



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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Mahikeng 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 information with actual information 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), 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), 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 of opinion

Property, plant and equipment

6. I was unable to obtain sufficient appropriate audit evidence to support the unit rates used in the calculation of the deemed cost for infrastructure assets of R715 534 836 (2013: R740 336 384) included in property, plant and equipment as all of the information and explanations considered necessary for the valuation of these assets were not available. In addition, I was unable to obtain sufficient appropriate audit evidence for roads of R590 440 221 (2013: R611 539 552) due to lack of proper records available on the ownership of roads. I was not able to confirm the value of these assets by alternative means. Consequently, I was unable to determine whether any adjustments relating to these assets and depreciation of R48 997 348 (2013: R49 856 257) were necessary.

Cash and cash equivalents

7. I was unable to obtain sufficient appropriate audit evidence regarding the cash and cash equivalents as the municipality could not provide proper substantiating records for reconciling items included in the bank reconciliation. I was unable to confirm this balance by alternative means. Consequently I was unable to determine whether any adjustment relating to the cash and cash equivalents of R30 081 712 (2013: R35 169 001) as disclosed in statement of financial position and note 12 to the financial statements was necessary.

Accumulated surplus

8. I was unable to obtain sufficient appropriate audit evidence for the accumulated surplus for the current and prior year due to the lack of proper substantiating accounting records. I was unable to confirm the accumulated surplus by alternative means. Consequently, I was unable to determine whether any adjustments to accumulated surplus of R1 074 165 750 (2013: R1 084 857 393) in the financial statements was necessary.

Revenue

9. The municipality did not account for all water sales in the current and prior period as revenue, in accordance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions*. As the municipality did not maintain adequate records of water consumption, I was not able to determine the full extent of the understatement of sale of water of R62 763 816 (2013: R69 751 594) disclosed in the statement of financial performance and note 22 and the related consumer debtors of R122 677 627 (2013: R118 781 503) disclosed in the statement of financial position and note 11 to the financial statements were necessary.

Expenditure

10. The municipality did implement adequate controls to comply with the SA Standards of GRAP, GRAP 1 *Presentation of financial statements* over the recording and classification of transactions for goods and services. The extent of the misstatement over the recording and classification of transactions for goods and services is approximately R11 475 963. I was not able to determine the full extent of the misstatement of trade creditors, general expenses, repairs and maintenance and value added tax (VAT), as it was impracticable to do so.

Irregular expenditure

11. Section 125(2)(d)(i) of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R11 670 498 (2013: R2 782 173) in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm that awards of R20 195 735 were made in terms of the supply chain management requirements As the municipality did not quantify the full extent of the irregular expenditure, it



was impracticable to determine the resultant understatement of irregular expenditure as per note 47 to the financial statements.

Aggregation of immaterial uncorrected misstatements

12. I was unable to obtain sufficient appropriate audit evidence regarding the following items making up the statement of financial position, and the statement of financial performance and the notes to the financial statements, which had a cumulative effect on the financial statements:

- Consumer debtors of R3 631 673 as included in the disclosed balance of R160 287 748 in note 11
- Employee cost of R1 532 670 as included in the disclosed balances of R191 142 863 in note 26
- Other income of R1 800 322 as included in the disclosed balance of R167 470 607 in the statement of financial performance

I was unable to confirm these items by alternative means. As a result, I was unable to determine whether any further adjustment to these items was necessary

Cash flow statement

13. As a result of the misstatements identified in the financial statements as set out in this report, I was unable to practicably quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine whether any adjustment relating to the cash flow statement and notes thereto was necessary.

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 Mahikeng 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 the DoRA.

Emphasis of matters

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

Unauthorised and fruitless and wasteful expenditure

16. As disclosed in note 45 to the financial statements, unauthorised expenditure of R1209 650 was incurred in the current year and the unauthorised expenditure from prior years of R111 809 414 had not yet been dealt with in accordance with section 32 of the MFMA.

17. As disclosed in note 46 to the financial statements, fruitless and wasteful expenditure of R819 386 was incurred in the current year and fruitless and wasteful from prior years of R5 367 324 not yet been dealt with in accordance with section 32 of the MFMA.

Material impairments

18. As disclosed in note 28 to the financial statements, material impairment to the amount of R139 375 927 were incurred as a result of the assessment of the recoverability trade debtors.

Material losses

19. As disclosed in note 48 to the financial statements, material losses to the amount of R14 718 475 (2013:R8 732 766) were incurred as a result of losses on water.



Restatement of corresponding figures

20. As disclosed in note 42 to the financial statements, the corresponding figures for 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the Mahikeng Local Municipality and for the year ended, 2013.

Additional matters

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

Unaudited disclosure notes

22. 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.

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.

REPORT ON OTHER LEGAL AND REGULARITY REQUIREMENTS

24. 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 the 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

25. 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 4 : Basic service delivery and infrastructure investment on pages [xx] to [xx]
- Development priority 5 : Local economic development and spatial rational on pages [xx] to [xx]

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

27. 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).

28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

29. The material findings in respect of the selected development priorities are as follows:



Development priority 4: Basic service delivery and infrastructure investment

Usefulness of reported performance information

30. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:

- A total of 32% of the targets were not specific.
- The required performance for 32% of the targets could not be measured.
- A total of 25% of the indicators were not well defined.
- A total of 25% of the indicators were not verifiable.

This was due to lack of proper systems, processes and performance management policy.

Reliability of reported performance information

31. 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself 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.

Development priority 5: Local economic development and spatial rational

Usefulness of reported performance information

32. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:

- A total of 57% of the targets were not specific.
- The required performance for 57% of the targets could not be measured.

This was due to lack of proper systems, processes and performance management policy

Reliability of reported performance information

33. 10. 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. I was unable to obtain the information and explanations I considered necessary to satisfy myself 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 matter

34. I draw attention to the following matter:

Achievement of planned targets

35. Refer to the annual performance report on pages XX to XX 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 priorities reported in paragraphs 30 to 33 of this report

Compliance with legislation

36. I performed procedures to obtain evidence that the 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

Strategic planning and performance management

37. The annual performance report for the year under review does not include the performance of each external service provider and 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)(a), (b) and (c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

38. The performance management system and related controls were not in place 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 (MPPMR).

39. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by regulation 14(2) (a) of the MPPMR.

40. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

Human resource management

41. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

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

Annual report and financial statements

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

Internal audit

44. An internal audit unit was not established throughout the year, as required by section 165(1) of the MFMA.

Audit committee

45. An audit committee was not in place, as required by section 166(1) of the MFMA.

Liability management

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



Asset management

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

Revenue management

49. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
50. An adequate management, accounting and information system which accounts for revenue debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
51. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Expenditure management

52. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2)(b) of the MFMA.
53. 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.
54. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

Procurement and contract management

55. 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 management could not provide evidence of the procurement processes followed.
56. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by Supply Chain Management (SCM) regulations 17(a) and (c).
57. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids as required by SCM regulation 19(a).
58. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted 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).
59. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality as required by SCM regulation 13(c).
60. Awards were made to providers whose directors are in service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
61. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

62. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

Budgets

63. 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.

Consequences management

64. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Conditional grants received

65. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure grant, Municipal Systems Improvement Grant and Local Government Financial Management Grant allocation, as required by section 12(5) of the DoRA.

Waste management

66. The municipality operated its wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).

67. The municipality's operational activities at its waste disposal site and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license, section 67(1)(f) and (h) of the NEMWA and section 151(1)(c) and (i) of the NWA.

68. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

69. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

Internal control

70. 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

71. Management did not adequately exercise appropriate oversight over financial and performance reporting and related internal controls, while decisive actions to address risks relating to the achievement of complete and accurate financial and performance reporting was not taken.

Financial and performance management

72. Management did not adequately implement effective controls to ensure that information presented in the financial statements is reliable before submission for audit. Regular, accurate and complete financial and performance reports that are supported and evidenced by reliable



information were not properly prepared. Further, management did not adequately review and monitor compliance with applicable laws and regulation.

Governance

73. Management did not ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action throughout the year. In addition management did not establish an audit committee.

OTHER REPORTS

Investigations

74. An investigation was prompted by the municipal manager for transactions that were processed fraudulently by unknown persons from the municipal bank account. A case was opened with the South African Police Service. The investigation was still on-going at the reporting date.

75. Investigations were prompted by the municipal manager undertaken by an independent firm on the alleged irregular sale of property to an external party without following the correct disposal processes, the irregular appointment of service providers and on irregular payments of allowances to employees the matters are still to be finalised at reporting date.

Rustenburg

30 November 2014



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence