

Report of the auditor-general to the Northern Cape provincial legislature and the council on Kgatelopele local municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Kgatelopele 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, 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) 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 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

Infrastructure assets

4. I was unable to obtain sufficient appropriate audit evidence regarding infrastructure assets as the information supporting the values of infrastructure assets was not provided. Furthermore I could not physically verify the assets due to a lack of information on the asset register and also asset from the floor could not be traced to the asset register. I was unable to confirm the infrastructure assets by alternative means. Consequently I was unable to determine whether any adjustment relating to infrastructure assets stated at R115 036 178 (2014: R108 016 784) in note 5 to the financial statements was necessary. Additionally, there was a resultant impact on the depreciation, impairment loss and accumulated depreciation.

Land

5. I was unable to obtain sufficient appropriate audit evidence for land as the municipality had an inadequate system of internal control to account for land, as the ownership of the land cannot be verified. Furthermore the values of land could not be determined as the method to split the values of land and building from the valuation roll was not provided. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to land stated at R42 906 700 (2014: R42 616 800) in note 5 to the financial statements was necessary.

Buildings

6. I was unable to obtain sufficient appropriate audit evidence for buildings as the municipality had an inadequate system of internal control to account for buildings, as the value of buildings could not be determined as the method to split the values of land and building from the valuation roll was not provided. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to buildings stated at R16 902 287 in note 5 to the financial statements was necessary.

Other assets

7. I was unable to obtain sufficient appropriate audit evidence for other assets as the information supporting the values of other assets was not provided. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to other assets stated at R1 899 580 in note 5 to the financial statements was necessary.

Investment property

8. The municipality did not account for investment property as required by GRAP 16, *Investment Property*, as the municipality have included RDP houses in their register which do not belong to the municipality. I was not able to determine the full extent of the misstatement in investment property as it was impracticable to do so. In addition I was unable to obtain sufficient appropriate audit evidence for investment property. I was unable to confirm the investment property by alternative means. Consequently, I was unable to determine whether any further adjustment was necessary to investment property of R6 192 220 (2014: R6 192 220) in note 4 to the financial statements was necessary.

Consumer deposits

9. The municipality did not account for consumer deposits as required by GRAP 1, *Presentation of financial statements*, as the municipality raised consumer deposits without receiving physical cash. Consequently, consumer deposits and trade receivables from exchange transactions were overstated by R944 956.

Commitments

10. During 2014, I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality could not provide sufficient, appropriate audit evidence to substantiate the disclosure made on the financial statements. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustment to commitments stated at R11 369 273 was necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly.

Expenditure

11. I was unable to obtain sufficient appropriate audit evidence for expenditure as the municipality did not have adequate systems to maintain records for transfers and subsidies. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustments relating to expenditure stated at R7 698 868 in the financial statements was necessary.

Provision

12. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as provisions in note 15 to the financial statements and I could not confirm the balance by alternative means. Consequently, I was unable to determine whether any further adjustment to the provisions stated at R5 392 803 (2014: R5 308 812) in the financial statements was necessary.

VAT receivables

13. The municipality did not account for VAT receivables as required by GRAP 1, *Presentation of financial statements*, as there was a difference between the balance as per the VAT reconciliation re-performed and the VAT receivable as disclosed in the financial statements. I was not able to determine the full extent of the misstatement in VAT receivable as it was impracticable to do so.

Payables from exchange transactions

14. The municipality did not properly record payable from exchange transaction in accordance with the requirements of the Standards of Generally Accepted Accounting Practice, GRAP 1, *and Presentation of financial statements*. The municipality did not have adequate systems to maintain records of payables from exchange transactions as there were differences identified between the accounting records and the amounts recorded in the financial statements. Consequently, payables from exchange transactions were overstated by R5 636 559.55 and the effect of other components could not be determined as it was impracticable to do so.

Receivables from non-exchange transactions

15. During 2014, the municipality did not properly record receivables from non-exchange transactions in accordance with the requirements of GRAP 1, *Presentation of financial statements*, as the municipality did not have adequate systems to maintain records of receivables from non-exchange transactions as there were differences identified between the accounting records and the amounts recorded on the financial statements. Consequently, receivables from non-exchange transactions and revenue from non-exchange transaction were understated by R4 501 711 on the financial statements.

Receivables from exchange transactions

16. During 2014, the municipality did not properly record receivables from exchange transactions in accordance with the requirements of GRAP 1, *Presentation of financial statements*, as the municipality had written off receivables in excess to what the council had approved for the year. Consequently, receivables from exchange transactions were understated and debt impairment was overstated by R1 483 121 on the financial statements.

Irregular expenditure

17. The MFMA requires the municipality to include particulars of irregular expenditure in the notes to the annual financial statements. The municipality incurred expenditure in

contravention of the supply chain management requirements that were not included in irregular expenditure, which resulted in irregular expenditure being understated by R35 972 679 (2014: R4 600 589). In addition, the municipality did not have adequate systems to maintain complete records of irregular expenditure. Due to this lack of systems, I was not able to confirm the amount of irregular expenditure to be disclosed by alternative means. Consequently, I was unable to determine whether any further adjustment to irregular expenditure was necessary.

Distribution losses

18. During 2014, I was unable to obtain sufficient appropriate audit evidence regarding distribution losses in relation to water. The municipality did not have adequate systems in place over record keeping. I was unable to confirm the full extent of distribution losses by alternative means. Consequently, I was unable to determine whether any adjustments relating to distribution losses in note 49 to the financial statements were necessary.

Contingent Liabilities

19. The municipality did not account for contingent liabilities as required by GRAP 1, *Presentation of financial statements*, as the municipality did not disclose the comparatives amounts. Consequently, contingent liabilities comparatives are understated.

Prior error note

20. The municipality's amount disclosed in the prior year errors note was not properly disclosed, in accordance with GRAP 3, *Accounting Policies, changes in accounting estimates and errors*, as the municipality did not disclose the full amount of the prior year error. I was not able to determine the full extent of the understatement in prior error note as it was impracticable to do so.

Aggregation of immaterial uncorrected misstatement

21. I was unable to obtain sufficient appropriate audit evidence regarding the following item making up the statement of financial performance, which had a cumulative effect on the financial statements.

- Fees earned of R716 821 as included in the disclosed balance of R716 821
- Inventory of R481 497 as included in the disclosed balance of R545 743 (2014: R464 457)

22. I was unable to confirm this item by alternative means. As a result, I was unable to determine whether any adjustment to this item was necessary.

Disclaimer of opinion

23. 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

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

Significant uncertainties

25. With reference to note 38 to the financial statements, the municipality is the defendant in various claims and litigations to the amount of R 8 878 222.

Going concern

26. Note 44 to the financial statements indicates that the municipality's current liabilities exceeds its current assets by R9 174 850 during the year ended 30 June 2015. These conditions, along with other matters as set forth in the note 44, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Material losses

27. As disclosed in note 49 to the financial statements, material losses to the amount of R9 678 485 were incurred as a result of distribution losses for electricity.
28. As disclosed in note 49 to the financial statements, material losses to the amount of R389 939 were incurred as a result of distribution losses for water.
29. As disclosed in note 11 to the financial statements, a significant provision for the impairment of receivables from exchange transactions was created which constitutes 89.44% (R25 177 645/ R28 150 436) of the total consumer debtors.

Additional matters

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

Unaudited disclosure notes

31. 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

32. 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 schedule(s) and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

33. 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 development priorities 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

34. 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 2015:

- Development priority 1: Basic service delivery on pages x to x
- Development priority 3: Local economic development on pages x to x

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

36. 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).

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

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

Basic service

Usefulness of reported performance information

Consistency of the targets

39. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 75% of the reported targets were not consistent with those in the approved Service Delivery Budget Implementation Plan (SDBIP). This was because management was not aware of the requirements of the FMPPI due to a lack of proper systems and processes

Measurability of indicators and targets

40. The FMPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 56% were not specific.
- Performance targets must be measurable. We could not measure the required performance for 50% of the targets
- The period or deadline for delivery of targets must be specified. A total of 25% of the targets were not time bound.

- The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicator were not verifiable.

This was because management was not aware of the requirements of the FMPPI due to a lack of proper systems and processes

Reliability of reported performance information

41. 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 auditee's records not permitting the application of alternative audit procedures

Local economic development

Usefulness of reported performance information

Measurability of indicators and targets

42. The FMPPI requires the following:

- Performance targets must be measurable. We could not measure the required performance for 30% of the targets
- 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 30% of the indicators were not well defined
- The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicator were not verifiable.

This was because management was not aware of the requirements of the FMPPI due to a lack of proper systems and processes

Additional matters

43. I draw attention to the following matter

Achievement of planned targets

44. Refer to the annual performance report on page(s) x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraph(s) x to xx of this report.

Adjustment of material misstatements

45. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for Basic service and Local economic development. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

Compliance with legislation

46. 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

47. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation; electricity and solid waste removal were not set by the municipality as required by section 43(2) of the MSA and the Municipal planning and performance management regulation 10(a).

Financial statements, performance and annual reports

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure 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 disclaimer audit opinion.

49. The annual performance report for the year under review did not include

- comparison with the previous financial year and
- measures taken to improve performance,
- as required by section 46 (1)(b) (c) of the MSA.

Procurement and contract management

50. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) & (c).

51. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services as required by SCM regulation 28(2)

52. Contracts and quotations were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.

53. Contracts 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).

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

55. Awards were made to providers who are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44.

Human resource management and compensation

56. 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 Municipal Systems Act.

Expenditure management

57. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the Municipal Finance Management Act.
58. Payments were made from the municipality's bank account without the approval of the accounting officer, as required by section 11(1) of the Municipal Finance Management Act.
59. An effective system of expenditure control, including procedures for the payment of funds, was not in place, as required by section 65(2)(a) of the Municipal Finance Management Act.
60. An adequate management, accounting and information system was not in place which accounted for payments made, as required by section 65(2)(b) of the Municipal Finance Management Act.
61. 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 Municipal Finance Management Act.

Revenue management

62. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of Municipal Finance Management Act.
63. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the Municipal Finance Management Act.

Asset and liability management

64. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the Municipal Finance Management Act.
65. An effective system of internal control for assets was not in place, as required by section 63 (2)(a) of the Municipal Finance Management Act.
66. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the Municipal Finance Management Act.

Consequence Management

- | 67. Unauthorised / Irregular, ~~+~~ 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 Municipal Finance Management Act.

Internal control

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

Leadership

- 69. Management did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
- 70. Management did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
- 71. Management did not establish and communicate approved policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities.
- 72. Management did not develop and monitor the implementation of action plans to address internal control deficiencies.
- 73. Management did not establish an information technology governance framework that supported and enabled the business, delivered value and improved performance.

Financial and performance management

- 74. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
- 75. Management did not implement controls over daily and monthly processing and reconciling of transactions.
- 76. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
- 77. Management did not review and monitor compliance with applicable laws and regulations.
- 78. Management did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.
- 79. The municipality did not have the capacity to address backlog issues and financial system problems, resulting in the need to appoint consultants. Consultants assisted with the preparation of an asset register and annual financial statements but there still material misstatement in the annual financial statements.

Governance

80. Appropriate risk management activity was not implemented to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks are developed and monitored

Auditor-General

Kimberley

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence