

# Report of auditor-general to the Limpopo Provincial legislature and council on Molemole Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Molemole Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information 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 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, 2013 (Act No. 2 of 2013) (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 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. 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 qualified audit opinion.

## Basis for qualified opinion

### Property, plant and equipment

6. The municipality did not have adequate systems in place to maintain accurate and complete records of assets, which resulted in the following findings:
  - Depreciation was not calculated in terms of the municipality's accounting policy, resulting in property, plant and equipment being understatement by R22 589 822.
  - The values of land and buildings do not agree to the valuation report, resulting in an overstatement of R5 792 965.
  - Assets were not always correctly classified in the sub categories on the disclosure note.
  - There was an unexplained difference of R 1 392 700 between the additions per the financial statements and the additions per the accounting records.
  - Items of capital work in progress amounting to R 7 239 372 were not measured at cost.
  - Completed projects amounting to R 1904 439 were not measured at depreciated cost.
  - A significant number of assets were not accounted for in the financial statements.

Furthermore, SA Standards of GRAP 17, *Property, plant and equipment*, requires entities to assess the useful lives and residual values of items of property, plant and equipment at each reporting date. The municipality did not assess the useful lives and residual values of its items of property, plant and equipment. As a result, the municipality has not complied with the requirements of GRAP 17.

Consequently, property, plant and equipment, depreciation and the revaluation reserve are misstated. As the municipality did not maintain an accurate asset register, I was not able to determine the full extent of the misstatement of property plant and equipment stated at R177 061 543 (2013: R168 063 530), depreciation expense stated at R13 454 673 (2013: R12 556 107) and revaluation reserve stated R36 841 347 as it was impracticable to do so.

### Provisions

7. The municipality did not account for a rehabilitation provision for the landfill site as required by SA Standards of GRAP 19, *Provisions, contingent liabilities and contingent assets*. Consequently, provisions and assets are understated. As the municipality did not perform an environmental impact assessment, I was unable to determine the full extent of the misstatement in the financial statements as it was impractical to do so

### Irregular expenditure

8. The municipality did not include particulars of irregular expenditure in the notes to the financial statements. The municipality made payments in contravention of the supply chain management requirements to the amount of R47 694 900 that were not included in irregular expenditure, resulting in irregular expenditure being understated. As the municipality did not maintain an irregular expenditure register, I was not able to determine the full extent of the misstatement of irregular expenditure stated at R3 645

406 (2013: R3 645 406) in note 41 to the financial statements as it was impracticable to do so.

## Fruitless and wasteful expenditure

9. The municipality did not include particulars of fruitless and wasteful expenditure in the notes to the financial statements. The municipality made payments in vain to the amount of R2 394 574 which could have been avoided that were not included in fruitless and wasteful expenditure disclosure, resulting in fruitless and wasteful expenditure being understated. As the municipality did not maintain a fruitless and wasteful expenditure register, I was not able to determine the full extent of the misstatement of fruitless and wasteful expenditure stated at R186 140 (2013: R186 140) in note 40 to the financial statements as it was impracticable to do so.

## Budget information

10. SA Standard of GRAP 24, *Presentation of budget information in the financial statements*, requires entities to disclose by way of a disclosure note, explanations for material differences between budget for which the entity is held publicly accountable and actual amounts unless such explanation is included in other public documents issued in conjunction with the financial statements. In contravention of GRAP 24, the municipality has not disclosed explanations for material variances between budget and actual amounts.

## Cash flow statement

11. The municipality did not present the correct amounts in the cash flow statement as required by SA Standards of GRAP 2, *Cash flow statements*. The following figures are misstated:
  - Receipts from sale of goods and services is understated by R 11 701 959.
  - Finance costs are overstated by R 867 731.

## Prior period errors

12. The municipality did not disclose, in respect of prior period errors, the nature of prior period errors, the amount of the correction for each financial statement line item affected and the amount of the correction at the beginning of the earliest period presented as required by SA Standard of GRAP 3, *Accounting policies, estimates and errors*. The disclosures relating to prior period errors in note 37 are therefore incomplete.

## Qualified opinion

13. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Molemole Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended., in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

## Emphasis of matters

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

## **Material losses**

15. As disclosed in note 47 to the financial statements, distribution losses to the amount of R3 448 200 were incurred relating to electricity.
16. As disclosed in note 27 to the financial statements, material losses to the amount of R10 470 453 were incurred as a result of significant impairment of debtors due to poor collection practices.

## **Restatement of corresponding figures**

17. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

## **Additional matter**

## **Unaudited supplementary schedules**

18. 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.

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

19. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, non-compliance with legislation as well as 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 development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Electrical Services on pages xx to xx
  - Roads and storm water on pages xx to xx
  - Public and social amenities on pages xx to xx
  - Waste and environmental services on pages xx to xx
  - Traffic and licensing services on pages xx to xx

21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
22. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. The material findings in respect of the selected development priorities are as follows:

## **Electrical services**

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

25. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The municipality did not include material output key performance indicators and targets in relation to all the above development priorities. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets that are relevant to the achievement of the municipality's strategic goals and objectives.

## **Roads and storm water**

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

26. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The municipality did not include material output key performance indicators and targets in relation to all the above development priorities. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets that are relevant to the achievement of the municipality's strategic goals and objectives.

## **Public and social amenities**

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

27. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The municipality did not include material output key performance indicators and targets in relation to all the above development priorities. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets that are relevant to the achievement of the municipality's strategic goals and objectives.

## Waste and environmental services

### Usefulness of reported performance information

28. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The municipality did not include material output key performance indicators and targets in relation to all the above development priorities. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets that are relevant to the achievement of the municipality's strategic goals and objectives.

## Traffic and licensing services

### Usefulness of reported performance information

29. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The municipality did not include material output key performance indicators and targets in relation to all the above development priorities. This was because proper performance planning and management practices had not been developed and/or implemented to provide for the development of performance indicators and targets that are relevant to the achievement of the municipality's strategic goals and objectives.

## Additional matter

I draw attention to the matter below.

## Adjustment of material misstatements

30. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for waste and environmental management, traffic and licensing and electrical services development priorities. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness of the reported performance information

## Achievement of planned targets

31. Refer to the annual performance report on pages X to X and X to X for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on usefulness and reliability of the reported performance information for the selected programmes reported in paragraphs XX to XX of this report.

## Compliance with legislation

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

follows:

## **Budgets**

33. 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**

34. 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, liabilities, and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently, but the uncorrected material misstatements and/ or supporting records that could not be provided resulted in the financial statements receiving a modified audit opinion.

## **Audit committee**

35. 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 as the financial statements were not provided to the committee by the accounting officer.

## **Asset management**

36. 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.
37. An effective system of internal control for assets (including an accurate asset register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Revenue management**

38. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

## **Procurement and contract management**

39. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
40. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and in contravention of SCM regulation 16(b) and 17(b).
41. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).

42. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
43. Bids were not always evaluated by bid evaluation committees which were composed of at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
44. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
45. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations.
46. Construction contracts were awarded to contractors that did not qualify for the contract, in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
47. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
48. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
49. Contracts were awarded to 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).

## **Expenditure management**

50. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Internal control**

51. 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 qualified opinion and the findings on compliance with laws and regulations included in this report.

## **Leadership**

52. Insufficient oversight responsibility regarding financial and performance reporting and compliance and related internal control.
53. Action plans were developed but not fully implemented, hence the recurrence of findings identified in the prior years.
54. Ineffective human resources management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.



## Financial and performance management

- 55. A lack of adequate technical knowledge within management with regard to the preparation of financial statements and a lack of adherence to laws and regulations resulted in the modified opinion on the financial statements.
- 56. A lack of adequate technical knowledge in the finance section , including the asset management unit, with regard to accounting standards and legislation applicable to the municipality to adequately perform their functions relating to regular reconciliations, adherence to laws and regulations and reporting against predetermined objectives.
- 57. Insufficient implementation and monitoring of controls over daily and monthly processing and reconciling of transactions.

## Governance

- 58. Management's ineffectiveness with the implementation of recommendations from internal and external audit prevented the audit committee from promoting accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Polokwane

28 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*