

Report of the auditor-general to the Limpopo Provincial Legislature and the council of the Modimolle Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Modimolle 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 and cash flow statement and the statement of comparison of budget and actual amounts 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), and the Division of Revenue Act of South Africa, 2013 (Act No.2 of 2013) (DoRA) 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

Cash and cash equivalents

6. I have identified old reconciling items to the amount of R11 918 968 (2013: R4 306 755) which were included in the year-end bank reconciliation. I was unable to confirm these reconciling items by alternative means. Consequently I was unable to determine whether any adjustment relating to bank balances in cash and cash equivalents stated at R6 792 665 (2013: R25 287 332) in note 12 to the financial statements were necessary.

Value Added Tax (VAT)

7. The municipality could not provide me with supporting documentation for a difference identified between the general ledger and the VAT 201 returns amounting to R3 425 216 (2013: R5 178 502). The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments relating to the VAT payable stated at R25 970 784 (2013: R21 136 174) in financial statements were necessary.
8. During 2013, I was unable to obtain sufficient appropriate audit evidence for journal entries amounting to R929 331 for which no sufficient appropriate audit evidence could be provided. I was unable to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustment to VAT payables stated at R21 136 174 was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 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.
9. During 2013, the municipality had claimed VAT amounting to R1 016 124 without having a valid tax invoice. As a result, operating expenditure was overstated and VAT payable understated by R1 016 124. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the effect of this matter on the comparability of the current period's figures.

Receivables from non-exchange transactions

10. Included in receivables from non-exchange transaction is an item of R4 142 073 for which no sufficient appropriate audit evidence could be provided. I was unable to confirm this amount by alternative means. Consequently I was unable to determine whether any adjustments relating to the receivables from non-exchange transaction stated at R24 179 309 in the financial statements were necessary.

Receivables from exchange transactions

11. The Standard of Generally Recognised Accounting Practice, GRAP 104, *Financial Instruments*, states that an entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and

individually or collectively for financial assets that are not individually significant. If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective. The municipality did not apply the above stated principles of GRAP 104 while assessing receivables for impairment. Consequently I was not able to determine the correct amount of provision for impairment stated at R27 371 247 (2013: R24 401 712), as it was impracticable to do so.

Payables from exchange transactions

12. During 2013, I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions, other creditors and retentions amounting to R18 757 806. I was unable to confirm these payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to payables from exchange transactions stated at R31 592 256 was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 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.
13. During 2013, I was unable to obtain sufficient appropriate audit evidence for journal entries amounting to R18 763 806. I was unable to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustment to payables from exchange transactions stated at R31 592 256 was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 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.

Expenditure

14. During 2013, I was unable to obtain sufficient appropriate audit evidence for expenditure amounting to R15 951 321. I was unable to confirm these expenditures by alternative means. Consequently, I was unable to determine whether any adjustment to the bulk purchases, contracted services and general expenses amounting to R111 721 184 was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 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.

Irregular Expenditure

15. The municipality did not include particulars of irregular expenditure in the notes to the financial statements, as required by section 125 (2)(d)(i) of the MFMA. The municipality made payments in contravention of the supply chain management requirements that were not included in irregular expenditure stated at R6 363 708 (2013: R6 058 229) in note 43 of the financial statements. I was not able to determine the correct amount of irregular expenditure as it was impracticable to do so.

Qualified Opinion

16. 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 Modimolle 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

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

Restatement of corresponding figures

18. As disclosed in note 34 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 losses and impairments

19. As disclosed in note 10 to the financial statements, material losses to the amount of R10 050 001 were incurred as a result of a write-off of irrecoverable trade debtors.
20. As disclosed in note 50 to the financial statements, material distribution losses of 19.39% relating to water services were incurred as a result of ageing infrastructure.

Material underspending of the budget and conditional grants

21. With reference to note 15 to the financial statements, the municipality materially underspent its conditional grants for the year under review by R23 467 722.

Additional matter

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

Unaudited supplementary schedules

23. 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

24. 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

25. 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

26. 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.
- Development priority: Promote welfare of the community on pages X to X
 - Development priority: Resource management and infrastructure services on pages X to X.
27. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
28. I evaluated the usefulness of 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 priority. 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).
29. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
30. The material findings in respect of the selected programmes are as follows:

Promote welfare of the community

Usefulness of reported performance information

31. 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 27% of the reported targets were not consistent with those in the approved integrated development plan. This was due to limited review of the reporting documents.

Reliability of reported performance information

32. 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 monitoring of the completeness of source documentation in support of actual achievements and lack of frequent review of the validity of reported achievements against source documentation.

Resource management and infrastructure services

Usefulness of reported performance information

33. The FMPPI requires the following:

- 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 20% were not well defined.

This was because management was not trained in 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. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information and the auditee's records not permitting the application of alternative audit procedures.

Additional matters

35. I draw attention to the following matters:

Achievement of planned targets

36. 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 22 to 25 of this report.

Unaudited supplementary schedules

37. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. We have not audited these schedules and, accordingly, we do not express a conclusion thereon.

Compliance with laws and regulations

Strategic planning and performance management

38. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

39. The annual performance report for the year under review did not include a comparison of the performance with set targets and a comparison with the previous financial year

and measures taken to improve performance as required by section 46 (1)(b) and (c) of the MSA.

40. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the *Municipal planning and performance management regulations*.

Budgets

41. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the MFMA.

Annual financial statements, performance and annual reports

42. 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, revenue, expenditure 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 supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

43. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the contracts were not made available for the purposes of audit.
44. 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).
45. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
46. 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).
47. Contracts and quotations 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).
48. 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.
49. Contracts were extended/ modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
50. Contracts and quotations 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.

Human resource management and compensation

51. An acting municipal manager was appointed for a period of more than six months, in contravention of section 54A (2A) of the MSA.

Expenditure management

52. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.
53. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.
54. 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.

Revenue management

55. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
56. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.

Asset management and liability management

57. 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.

Internal control

58. 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

59. Management designed controls to prevent non-compliance with laws and regulations; however, these were not adequately implemented and reviewed throughout the year. Action plans were developed but not fully implemented, hence the recurrence of findings identified in the prior year.

Financial and performance management

60. 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 qualified opinion on the financial statements.
61. A lack of technical knowledge in the finance section with regard to new 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.

62. There is no monitoring of, and controls within the performance management process to ensure performance against predetermined objectives are useful and reliable.

Auditor-General.

Polokwane

28 November 2014



**AUDITOR - GENERAL
SOUTH AFRICA**

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