Auditor's report

Msukaligwa Local Municipality

30 June 2015

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Msukaligwa Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Msukaligwa 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 the financial statements based on conducting the 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. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. In terms of GRAP 17 *Property, plant and equipment*, an entity shall recognise an item of property, plant and equipment that qualifies for recognition as an asset in the financial statements. Contrary to this requirement, the municipality did not recognise all assets in its financial statements, as assets selected from the floor could not be traced to the asset register. Assets selected from the asset register amounting to R15 615 681 could also not be physically verified. I was not able to determine the full extent of the misstatement on property, plant and equipment, as it was impracticable to do so.

5. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to property, plant and equipment amounting to R301 925 959 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the R1 769 319 793 (2013-14: R1 826 207 341) disclosed in note 4 to the statement of financial position.

Revenue from exchange transactions

6. GRAP 9 *Revenue from exchange transactions* outlines the recognition and requirements pertaining to service charges. Contrary to these requirements, the municipality did not recognise all revenue in its financial statements, as metres installed during the year had not been billed. I was not able to determine the full extent of the understatement of revenue from exchange transactions and receivables from exchange transactions, as it was impracticable to do so. In addition, I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to revenue from exchange transactions amounting to R27 796 841 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the R276 498 170 (2013-14: R244 496 780) disclosed in notes 19, 20, 21 and 22 to the statement of financial performance.

Revenue from non-exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to revenue from non-exchange transactions amounting to R25 534 016 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, my opinion on the current period's financial statements is modified because of the possible effect of this matter on the comparability of the current period's figures.

Expenditure

8. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to expenditure amounting to R34 570 098 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, my opinion on the current period's financial statements is modified because of the possible effect of this matter on the comparability of the current period's figures.

Receivables from exchange transactions

9. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to receivables from exchange transactions amounting to R46 354 357 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the corresponding figure stated at R11 844 981 as disclosed in note 8 to the statement of financial position. My opinion on the current period's financial statements is modified because of the possible effect of this matter on the comparability of the current period's figures.

Receivables from non-exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to receivables from non-exchange transactions amounting to R31 217 302 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the R9 563 822 (2013-14: R0) disclosed in note 9 to the statement of financial position.

Consumer debtors

11. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to consumer debtors amounting to R34 514 918 as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the corresponding figure stated at R42 687 200 (2013-14: R34 514 918) as disclosed in note 11 to the statement of financial position. My opinion on the current period's financial statements is modified because of the possible effect of this matter on the comparability of the current period's figures.

Cash flow statements

12. I was unable to obtain sufficient appropriate audit evidence regarding the prior period error adjustment to cash flows from operating activities and investing activities amounting to R36 897 698 and R36 901 849, respectively, as disclosed in note 41 to the financial statements. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to the corresponding amounts stated at R30 906 754 for net cash flows from operating activities and R48 363 649 for net cash flows from investing activities as disclosed in the cash flow statement. My opinion on the current period's financial statements is modified because of the possible effect of this matter on the comparability of the current period's figures.

Irregular expenditure

13. I was unable to obtain sufficient appropriate evidence for irregular expenditure. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the prior year's irregular expenditure of R41 358 653 as disclosed in note 46 to the financial statements.

Aggregation of immaterial uncorrected misstatements

14. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position:

    - Value-added tax (VAT) receivable reflected as R25 264 630 is understated by R371 288

15. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:

    - Inventory of R2 487 071 as included in the disclosed balance of R7 934 341
    - Other receivables from exchange transactions of R5 619 060 as included in the prior period error note 41
    - VAT receivable of R4 520 820 as included in the prior period error note 41
    - Payables from exchange transactions of R6 001 262 as included in the prior period error note 41
    - Unspent conditional grants and receipts of R15 551 354 as included in the prior period error note 41

16. As a result, I was unable to determine whether any further adjustments were necessary to these items.

Disclaimer of opinion

17. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

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

Restatement of corresponding figures

19. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

20. As disclosed in note 47 to the financial statements, material losses of R43 920 534 (2013-14: R71 648 533) were incurred as a result of electricity distribution losses, which represented 37% (2013-14: 35%) of the total electricity purchased. Material losses of R31 565 788 (2013-14: R3 825 748) were incurred as a result of water distribution losses, which represented 65% (2013-14: 55%) of the total water purchased.

Material impairments

21. As disclosed in note 11 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R283 193 080 (2013-14: R266 951 580), which represented 87% (2013-14: 89%) of the total consumer debtors. The contribution to the provision for debt impairment was R16 241 500 (2013-14: R11 446 707).

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 on pages ... to ... 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 have a responsibility to report findings on the reported performance information against predetermined objectives for selected development objectives 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

26. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objective presented in the annual performance report of the municipality for the year ended 30 June 2015:

    - Key performance area 2: basic service delivery and infrastructure development, on pages ... to ...

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

28. 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).

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 development objective are as follows:

Basic service delivery and infrastructure development

Usefulness of reported performance information

31. Performance indicators must be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 27% of the indicators were not well defined.

32. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 27% of the indicators were not verifiable.

    This was because management had not been trained in, and did not adhere to, the requirements of the FMPPI.

Reliability of reported performance information

33. 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 standard operating procedures or documented system descriptions for the accurate recording of actual achievements; technical indicator descriptions for the accurate measurement, recording and monitoring of performance; monitoring of the completeness of source documentation in support of actual achievements; and frequent review of the validity of reported achievements against source documents.

Additional matter

34. I draw attention to the following matter:

Achievement of planned targets

35. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 33 to 35 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 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:

Strategic planning and performance management

37. The municipality had not established a performance management system, as required by section 38(a) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

38. A 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 and improvement as well as how it is to be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Annual financial statements, performance report and annual report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Some material misstatements of non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer of audit opinion.

40. The 2013-14 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

41. The annual performance report for the year under review did not include the performance of the municipality and external service providers, a comparison of performance with set targets, a comparison with the previous financial year as well as measures taken to improve performance, as required by section 46 (a) and (b) of the MSA.

Audit committee

42. The audit committee did not advise the council or 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 MFMA.

43. The audit committee did not advise the accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

44. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.

45. 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).

46. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

47. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

48. Sufficient appropriate audit evidence could not be obtained that all contracts had been awarded in accordance with the legislative requirements and a procurement process that is fair, equitable, transparent and competitive, as management had placed a limitation in providing me with the required records.

49. Sufficient appropriate audit evidence could not be obtained that bid specifications for the procurement of goods and services through competitive bids had been drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by supply chain management (SCM) regulation 27(2)(a).

50. Sufficient appropriate audit evidence could not be obtained that bid specifications had been drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM regulation 27(3).

51. Invitations for competitive bidding were not always advertised for the required minimum period, as required by SCM regulation 22(1) and 22(2).

52. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).

53. Quotations were awarded to bidders based on preference points that had not been allocated in accordance with the requirements of the PPPFA and its regulations.

54. Sufficient appropriate audit evidence could not be obtained that quotations had been awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA.

55. 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).

56. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

57. Sufficient appropriate audit evidence could not be obtained that quotations had only been awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

58. Prospective providers were not invited to apply for listing in the list of approved prospective providers at least once a year, as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).

Human resource management and compensation

59. The competencies of financial and SCM officials were not assessed in a timely manner to identify and address gaps in competency levels, as required by municipal regulation on minimum competency levels 13.

60. The municipality did not submit a report on compliance with the prescribed competency levels to the National Treasury and relevant provincial treasury, as required by municipal regulation on minimum competency levels 14(2)(a).

61. The annual report of the municipality did not reflect information on compliance with the prescribed minimum competencies, as required by municipal regulation on minimum competency levels 14(2)(b).

62. The competencies of the senior managers were not assessed in a timely manner to identify and address gaps in competency levels, as required by municipal regulation on minimum competency levels 13.

63. Sufficient appropriate audit evidence could not be obtained that the municipality had developed and adopted appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff, as required by section 67(d) of the MSA.

64. Senior managers did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Expenditure management

65. 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.

66. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Revenue management

67. A tariff policy was not adopted for the levying of fees for the provision of municipal services, as required by section 74(1) of the MSA and section 62(1)(f)(i) of the MFMA.

68. A policy was not adopted for the levying of rates on rateable property within the municipality, as required by section 3(1) of the Municipal Property Rates Act of South Africa, 2004 (Act No. 6 of 2004) and section 62(1)(f)(ii) of the MFMA.

69. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

70. 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

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

72. Allegations of financial misconduct laid against officials of the municipality were not investigated in accordance with the requirements of section 171(4)(a) of the MFMA and municipal regulation on financial misconduct procedures and criminal proceeding 5(1).

Internal control

73. 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 the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

74. The municipality did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.

75. The accounting officer did not always ensure that ongoing monitoring and supervision were undertaken to enable an assessment of the effectiveness of internal control.

76. The accounting officer did not evaluate whether management had implemented effective internal controls by gaining an understanding of how senior management members had met their responsibilities.

Financial and performance management

78. Management did not implement adequate controls over daily and monthly processing and reconciling of transactions.

79. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

80. Management at the appropriate level did not ensure that compliance with applicable laws and regulations was adequately reviewed and monitored throughout the year.

81. Financial information submitted with the financial statements for auditing was not adequately reviewed for accuracy and completeness.

Governance

82. The risk management unit did not operate effectively during the current period and was not able to positively influence the audit outcome.

83. The internal audit unit did not operate effectively during the current period and was not able to positively influence the audit outcome. As the audit action plan was not adequately designed and monitored, numerous instances of non-compliance with laws and regulations recurred.

84. The audit committee did not adequately promote accountability and service delivery through evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation.

Auditor - General

Mbombela

30 November 2015

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence