



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

### Report on the audit of the financial statements

#### Disclaimer of opinion

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 of the statement of financial position as at 30 June 2017, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

#### Basis for disclaimer of opinion

##### Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment, including the restatement to the corresponding figure, due to a lack of implemented controls by the municipality to ensure that all assets were correctly accounted for. I was unable to confirm these assets by alternative means. In addition, the municipality did not review the residual values and useful lives of movables assets as required by GRAP 17, *Property, plant and equipment*. I was unable to quantify the resultant misstatements as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments relating to property, plant and equipment of R3 371 078 324 (2016: R3 670 800 659) disclosed in note 3 and the related depreciation and amortisation expense of R384 823 828 (2016: R334 912 968) in the financial statements were necessary.

##### VAT receivable

4. I was unable to obtain sufficient appropriate audit evidence for the VAT receivable due to a lack of reconciliations performed between the VAT returns submitted by the municipality and the accounting records. I was unable to confirm this VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustment relating to the VAT receivable of R114 240 392 (2016: R108 949 025) disclosed in note 9 to the financial statements was necessary.

### **Payables from exchange transactions**

5. I was unable to obtain sufficient appropriate audit evidence for trade payables due to differences between the financial statements and the accounting records. I was unable to confirm these payables by alternative means. Consequently, I was unable to determine whether any adjustments relating to trade payables of R456 979 044 (2016: R408 214 946) included in payables from exchange transactions disclosed in note 15 to the financial statements was necessary.

### **Provision of retail water services**

6. I was unable to obtain sufficient appropriate audit evidence that revenue, expenditure and receivables relating to the provision of retail water services have been correctly accounted for by the district municipality as the service delivery agreement entered into between the district municipality as water service authority and the Ditsobotla Local Municipality as water service provider has expired. In terms of section 22 of the Water Services Act, 1997 (Act No. 108 of 1997), no person may operate as a water service provider without the approval of the water service authority. I was unable to confirm by alternative means that the local municipality was authorised to operate as water service provider. Consequently, I was unable to determine whether any adjustments to revenue, expenditure, receivables or any other items relating to the provision of retail water services by the Ditsobotla Local Municipality in the financial statements of the district municipality were necessary.

### **Expenditure**

7. I was unable to obtain sufficient appropriate audit evidence for shift and standby allowances included in employee related costs due to the supporting documents for these allowances not being timeously submitted for audit. I was unable to confirm these allowances by alternative means. In addition, the skills development levy was incorrectly classified as general expenses resulting in the understatement of employee cost and overstatement of general expenses by R2 509 061. Consequently, I was unable to determine whether any adjustment relating to employee related cost of R306 936 890 disclosed in note 20 to the financial statements was necessary.
8. I was unable to obtain sufficient appropriate audit evidence for contracted services due to differences between the financial statements and the accounting records and lack of implemented controls by the municipality to ensure that goods and services relating to bulk water purchases and drought-relief was indeed received at the required level before payment was made. I was unable to confirm these expenses by alternative means. Consequently, I was unable to determine whether any adjustments relating to contracted services of R123 457 091 disclosed in note 37 to the financial statements was necessary.
9. I was unable to obtain sufficient appropriate audit evidence for general expenses due to a lack of record management controls by the municipality to ensure that documents were available. I was unable to confirm these general expenses by alternative means. In addition, the municipality did not record expenditure in the correct period as required by GRAP 1, *Presentation of financial statements* resulting general expenses being overstated by R23 582 104. Additionally, there is a consequential impact on the deficit for the year and the accumulated surplus. Consequently, I was unable to determine whether any further adjustment relating to general expenses of R40 259 743 (R52 372 919) disclosed in note 22 to the financial statements was necessary.

### **Commitments**

10. The municipality did not have an adequate system in place to disclose its commitments in terms of the accounting policy and capital commitments as required by GRAP 17, *Property, plant and equipment*. Consequently, commitments as disclosed in note 26 to the financial statements is understated by R174 431 636 (2016: R46 865 345).



### **Prior-year adjustments**

11. I was unable to obtain sufficient appropriate audit evidence for some of the adjustments to the accumulated surplus and to the corresponding figures as disclosed in note 28 as adequate supporting documents for these adjustments were not submitted for audit or did not agree to the disclosed adjustments. I was unable to confirm the disclosure of these adjustments by alternative means. Consequently, I was unable to determine whether any adjustment relating to the accumulated surplus of R2 894 016 400 (2016: R3 118 407 437) as presented in the statement of changes in net assets and statement of financial position was necessary or whether all adjustments have been appropriately disclosed in note 28 to the financial statements as required by GRAP 3, *Accounting policies, changes in accounting estimates and errors*.

### **Unauthorised expenditure**

12. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure due to the status of the accounting records. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to unauthorised expenditure of R1 704 192 565 (2016: R1 562 125 979) disclosed in note 32 to the financial statements was necessary.

### **Irregular expenditure**

13. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. I was unable to obtain sufficient appropriate audit evidence for the restatement made to the corresponding figure for irregular expenditure, adjustments made in the current year relating to prior year corrections or for irregular expenditure incurred in the current year due to the status of the accounting records. In addition, the municipality made payments of R69 831 827 in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to determine whether any further adjustment relating to irregular expenditure of R1 487 557 347 (2016: R659 716 803) disclosed in note 34 to the financial statements was necessary.

### **Fruitless and wasteful expenditure**

14. Section 125 of the MFMA requires the disclosure of fruitless and wasteful expenditure incurred. The municipality made payments of R6 119 014 in the current year and R23 792 041 in previous years that was regarded as fruitless and wasteful expenditure, which was not included in the fruitless and wasteful expenditure disclosed. As the 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 as disclosed in note 33 to the financial statements.

### **Cash flow statement**

15. I was unable to obtain sufficient appropriate audit evidence for the cash flow from operating activities and investing activities 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 practically quantify the misstatements in the cash flow statement and notes thereto by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement and notes thereto were necessary.

### **Material losses and MFMA disclosures**

16. The municipality did not disclose water distribution losses in the current and the previous year as required by section 125(2)(d)(i) of the MFMA. As the municipality does not have adequate

control measures in place to accurately determine the extent of water distribution losses, I was unable to quantify the resulting understatement as it was impracticable to do so. In addition, the municipality did not include the other compulsory MFMA disclosures required by section 125(1)(b) and (c) of the MFMA in note 35 to the financial statements, I was unable to quantify the omitted disclosure as it was impracticable to do so.

## **Material uncertainty related to going concern**

17. I draw attention to the matter below. My opinion is not modified in respect of this matter.
18. I draw attention to note 30 in the financial statements, which indicates that the municipality incurred a deficit of R224 391 037 during the year ended 30 June 2017 and, as of that date the municipality's current liabilities exceeded its current assets by R430 083 935. As stated in note 30, these events or conditions, along with other matters as set forth in the note, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

## **Emphasis of matter**

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

## **Restatement of corresponding figures**

20. As disclosed in note 28 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors discovered in the financial statements of the municipality for the year ended 30 June 2017.

## **Other matter**

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

## **Unaudited disclosure notes**

22. 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.

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

23. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and the 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.
24. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

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

25. My responsibility is to conduct an audit of the financial statements in accordance with International Standards on Auditing (ISAs) and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of my report, I was not



able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

26. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' Code of ethics for professional accountants (IESBA code) together with the ethical requirements that are relevant to my audit of the financial statements. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

## Report on the audit of the annual performance report

### Introduction and scope

27. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
28. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
29. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2017:

Key Performance Areas	Pages in the annual performance report
KPA 2: Basic service delivery	x – x
KPA 4: Local economic development	x – x

30. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
31. The material findings in respect of the usefulness and reliability of the selected key performance areas are as follows:

#### KPA2: Basic service delivery

##### KPI 17: Number of capital projects in construction stage to be completed by 30 June 2017

32. The indicator and target was not included in the service delivery and budget implementation plan, however the indicator and target was reported in the annual performance report. This is not in line with the requirements of section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

## **KPI 20: Number of villages served with water supply by June 2017**

33. I was unable to obtain sufficient appropriate audit evidence for the reported achievement for this indicator, as the target determined during planning for this indicator was not specific in clearly identifying the nature and required level of performance, as required by the Framework for Managing Programme Performance Information (FMPPI). This is not in line with the requirements in section 41(c) of the MSA. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 127.

### **Various indicators**

34. There was no clear and logical link between the indicators and targets and the strategic objectives to which it relates, as required by the FMPPI. These indicators focused on reports and appointment of services provider and not the achievement of basic service delivery relating to monitoring of water services, addressing water service emergencies and promoting transport engineering respectively:

- KPI 18: Number of underground water management reports submitted to the municipal manager in terms of 340 boreholes
- KPI 21: Number of reports on water supply schemes (borehole maintenance, leakages maintenance) submitted to the municipal manager
- KPI 23: Procurement of a professional service provider for Rural Roads Asset Management System by end June 2017

## **KPA4: Local economic development**

35. I did not identify any material findings on the usefulness and reliability of the reported performance information for this key performance areas.

### **Other matters**

36. I draw attention to the matters below.

#### **Achievement of planned targets**

37. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 32 to 35 of this report.

#### **Adjustment of material misstatements**

38. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 2: Basic service delivery. As management subsequently corrected only some of the misstatements, I reported material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

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

### **Introduction and scope**

39. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific



matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

40. The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

### **Consequence management**

41. 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.
42. Allegations of financial misconduct against the accounting officer were not investigated, as required by section 171(4) of MFMA.
43. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the MFMA.

### **Budgets**

44. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the unauthorised expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed unauthorised expenditure was caused by overspending of the budget.

### **Annual financial statements**

45. 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 contingent assets and contingent liabilities identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
46. The oversight report adopted by the council on the 2015-16 annual report was not made public, as required by section 129(3) of the MFMA.
47. The annual performance report for the year under review did not include the performance of each external service provider of the municipality, as required by section 46(1)(a) of the MSA.

### **Liability management**

48. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
49. 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.

### **Expenditure management**

50. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
51. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by awarding of contracts without following a competitive bidding process.
52. Effective steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA. The fruitless and wasteful expenditure disclosed does not reflect the full extent of the fruitless and wasteful expenditure incurred as indicated in the basis for qualification paragraph. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties paid on overdue accounts.



### **Asset management**

53. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

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

54. Key performance indicators were not set for the provision of basic sanitation services as required by section 43(2) of the MSA and regulation 10(a) of the Municipal planning and performance management regulations.

### **Human resource management**

55. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.

### **Procurement and contract management**

56. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements due to lack of proper keeping to ensure all documents relating to the awards were available for audit.
57. Some of the contracts and quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
58. Some of the contracts and quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.
59. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of SCM regulations 22(1) and 22(2). Similar non-compliance was also reported in the prior year.
60. The preference point system was not applied to some of the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act.
61. Contracts and quotations were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
62. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
63. 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. Similar non-compliance was also reported in the prior year.
64. Awards were made to providers who were in the service of other state institutions in contravention of section 112(j) of 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).

### **Other information**

65. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected key performance areas presented in the annual performance report that have been specifically reported on in the auditor's report.





66. My opinion and findings do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
67. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected key performance areas presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
68. I did not receive the other information prior to the date of the auditor's report. When I do receive this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to re-issue my auditor's report amended as appropriate.

## Internal control deficiencies

69. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. 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.
  - Adequate oversight responsibility regarding financial and performance reporting and compliance and related internal controls was not exercised. Management did not implement effective human resources management processes to ensure that adequate and sufficiently skilled resources were in place and that performance is monitored which included the position of municipal manager what was only filled in an acting capacity for the year under review. 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.
  - The municipality did not implement a proper record keeping system to ensure that complete, relevant and accurate information is accessible and available to support financial reporting and compliance with laws and regulations. The municipality did not prepare regular, accurate and complete financial reports that are supported and evidenced by reliable information.
  - Management's continuous failure to comply with laws and regulations as well as their inability to implement controls to ensure reliable and accurate financial reporting, is a concern. This factor, as well as the continuous non adherence with the council's supply chain management policy without consequences reflects negatively on management's commitment towards a clean administration.
  - There is no adequate risk strategy in place that addresses identified risks in supply chain management, performance reporting as well as non-compliance with laws and regulations. The audit committee did not adequately exercise its oversight responsibility of reviewing the financial statements and providing council with a credible view of the financial position of the municipality and its overall level of compliance with legislation. The effectiveness of the audit committee and internal audit's role as an assurance provider was further compromised by management's inability to adequately address and react to internal audit's findings and recommendations mainly due to the vacancies at senior management level within the municipality.

## Other reports

70. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
71. An independent consulting firm is performing an investigation at the request of the North West department of Finance and department of Local Government and Human Settlements. 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 which covers the period 1 January 2011 to 30 November 2014. The investigation was still in progress at the date of this report.

*Auditor General*

Potchefstroom

30 November 2017



AUDITOR - GENERAL  
SOUTH AFRICA

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