

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 ... 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 the 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 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, useful lives and depreciation method of property, plant and equipment at each reporting date in accordance with GRAP 17, *Property, plant and equipment*. The municipality also did not assess whether there is any indication that property, plant and equipment may be impaired in accordance with GRAP 26, *Impairment of cash-generating assets*, which resulted in property, plant and equipment being overstated and impairment losses being understated by R11 813 665. The municipality did not comply with these requirements in the current year. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the balance of property, plant and equipment disclosed as R573 468 551 in note 9 and depreciation and amortisation stated at R38 167 156 in note 32 to the financial statements. I was unable to confirm the balance disclosed by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for property, plant and equipment, accumulated depreciation and depreciation and amortisation.

Employee benefit liabilities

7. I was unable to obtain sufficient appropriate audit evidence that management had accounted for all for employee benefit liabilities due to the status of the accounting records and non-submission of supporting documentation for the inputs used. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to employee benefit liabilities stated at R18 655 660 as per note 18 to the financial statements was necessary.

Receivables from exchange and non-exchange transactions

8. The municipality did not recognise the provision for impairment loss in accordance with GRAP 104, *Financial instruments*, as the basis for the calculation of the impairment did not comply with the stipulations of GRAP 104. The municipality did not comply with these requirements in the current and prior years. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the balance of receivables from exchange transactions and receivables from non-exchange transactions disclosed as R11 139 040 (2014: R14 627 692) and R5 796 269 (2014: R5 009 271), respectively, in note 3 and 4 to the financial statements. I was unable to confirm the balance disclosed by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for receivables from exchange and non-exchange transactions.

VAT receivable

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 balance by alternative means. Consequently, I was unable to determine whether any adjustment to receivable for VAT stated at R5 399 761 (2014: R6 979 114) as per note 5 to the financial statements was necessary.

Cash flow statement

10. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement due to differences between my calculations and amounts disclosed in the cash flow statement. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement in the financial statements were necessary.

Statement of comparison of budget and actual amounts

11. The municipality did not disclose the statement of comparison of budget and actual amounts in accordance with GRAP 24, *Presentation of budget information in financial statements*, resulting in differences amounting to R41 470 997 identified between the budget amounts and actual amounts as disclosed in the statements of comparison of budget and actual amounts.

Revenue from non-exchange transactions

12. During 2014, I was unable to obtain sufficient appropriate audit evidence regarding 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 adjustment relating to revenue from non-exchange transactions stated at R85 436 614 in the financial statements was necessary.

Revenue from exchange transactions

13. During 2014, I was unable to obtain sufficient appropriate audit evidence regarding 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 adjustment relating to revenue from exchange transactions stated at R105 459 328 in the financial statements was necessary.

Aggregation of immaterial uncorrected misstatements

14. 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 and the statement of financial performance:
 - Revenue from non-exchange transactions reflected as R85 436 614 was understated by R815 244.
 - Payables from exchange transactions reflected as R156 618 322 was overstated by R1 318 625.
15. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:
 - Revenue from non-exchange transactions of R3 317 278 as included in the disclosed balance of R85 436 614.

- Payables from exchange transactions of R5 059 010 as included in the disclosed balance of R156 618 322.
16. Consequently, I was unable to determine whether any adjustment to these items was necessary.

Qualified opinion

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

Emphasis of matters

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 40 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 30 June 2015 in the financial statements of the Nama Khoi Local Municipality at, and for the year ended, 30 June 2015.

Material losses

20. As disclosed in note 38.1 to the financial statements, water and electricity losses to the amount of R9 475 139 (2014: R14 052 419) were incurred.

Unauthorised expenditure

21. As disclosed in note 45.1 to the financial statements, the municipality incurred unauthorised expenditure of R33 968 290 (2014: R82 601 658) during the year under review mainly due to the overspending of the total amount appropriated for a few votes and departments of the municipality's approved budget. The total amount of unauthorised expenditure recorded in the annual financial statements at 30 June 2015 amount to R227 421 051 (2014: R193 452 761).

Irregular expenditure

22. As disclosed in note 45.3 to the financial statements, the municipality incurred irregular expenditure of R40 413 477 (2014: R84 128 376) during the year under review mainly due to non-compliance with supply chain management requirements. The total amount of irregular expenditure recorded in the annual financial statements at 30 June 2015 amount to R149 740 081 (2014: R109 326 604). In addition, the full extent of irregular expenditure is still in the process of being determined.

Financial sustainability

23. Note 57 to the financial statements indicates that the municipality had a deficit of R62 970 939 for the year ended 30 June 2015 and, as of that date, the municipality's current liabilities exceeded its current assets by R136 545 769. These conditions 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 to achieve service delivery objectives.

Additional matters

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

Unaudited supplementary schedules

25. 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

26. 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 we do not express an opinion thereon.

Supplementary explanations of budget variances presented outside the financial statements

27. The supplementary explanations of budget variances contained in appendix E1 to E3, as referred to in note 54 do not form part of the financial statements. I have not audited these explanations and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

28. 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 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

29. The annual performance report presented for auditing did not include the actual performance of all the planned objectives, indicators and targets specified in the integrated development plan for the year under review as required by section 46 of the Municipal Systems Act (MSA). Consequently I am unable to report on the reliability of

the performance information. I performed procedures to obtain evidence about the usefulness of the reported performance information for the following selected objectives:

- Objective: Basic Services and Infrastructure
30. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
 31. 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 objectives. 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).
 32. The material findings in respect of the selected objectives are as follows:

Objectives: Basic Services and Infrastructure

Usefulness of reported performance information

Consistency of objectives and indicators and targets

33. Section 41(c) of the MSA requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of all planned objectives, indicators and targets specified in the integrated development plan for the year under review. This was due to a lack of properly implemented systems and processes.

Measurability of indicators and targets

34. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 44% of the targets were not specific.
35. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 100% of the targets.
36. Performance indicators should 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 86% of the indicators were not well defined.
37. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.
38. This was because management did not adhere to the requirements of the FMPPI and due to a lack of technical indicator descriptions.

Compliance with legislation

39. 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

40. The key performance indicators (KPIs) set by the municipality did not include indicators on the percentage of households with access to basic level of electricity and solid waste removal as required by section 43(2) of the MSA and the Municipal planning and performance management regulation 10(a).
41. The municipality did not conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.

Financial statements, performance and annual reports

42. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.
43. The annual performance report for the year under review did not include:
 - the performance of the municipality;
 - 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) (c) of the MSA.
44. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013/14 annual report was tabled, as required by section 129(1) of the MFMA.

Audit committees

45. The audit committee was not constituted, in the manner required by section 166(4) of the MFMA as the following requirements were not adhered to: Section 166 (4)(a) "An audit committee must - consist of at least three persons with appropriate experience, of whom the majority may not be in the employ of the municipality, as the case may be."

Procurement and contract management

46. 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).
47. Awards were made to providers whose directors or principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) 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).

Human resource management and compensation

48. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
49. The 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 MSA.
50. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of MSA.

Expenditure management

51. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.
52. An effective system of expenditure control, including procedures for the approval, authorisation and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
53. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.
54. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants received

55. Municipal Systems Improvement Grant (MSIG) funds were retained or rollover to the next financial year without seeking the approval of the National Treasury, as required by sections 22(1) of the DoRA.

Revenue management

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

57. 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 MFMA.

Asset and liability management

58. 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.
59. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

60. The unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
61. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Internal control

62. 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 compliance with legislation included in this report.

Leadership

63. The leadership set a tone at the top of zero tolerance for non-performance, but evidence was lacking that this was consistently applied to where individuals did not contribute to the quality of financial and performance reporting as required by legislation.
64. HR management was not effective in ensuring that competent and sufficiently skilled officials were appointed to ensure that performance is monitored.
65. Oversight bodies were not effective to ensure that corrective actions were implemented to address prior year audit findings. Their efficiency was further negatively impacted by the lack of an action plan to address the prior year audit findings.

Financial and performance management

66. During the financial year under review, management also did not ensure that all transactions and records were internally checked to detect and correct errors in the financial records.
67. During the year under review, management did not regularly review and monitor management's compliance with all laws and regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted that could

have been prevented. There were deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations and performance information and these were not addressed.

68. Management did not review the financial statements, to ensure the achievement of fair presentation; this resulted in material amendments to the financial statements.
69. Although effort had been made by leadership to implement adequate processes and systems to ensure the availability of all documentation and information to meet the requirements of the financial and performance reporting frameworks shortcomings still exist.

Governance

70. Management did not review or monitor risks identified. In addition no risk assessment was performed relating to the IT environment.
71. 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, financial reporting and weaknesses in the information systems. This also resulted in the prior year audit findings not being substantially addressed.



Kimberley

30 November 2015



Auditing to build public confidence