

Report of the auditor-general to the Free State Legislature and the council on the Nketoana Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Nketoana Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and 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) 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. The municipality did not review the residual values and useful lives of infrastructure assets at each reporting date in accordance with SA Standards of GRAP, GRAP 17 *Property, plant and equipment*. As a result, infrastructure assets with a gross carrying amount of R133 168 716 (2014: R133 168 716) were valued at a zero net carrying amount while still being in use. I was not able to determine the impact on the net carrying amount of infrastructure assets as it was impracticable to do so. Furthermore all assets were not recorded in the asset register and certain assets that were recorded in the asset register could not be found. Consequently, property, plant and equipment were understated by R92 302 691. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Aggregation of immaterial uncorrected misstatements

7. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position, the statement of financial performance and the notes to the financial statements:
 - Current assets reflected as R62 274 427 were understated by R3 684 957.
 - Non-current assets reflected as R588 233 577 were overstated by R149 500.
 - Current liabilities reflected as R135 065 773 were overstated by R530 182.
 - Revenue reflected as R287 905 149 was understated by R2 864 788.
 - Expenditure reflected as R328 411 769 was understated by R2 166 818.

Qualified opinion

8. 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 Nketoana Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Unauthorised expenditure

10. As disclosed in note 51 to the financial statements, the municipality incurred unauthorised expenditure of R5 361 768 (2014: R13 227 353). The unauthorised expenditure was incurred as a result of an improper budgeting process.

Irregular expenditure

11. As disclosed in note 53 to the financial statements, the municipality incurred irregular expenditure of R26 178 926 (2014: R34 014 272). The irregular expenditure was as a result of contravention of the supply chain management regulations.

Material losses

12. As disclosed in note 36 to the financial statements, material losses to the amount of R50 745 983 (2014: R41 712 998) were incurred as a result of a write-off of irrecoverable trade debtors without council approval.
13. As disclosed in note 54 to the financial statements, the municipality incurred material losses to the value of R5 463 500 (2014: R4 318 449) as a result of electricity distribution losses.

Material impairments

14. As disclosed in note 7 to the financial statements, a provision for impairment of R225 045 597 (2014: R208 898 712) has been made with regard to consumer receivables from exchange transactions of R257 808 213 (2014: 239 109 888).

Going concern

15. Note 50 to the financial statements indicates that the Nketoana Local Municipality incurred a net loss of R40 312 334 (2014: R75 463 937) during the year ended 30 June 2015 and, as of that date, the municipality's current liabilities exceeded its current assets by R72 791 346. These conditions, along with other matters as set out in note 50, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to meet its financial obligations as they fall due and achievement of service delivery as outlined in the annual performance plan..

Restatement of corresponding figures

16. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2014 were restated as a result of errors discovered during 2014-2015 in the financial statements of the Nketoana Local Municipality at, and for the year ended, 30 June 2014.

Additional matters

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

Unaudited disclosure note

18. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas (KPA) presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2015:
- KPA1: Basic service delivery on pages x to x
21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
22. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned KPA. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. I did not raise material findings on the usefulness and reliability of the reported performance information for the following key performance area:
- KPA1: Basic service delivery

Additional matters

25. I draw attention to the following matters:

Achievement of planned targets

26. Refer to the annual performance report on page x to x for information on the achievement of the planned targets for the year.

Unaudited supplementary schedules

27. 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 legislation

28. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. Material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Financial statements, performance and annual report

29. 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, non-current liabilities, current liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected or the supporting records were provided, but the uncorrected material misstatements that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Audit committee

30. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).

Internal audit

31. The internal audit unit did not function as required by section 165(2) of the MFMA in that it did not advise the accounting officer and report to the audit committee on matters relating to internal controls, accounting procedures and practices and risk and risk management.

Procurement and contract management

32. 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) regulation 17(a) and (c).
33. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
34. Contracts were awarded to and quotations were accepted from bidders who had not 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).
35. Persons in the service of the municipality who had a private business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e), the code of conduct for councillors issued in terms of the Municipal Systems Act (MSA) and the code of conduct for staff members issued in terms of the MSA.
36. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

Human resource management and compensation

- 37. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by regulations 14(2)(b) and 14(3) of the *Municipal regulations on minimum competency levels*..
- 38. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.

Expenditure management

- 39. Reasonable steps were not taken to prevent unauthorised, irregular, as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
- 40. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Revenue management

- 41. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
- 42. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.

Conditional grants received

- 43. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal infrastructure grant, the local government financial management grant and the municipal systems improvement grant allocation, as required by section 12(5) of DoRA.

Asset management

- 44. 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 .
- 45. 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.

Consequence management

- 46. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

- 47. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported

below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

48. The leadership did not always take timeous and adequate action to address weaknesses in the finance and supply chain management directorate, which resulted in non-compliance with applicable legislation and gave rise to fruitless and wasteful and irregular expenditure. Integrity and ethical values were not adequate to prevent material irregular expenditure and to set the standard of sound corporate governance.
49. Deviations from the expected standards of conduct were not followed up to ensure that remedial or disciplinary action was taken in a timely and consistent manner. Overriding of internal controls occurred, which resulted in irregular expenditure. Value for money was not always obtained, which resulted in potential cases of fraud to be investigated by management.
50. Consequence management was not effective as the council did not investigate instances of unauthorised, irregular, fruitless and wasteful expenditure to determine whether any person was liable for the expenditure as the council neglected to appoint a committee to investigate the expenditure.
51. Key management positions were vacant during the year under review. Management did not implement effective human resource management to ensure that competent and sufficiently skilled officials are appointed and performance is monitored.
52. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evident in the failure of management to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause. This resulted in a recurrence of prior year audit findings.
53. Leadership did not evaluate the implementation of effective internal controls by ensuring proper records management, maintenance of an asset register and preparation of the annual financial statements.

Financial and performance management

54. There was a material breakdown of the internal controls at the municipality. The weak control environment led to monthly and daily controls not being implemented and monitored.
55. Compliance with laws and regulations is not monitored on a regular basis and non-compliance is not addressed in a timely manner as management did not implement the action plan on the prior year findings.
56. The financial statements were subject to material corrections resulting from the audit process, which are attributable to weaknesses in the design and implementation of internal control in respect of financial management and financial reporting and weaknesses in the information systems of the municipality, mainly due to vacancies in key positions.

Governance

57. Management's failure to perform a risk assessment for the year under review and the appointment of the internal auditor as acting chief financial officer hampered the productivity and reliability of the work of the internal audit section.

Other reports

Investigations

58. An investigation was conducted by independent forensic auditors at the request of the bank regarding alleged fraudulent transactions which occurred between 22 and 25 October 2010 on two of the municipality's bank accounts. The bank indicated in a letter Ref. 2030906 dated 2 August 2013 that they are not liable for the loss. Management did not take any action and no evidence could be provided of efforts by the municipality to recover the money or to follow up on the investigation since August 2013. The amount that was not recovered is R1 780 000.
59. An investigation was being conducted by the South African Police Service (SAPS) into alleged fraudulent procurement transactions between the 2009 and 2012 financial years. Supporting documentation has been seized by the SAPS. The investigation commenced towards the end of the 2013 financial year. The investigation was still ongoing at the reporting date.

Auditor - General

Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence