



REPORT OF THE AUDITOR-GENERAL TO THE NORTH WEST PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE KGETLENGRIVIER LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Kgetlengrivier Local Municipality, set out on pages **XX to XX**, which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and the cash flow statement for the year then ended, and the notes, comprising of 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, 2012 (Act No. 5 of 2012) (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 the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. 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

Accumulated surplus

4. I was unable to obtain sufficient appropriate audit evidence for adjustments made to the accumulated surplus or difference between the general ledger and the financial statements. I was unable to confirm the accumulated surplus by alternative means. In addition, contrary to the requirements of SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors* the municipality did not disclose in the notes the nature and amount of all the corrections made to each financial statement line item affected. Consequently I was unable to determine whether any adjustment to the accumulated surplus of R144 489 294 (2012: R149 247 167) in the financial statements was necessary.

Property, plant and equipment

5. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment as the municipality did not have adequate systems in place to maintain records of its assets. I was unable to confirm these assets by alternative means. In addition, the municipality did not review the residual values and useful lives of property, plant and equipment at each reporting date as required by SA Standards of GRAP, GRAP 17, *Property, plant and equipment*, this is evidenced by assets that have been fully depreciated whilst still being in use. Consequently I

was unable to determine whether any further adjustments relating to property, plant and equipment of R170 316 076 (2012: R165 899 899) as disclosed in note 9 or the related depreciation and amortisation expense of R13 411 371 (2012: R14 900 010) as disclosed in note 29 to the financial statements were necessary.

Investment property

6. The municipality did not recognise and disclose investment property in accordance with SA Standards of GRAP, GRAP 16, Investment properties. Investment property of R15 696 360 has not been disclosed separately on the face of the balance sheet, instead it has been incorrectly included in the balance property, plant and equipment. Additionally, the municipality did not value all investment property correctly resulting in investment property is understated by R6 738 000 and fair value adjustment is understated with the same amount. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

Inventory

7. In the prior year, I was unable to obtain sufficient appropriate audit evidence for inventory as the municipality did not have adequate systems in place to maintain records of its inventory. Consequently I was unable to determine whether any adjustments relating to the corresponding figure for inventory of R3 376 434 as disclosed in the statement of financial position and note 2 to the financial statements or the accumulated surplus was necessary.

Consumer debtors

8. I was unable to obtain sufficient appropriate audit evidence for consumer debtors, including debtors that were written off during the year. I was unable to confirm that the municipality correctly assessed, individually or by category, whether there is objective evidence that a financial asset or group of financial assets is impaired as required by SA Standard of GRAP, GRAP 104, *Financial instruments*. I was also unable to confirm I was unable to confirm these debtors and impairment by alternative means. In addition, debtors with credit balances were incorrectly included in consumer debtors resulting in consumer debtors being overstated by R19 264 732 (2012: R2 711 699) and payables understated by the same amount. Consequently I was unable to determine whether any further adjustments to consumer debtors of R29 830 656 (2012: R31 304 796) as disclosed in the statement of financial position and note 7 or the related debt impairment expense of R17 008 575 (2012: R5 536 233) as disclosed in note 27 to the financial statements were required.

Receivables for exchange transactions

9. I was unable to obtain sufficient appropriate audit evidence for material adjusting journals to receivables from exchange and receivables from non-exchange transactions as the municipality did not have adequate systems in place to maintain records of its receivables. I was unable to confirm these transactions by alternative means. Consequently I was unable to determine whether any adjustments to receivables from exchange transactions of R640 554 (2012: R640 544) and receivables from non-exchange transactions of R205 436 (2012: R715 093) as disclosed in the statement of financial position was necessary.

Value added tax (VAT)

10. I was unable to obtain sufficient appropriate audit evidence for VAT receivables due to unexplained difference on the VAT reconciliation. I was unable to confirm these reconciling items by alternative means. Consequently I was unable to determine if any adjustment to the VAT receivable of R1 220 069 as disclosed in note 6 to the financial statements was required.



Cash and cash equivalents

11. I was unable to obtain sufficient appropriate audit evidence for journals in cash and cash equivalents. I was unable to confirm the transactions by alternative means. Consequently I was unable to determine whether any adjustment to the cash and cash equivalents stated at R7 107 197 in the financial statements was necessary.

Non-current assets held for sale and assets of disposal groups

12. I was unable to obtain sufficient appropriate audit evidence for adjustments made to comparative figure of non-current assets held for sale and assets of disposal groups. I was unable to confirm or verify these adjustments by alternative means. Consequently I was unable to determine whether any further adjustments relating to the comparative figure of non-current assets held for sale and assets of disposal groups of R3 140 000 included in the statement of financial position were necessary.

Payables from exchange transactions

13. I was unable to obtain sufficient appropriate audit evidence for payable from exchange transactions as the municipality did not have adequate systems in place to maintain records of its payables. I was unable to confirm these payables by alternative means. Consequently I was unable to determine whether any adjustment to the payables from exchange transactions of R25 310 220 (2012: R28 068 493) in note 10 to the financial statements was necessary.

Retirement benefit obligation

14. I was unable to obtain sufficient appropriate audit evidence for adjustments made to corresponding figure for the retirement benefit obligation of R12 224 000. I was unable to confirm or verify these adjustments by alternative means. Consequently I was unable to determine whether any adjustments relating to the comparative figure for retirement benefit obligation as per the financial statements were necessary.

Unspent conditional grants and receipts

15. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts as the municipality did not have adequate systems in place to account for grants. I was unable to confirm the unspent balances by alternative means. In addition, unspent conditional grants and receipts are overstated by R6 247 492 (2012: R10 038 647) as a result of grants not correctly accounted when received or meeting the conditions. There is a consequential impact on revenue for the period and the accumulated surplus. Consequently I was unable to determine whether any further adjustments relating to unspent conditional grants and receipts of R9 625 590 (2012: R27 176 263) included in note 12 to the financial statements were necessary.

Provisions and contingencies

16. I was unable to obtain sufficient appropriate audit evidence for adjustments made to corresponding figure for provisions and contingencies of R5 810 275. I was unable to confirm these adjustments by alternative means. Consequently I was unable to determine whether any further adjustments relating to the corresponding figure of provisions and contingencies were necessary.

Unidentified direct deposits and National Treasury loan

17. I was unable to obtain sufficient appropriate audit evidence for unidentified direct deposits and the National Treasury loan. I was unable to confirm these liabilities by alternative means. Consequently I was unable to determine whether any adjustments relating to unidentified direct deposits of R9 258 121 and the National Treasury loan of R3 705 000 in note 14 to the financial statements were necessary.



Revenue

18. SA Standards of GRAP, GRAP 9, Revenue requires that revenue be recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity and the amount of the revenue can be measured reliably. Contrary to the requirement, the municipality did not record all revenue relating to service charges resulting in revenue and consumer debtors being understated by R6 084 410.
19. I was unable to obtain sufficient appropriate audit evidence that all revenue from meeting the conditions of government grants and subsidies were recognised as the municipality did not have adequate systems in place to account for grants. I was unable to confirm the grants by alternative means. Consequently I was unable to determine whether any adjustment to revenue from government grants of R48 328 099 (2012: R45 318 637) disclosed in note 23 to the financial statements was necessary.
20. I was unable to obtain sufficient appropriate audit evidence for adjustments made to corresponding figures for revenue. I was unable to confirm these adjustments by alternative means. Consequently I was unable to determine whether any further adjustments relating to the corresponding figure for revenue of R89 902 493 included in the statement of financial performance were necessary.

Operating expenditure

21. I was unable to obtain sufficient appropriate audit evidence for bulk purchase and journals in the current year and adjustments made to operating expenditure in the prior year as the municipality did not have adequate systems in place to maintain records of its operating expenditure. In addition, operating expenditure and payable from exchange transactions are overstated by R1 082 945. Consequently I was unable to determine whether further any adjustment to operating expenditure of R134 378 256 (2012: R111 947 071) included in the statement of financial performance was necessary.

Cash flow statement

22. I was unable to obtain sufficient appropriate evidence for the amounts included in the cash flow statement taking into account the misstatements identified in the financial statements as 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.

Irregular expenditure

23. Section 125(2)(d)(iii) of the MFMA requires disclosure of all irregular expenditure incurred by the municipality. I was unable to obtain sufficient appropriate audit evidence that awards of R5 913 050 (2012: R15 049 984) made by the municipality were in terms of the supply chain management requirements. Consequently I was unable to determine whether any further irregular expenditure should have been disclosed in note 37 to the financial statements.

Material losses

24. Contrary to the requirements of section 125(2)(d)(iii) of the MFMA, the municipality did not disclose its distribution and reticulation losses. Due to the nature of these items I was unable to verify or reliably estimate the amounts not disclosed by alternative means.

Commitments

25. During the prior year, I was unable to obtain sufficient appropriate audit evidence for commitments. Alternative procedures identified commitments of R5 304 780 that were



incorrectly calculated using the budget values instead of the contract values resulting in commitments being overstated by R5 304 780. Consequently I was unable to determine whether any further adjustment to the corresponding figure for commitments of R19 836 742 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. 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.

Budget information

26. SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements* requires disclosure of budget information in the financial statements. The municipality did not disclose an explanation of the differences between the budget for which the entity is held publicly accountable and actual amounts for all material differences.

Disclaimer of opinion

27. 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 matters

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

Unauthorised as well as fruitless and wasteful expenditure

29. As disclosed in note 35 to the financial statements unauthorised expenditure of R33 314 756 was incurred during the year.

30. As disclosed in note 36 to the financial statements fruitless and wasteful expenditure of R755 438 was incurred in the current year.

Additional matter

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

Unaudited supplementary schedules

32. 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 annexures and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

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

Predetermined objectives

34. The annual performance report was not presented in time for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.

35. The information was assessed to determine whether performance indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury Framework for managing programme performance information (FMPPI).

36. The material findings are as follows:



Usefulness of information

37. The FMPPI requires that performance indicators be well defined and verifiable and targets be specific, measureable and time bound:
- A total of 20% of the indicators and significantly important indicators in relation to the overall mandate of the entity and of significant interest to the public were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently.
 - A total of 20% of the indicators and significantly important indicators in relation to the overall mandate of the entity and of significant interest to the public were not verifiable in that valid processes and systems that produce the information on actual performance did not exist.
 - A total of 20% of the significantly important targets in relation the overall mandate of the entity and of significant interest to the public were not specific in clearly identifying the nature and the required level of performance.
 - The required performance could not be measured for a total of 20% of the significantly important targets in relation to the overall mandate of the entity and targets of significant interest to the public.
 - A total of 100% of the targets and significantly important targets in relation to the overall mandate of the entity and of significant interest to the public were not time bound in specifying a time period or deadline for delivery.

This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training and resources to enable application of the principles.

Compliance with laws and regulations

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

Strategic planning and performance management

39. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the integrated development plan, as required by section 41(1)(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and the Municipal planning and performance management regulations 12(1) and 12(2)(e).
40. The municipality did not have and maintain effective, efficient and transparent systems of internal controls relating to performance management as required by section 62(1)(c)(i) of the MFMA.
41. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
42. The annual performance report for the financial year under review was not prepared and was not included in the annual report, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

Budgets

43. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.



Annual financial statements, performance and annual report

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, which resulted in the financial statements receiving a disclaimer audit opinion.

Audit committee

45. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
46. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
47. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
48. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
49. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
50. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by Municipal planning and performance management regulation 14(2)(a).

Internal audit

51. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
 - it did not report to the audit committee on the implementation of the internal audit plan.
 - it did not advise the accounting officer or report to the audit committee on matters relating to risk and risk management.
52. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, the DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.
53. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal planning and performance management regulation 14(1)(a).
54. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1)(b)(i).
55. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1)(b)(iii).
56. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal planning and performance management regulation 14(1)(c).

Expenditure management

57. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
58. An effective system of expenditure control, including procedures for the payment of funds and accounting for creditors, was not in place, as required by section 65(2)(a) of the MFMA.
59. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

60. The municipality did not submit MFMA implementation plans to National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework, Gazette No. 35399.
61. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to National Revenue Fund, as required by section 21(1) of the DoRA.

Revenue management

62. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
63. Contrary to the requirements of section 11 of the Prescription Act, 1969 (Act 68 of 1969), the municipality wrote off consumer debtors of R6 323 950 relating to property rates.

Asset management

64. 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

65. 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.

Consequences management

66. Irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
67. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2) of the MFMA.

Human resource management and compensation

68. Sufficient appropriate audit evidence could not be obtained that appointments were only made in posts which were provided for in the approved staff establishment of the municipality, as required by section 66(3) of MSA.
69. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
70. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the MSA.
71. Supply chain management officials did not have the higher education qualification and did not meet the prescribed competency areas as required by Municipal Regulations on Minimum Competency Levels regulations 8 and 9

Waste management

72. The municipality operated its waste disposal sites and wastewater treatment facilities without a license or permit 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), section 20(1) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989) (ECA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
73. The municipality's operational activities at its waste disposal sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management permit or license and the regulatory provisions in terms of section 67(1)(f)&(h) of the NEMWA and section 29(4) of the ECA in instances where such were issued.
74. 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)&(d) and 26(1)(b) of the NEMWA.

Procurement and contract management

75. 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.
76. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM Regulation 5.
77. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
78. 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.
79. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
80. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act and CIDB regulation 18.
81. Sufficient appropriate audit evidence could not be obtained that all contracts and were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive. This is due to the contract performance and monitoring measures and methods of the municipality that are insufficient to ensure that an effective and adequate contract management system is in place to maintain records of supply chain processes and contractual obligations.

Internal control

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

Leadership

83. Management failed to appoint sufficient appropriately skilled staff in key positions within the finance unit and training and development initiatives failed to address the underlying deficiencies that caused the matters to be repeatedly reported on in the audit report. Policies and procedures did not adequately guide financial and performance activities and failed to



address the shortcomings in internal controls that resulted in the compliance deviations that have been reported. Furthermore management's oversight was inadequate in preventing material misstatements in the financial statements.

Financial and performance management

84. Management failed to implement proper record keeping or effective controls to ensure that information in the financial statements and the report on predetermined objectives were reliable before submission for audit, or readily available for audit purposes. This was mainly due to the inability of management to address the prior year audit findings. Management failed to prepare regular, accurate and complete performance reports that were supported and evidenced by reliable information. Review and monitoring of compliance with applicable laws and regulations were not effectively performed.

Governance

85. The audit committee did not adequately provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness of the internal control environment and its overall level of compliance with the MFMA and the DoRA, resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective.

Auditor - General

Rustenburg

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence