

Report of the auditor-general to the Limpopo Provincial Legislature and the council on the Lepelle – Nkumpi Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Lepelle - Nkumpi Local Municipality set out on pages ... to ..., 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 budget for the year then ended, and 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), Division of Revenue Act of South Africa, 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. Assets to the value of R38 954 610, included in the financial statements of the municipality could not be physically verified. Furthermore, I identified a significant number of assets belonging to the municipality that were not accounted for in the accounting records and financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to property, plant and equipment stated at R542 651 788 (2013: R509 647 476) in the financial statements was necessary.
7. I was unable to verify the accuracy of the depreciation expense of R32 432 854 (2013: R26 078 999) as disclosed in note 8 to the financial statements.

Cash flow statement

8. I was unable to obtain sufficient appropriate audit evidence in respect of the decrease in net cash and cash equivalents amounting to R10 897 812. Consequently, I was unable to determine whether any adjustments to the increase in net cash and cash equivalents were necessary.

Irregular expenditure

9. The municipality made payments in contravention of the supply chain management requirements. The municipality did not include particulars of irregular expenditure in note 36 to the financial statements as required by section 125(2) (d) of the MFMA. Consequently I was unable to determine the full extent of the understatement in irregular expenditure stated at R95 762 200 (2013: R 72 104 730), as it was impracticable to do so.

Commitments

10. I identified differences to the amount of R27 909 770 between the supporting documentation and what was recorded in the underlying accounting records of the municipality. Consequently, commitments amounting to R77 387 771 as disclosed in note 33 to the annual financial statements is overstated by R27 909 770.

Aggregation of immaterial uncorrected misstatements

11. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position, the statement of financial performance and the notes to the financial statements:
 - General expenses reflected as R65 615 345 was understated by R1 497 195.
 - Employee cost reflected as R62 235 669 was understated by R294 357.
 - Receivables reflected as R4 804 42 was understated by R665 732.
 - Inventory reflected as R761 289 was overstated by R195 705.
 - Payables reflected as R29 688 358 was overstated by R485 212.



Qualified opinion

12. In my opinion, except for the 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 Lepelle – Nkumpi Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

14. As disclosed in note 31 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

Material underspending of the conditional grant

15. As disclosed in note 11 to the annual financial statements, the municipality has materially underspent the budget on Municipal Infrastructure Grant to the amount of R13 450 757.

Unauthorised expenditure

16. As disclosed in note 36 to the annual financial statements, the municipality has incurred unauthorised expenditure amounting to R1 257 209 (2013: R13 916 876), as a result of overspending on budget.

Material impairments

17. The municipality had consumer debtors totalling R106 818 465 at 30 June 2014. The recoverability of R71 675 412 debtors is doubtful.

Additional matters

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

Unaudited supplementary schedules

19. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.



Unaudited disclosure notes

20. 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

21. 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

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- a. Institutional transformation and organisational development on pages xx to xx.
 - b. Basic services and infrastructure development on pages xx to xx.
 - c. Good governance and public participation on pages xx to xx.
23. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
24. 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 objectives. I further performed tests to determine whether indicators and targets were well-defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. The material findings in respect of the selected development objectives are as follows:

Development objective 1: Institutional transformation and organisational development

Usefulness of reported performance information

27. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the objectives were not consistent with those in the approved integrated



development plan. This was due to management not exercising proper oversight responsibility over performance reporting and compliance.

28. The FMPPI requires that performance indicators must be well-defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well-defined. This was because management did not adhere to the requirements of the FMPPI due to a lack of technical indicator descriptions.
29. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific. This was because management was not aware of the requirements of the FMPPI.

Reliability of reported performance information

30. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of frequent review of the validity of reported achievements against source documentation.

Development objective 2: Basic services and infrastructure development

Usefulness of reported performance information

31. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 100% of the objectives were not consistent with those in the approved integrated development plan. This was due to management not exercising proper oversight responsibility over performance reporting and compliance.
32. The FMPPI requires that performance indicators must be well-defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well-defined. This was because management did not adhere to the requirements of the FMPPI due to a lack of technical indicator descriptions.
33. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific. This was because management was not aware of the requirements of the FMPPI.

Reliability of reported performance information

34. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of frequent review of the validity of reported achievements against source documentation.



Development objective 5: Good governance and public participation

Usefulness of reported performance information

35. The FMPPI requires that performance indicators must be well-defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 100% of the indicators were not well-defined. This was because management did not adhere to the requirements of the FMPPI due to a lack of technical indicator descriptions.
36. The FMPPI requires that performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific. This was because management was not aware of the requirements of 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 valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of frequent review of the validity of reported achievements against source documentation.

Additional matters

38. I draw attention to the following matters. My conclusion is not modified in respect of these matters:

Achievement of planned targets

39. Refer to the annual performance report on pages 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 the usefulness and reliability of the reported performance information for the selected development priorities reporting in this report

Adjustment of material misstatements

40. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for Institutional transformation and organisational development; Basic services and infrastructure development and Good governance and public participation.

Compliance with laws and regulations

41. I performed procedures to obtain evidence that the municipality has 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:

Strategic planning and performance management

42. The annual performance report for the year under review did not include a comparison with the previous financial year, as required by section 46 (1) (b) of the MSA.

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 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 of current assets, and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting documents were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

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

Asset management

46. 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.
47. An effective system of internal control for assets was not in place, as required by section 63(2) (c) of the MFMA.

Procurement and contract management

48. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the Supply Chain Management (SCM) policy in contravention of SCM regulation 16(b) and 17(b).
49. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
50. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
51. Contracts were extended and/or modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
52. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2) (b) of the MFMA.

Consequence management

53. 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) (ii) of the MFMA.

Human resource management

54. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2) (a) of the MSA.

Internal control

55. I considered internal control relevant to my audit of the financial statements, 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 qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

56. The accounting officer does not perform adequate review and monitoring of the financial and performance reporting. This has resulted in the annual financial statements and the annual performance report containing material misstatements.

Financial and performance management

57. The accounting officer did not adequately review and monitor compliance with laws and regulations resulting in irregular, fruitless and wasteful and unauthorised expenditure.
58. The significant number of adjustments to the PPE balances and qualification paragraphs is attributable to capacity constraints.

Governance

59. The municipality's risk management strategy is ineffective to prevent the large number of internal control deficiencies identified.

Auditor-General
Polokwane

28 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

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