performing an investigation at the request of the North West Department of Finance and Economic Development and the North West Department of Local Government, which covers the period 1 January 2011 to 30 November 2014. The investigation was initiated after the Executive Council of the North West Province took a decision to undertake a comprehensive forensic investigation at the municipality following allegations of mismanagement, fraud, corruption and other related allegations. The matters under investigation mainly deal with procurement and human resource issues. The reports have been issued in draft pending further instructions.

Potchefstroom

30 November 2016



AUDITOR - GENERAL  
SOUTH AFRICA

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