

# **REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON NAMA KHOI LOCAL MUNICIPALITY**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Nama Khoi Local Municipality set out on pages X to X, 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 and 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the MFMA of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and 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**

### **Revenue from non-exchange transactions**

6. I was unable to obtain sufficient appropriate audit evidence for revenue from non-exchange transactions as the municipality had an inadequate system of internal control to account for revenue and keep proper record of all revenue charged. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to revenue from non-exchange transactions stated at R98 603 032 (2013: R84 901 669) in the financial statements were necessary. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

### **Revenue from exchange transactions**

7. I was unable to obtain sufficient appropriate audit evidence for revenue from exchange transactions as the municipality had an inadequate system of internal control to account for revenue and keep proper record of all revenue charged. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to revenue from exchange transactions stated at R111 910 681 (2013: R105 477 705) in the financial statements were necessary. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

### **Trade and other receivables**

8. I was unable to obtain sufficient appropriate audit evidence for the calculation of the provision for impairment in terms of GRAP 104, *Financial Instruments* and the balances disclosed for consumer debtors. I was unable to confirm these receivables by alternative means. Consequently, I was unable to determine whether any further adjustments to receivables from non-exchange transactions stated at R5 009 571 (2013: R6 372 951) and receivables from exchange transactions stated at R14 627 692 (2013: R18 118 843) in the financial statements were necessary. Additionally, there is a consequential impact on the debt impairment in the statement of financial performance, surplus for the period and the accumulated surplus.

### **Value-added Tax**

9. I was unable to obtain sufficient appropriate audit evidence for the receivable for VAT as the municipality could not provide all the required supporting documentation to verify the calculations made by management for the VAT returns. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables for VAT stated at R6 979 114 (2013: R9 620 047) in the financial statements were necessary. Additionally, I could not determine the possible effect of all the limitations in this report on the receivables for VAT.

## **Unspent conditional government grants and receipts**

10. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts as the municipality could not provide all the required supporting documentation. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to unspent conditional grants and receipts stated at R0 (2013: R8 403 409) in the financial statements were necessary. In addition, documentation to establish if all transactions took place according to the conditions of each grant and whether the expenditure against the grants should have been transferred to revenue in the statement of financial performance could not be supplied. I was unable to confirm these amounts disclosed by alternative means. Additionally, there is a consequential impact on the surplus for the period and the accumulated surplus.

## **Accumulated surplus**

11. I was unable to obtain sufficient appropriate audit evidence regarding the accumulated surplus and statement of changes in net assets, as I could not obtain supporting documentation for the prior year corrections made as well as the limitations which was placed on my audit of numerous components of the financial statements. I was unable to confirm the surplus and the statement of changes in net assets by alternative means. Consequently, I was unable to determine whether any adjustments to the accumulated surplus stated at R460 033 444 (2013: R540 164 268) in the financial statements were necessary.

## **Cash flow statement**

12. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement due to the limitations placed on my audit of various components of the financial statements. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether any adjustment relating to the cash flow statement in the financial statements was necessary.

## **Statement of comparison of budget and actual amounts**

13. I was unable to confirm the accuracy of the Statement of comparison of the budget and actual amounts included in the financial statements due to the significant casting misstatements and differences identified between the amounts included in the statements and the approved adjustment budget by council.

## **Qualified Opinion**

14. 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 Nama Khoi 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 matter**

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

## **Restatement of corresponding figures**

16. As disclosed in note 48 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 2014.

## **Material losses and impairments**

17. As disclosed in note 38 to the financial statements, material water losses to the amount of R8 107 781 (2013: R5 494 571) and material electricity losses to the amount of R9 050 939 (2013: R8 493 237) were incurred.

18. As disclosed in note 11 to the financial statements, material impairment to the amount of R12 643 562 (2013: R7 739 463) were incurred as a result of the impairment of trade debtors.

## **Fruitless and Wasteful expenditure**

19. As disclosed in note 47 to the financial statements, fruitless and wasteful expenditure to the amount of R8 498 098 (2013: R2 200 258) was incurred. The total amount of fruitless and wasteful expenditure recorded in the annual financial statements at 30 June 2014 amounted to R12 687 452 (2013: R4 189 354). The majority of fruitless and wasteful expenditure is due to interest on late payments made to suppliers.

## **Unauthorised Expenditure**

20. As disclosed in note 46 to the financial statements, unauthorised expenditure to the amount of R82 601 658 (2013: R21 085 482) was incurred. The total amount of unauthorised expenditure recorded in the annual financial statement at 30 June 2014 amount to R193 452 761 (2013: R 110 851 103). The unauthorised expenditure is due to the overspending of the total amount appropriated for a few votes and departments of the municipality's approved budget.

## **Irregular Expenditure**

21. As disclosed in note 48 to the financial statements, irregular expenditure to the amount of R84 128 376 (2013: R8 108 790) was incurred. The total amount of unauthorised expenditure recorded in the annual financial statement at 30 June 2014 amount to R109 326 604 (2013: R25 198 228). The unauthorised expenditure is due to the overspending of the total amount appropriated for a few votes and departments of the municipality's approved budget.

## **Additional matters**

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

## **Unaudited supplementary schedules**

23. The supplementary information set out in appendix A - G 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.

## **Supplementary explanations of budget variances presented outside the financial statements**

24. The supplementary explanations of budget variances contained in appendix E1 and E2, as referred to in note 49 do not form part of the financial statements. I have not audited these explanations and accordingly I do not express an opinion thereon.

## **Unaudited disclosure notes**

25. 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**

26. 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**

27. 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 2: Basic and Sustainable Service Delivery and Infrastructure Development on pages x to x.
- Development priority 5: Good Governance and Public Participation on pages x to x.

28. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

29. 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).

30. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
31. The material findings in respect of the selected development priorities are as follows.

## **Development priority 2: Basic and Sustainable Service Delivery and Infrastructure Development**

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

32. Section 41(c) of the Municipal Systems Act 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 reported indicators were not consistent with those in the approved integrated development plan. This was due to lack of review of the annual performance report.
33. The FMPPI requires the following:
  - The period or deadline for delivery of targets must be specified. A total of 41% of the targets were not time bound.
  - 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.
  - Performance indicator must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.
34. This was due to a lack of proper systems and processes and technical indicator descriptions.

### **Reliability of reported performance information**

35. 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.

## **Development priority 5: Basic services and infrastructure**

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

36. Section 41(c) of the Municipal Systems Act 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 reported indicators were not consistent with those in the approved integrated development plan. This was due to lack of review of the annual performance report.
37. The FMPPI requires the following:
- The period or deadline for delivery of targets must be specified. A total of 28% of targets were not time bound.
  - 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.
  - Performance indicator must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.
38. This was due to a lack of proper systems and processes and technical indicator descriptions.

### **Reliability of reported performance information**

39. 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.

### **Additional matter**

40. I draw attention to the following matter:

### **Achievement of planned targets**

41. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the 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 objectives reported in paragraphs x to xx of this report.

## **Unaudited supplementary schedules**

42. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## **Compliance with laws and regulations**

43. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. I did not identify any instances of 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.

## **Budgets**

44. 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 Municipal Finance Management Act.

## **Annual financial statements, performance and annual reports**

45. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act.
46. 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) / (c) of the MSA.

## **Audit Committees**

47. The audit committee did not advise the council / accounting officer on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the Municipal Finance Management Act.
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 Municipal Finance Management Act.

## **HR Management**

49. An acting municipal manager was appointed for a period of more than six months in contravention of section 56(1) (c) of the Municipal Systems Act.

50. An approved staff establishment was not in place, as required by section 66(1)(a) of the Municipal Systems Act.
51. Municipal manager and senior managers did not signed an annual performance agreement within one month after the beginning of financial year, as required by section 57(2) of the Municipal Systems Act.

## **Expenditure Management**

52. 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 Municipal Finance Management Act.
53. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 65(2)(a) of the Municipal Finance Management Act

## **Transfer of funds and/or conditional grants**

54. Sufficient appropriate audit evidence could not be obtained that the allocation for the Integrated National electrification Programme (Municipal) Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the Division of Revenue Act.
55. Sufficient appropriate audit evidence could not be obtained that the allocation for the Municipal Systems Improvement Grant was utilised for purposes other than those stipulated in the grant framework, in contravention of section 16(1) of the Division of Revenue Act.
56. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the Division of Revenue Act.

## **Revenue management**

57. A credit control and debt collection policy was not maintained, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of Municipal Finance Management Act.
58. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the Municipal Finance Management Act.
59. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated on a monthly basis, as required by section 64(2)(b) of the Municipal Finance Management Act.

## **Financial Misconduct**

60. Unauthorised 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 Municipal Finance Management Act.
61. Irregular 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 Municipal Finance Management Act.

62. 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 Municipal Finance Management Act

## **Procurement**

63. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
64. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).
65. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services as required by SCM regulation 28(2).
66. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
67. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) in accordance with section 18(1) of the CIDB Act [and CIDB regulations 17 and 25(7A)]
68. 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.

## **Strategic planning and performance management**

69. The local community was not consulted through a forum that enhances community participation in drafting and implementing the Integrated development plan (IDP), as required by section 28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).
70. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan (IDP) before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).
71. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and the Municipal planning and performance management regulations 12(1) and 12(2)(e).

## **Internal control**

72. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. I did not identify any deficiencies in internal control that I considered sufficiently significant for inclusion in this report.

## **Leadership**

73. The accounting officer did not take appropriate action to address lack of discipline in the finance and supply chain management directorate, resulting in non-compliance with applicable legislation.
74. The accounting officer did not exercise adequate oversight responsibility over financial and performance reporting and compliance with laws and regulations, as the municipality did not address the findings regarding the financial statements, performance information and compliance of the previous year. As a result, there were repeat findings in the current year.
75. The municipality did not have sufficient monitoring controls to ensure adherence to the internal policies and procedures at a programme level and for purposes of taking corrective action. As a result, material non-compliance issues were noted as detailed in the compliance with laws and regulations section of this report.

## **Financial and performance management**

76. The municipality did not formulate and implement a record management policy and related procedures to ensure that all documentation is properly controlled. Documentation supporting amounts disclosed in the financial statements and achievement of predetermined objectives targets disclosed in the annual report was not available.
77. Finance staff had an insufficient understanding of the accounting framework. This contributed to the numerous qualifications in the financial statements of the municipality.
78. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure
79. Effective performance systems, processes and procedures and the management thereof have not been adequately implemented. The financial statements were also subject to material adjustments. Documentation supporting amounts disclosed in the financial statements and achievement of predetermined objectives targets disclosed in the annual report was not available.

## **Governance**

80. The financial statements were subject to material corrections resulting from the audit, which are attributable to the lack of risk assessment performed, weaknesses in the design and implementation of internal control in respect of financial management, and financial reporting and weaknesses in the information systems. This also resulted in the prior year audit findings not being substantially addressed in certain instances.
81. A risk officer has been appointed and has compiled a risk register for the 2012/2013 period, however no formal Risk Committee that meets quarterly has been established
82. The accounting officer did not prioritise the appointment of the performance audit committee and therefore a performance audit committee was not in operation during the financial year. This also resulted in the committee not being able to fulfil all its responsibilities.

*Auditor-General*

Kimberley

30 January 2015



**AUDITOR - GENERAL  
SOUTH AFRICA**

*Auditing to build public confidence*