Report of the auditor-general to the Northern Cape provincial legislature and the council on Phokwane Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Phokwane 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

Property, Plant and Equipment

4. The municipality did not value property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* and Directive 7, *The application of deemed cost*. I was not able to determine the impact on the net carrying amount of property, plant and equipment, as it was impractical to do so. In addition, I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment recorded, as the municipality did not have adequate systems in place and I could not confirm this by alternative means. Consequently I was unable to determine whether any further

adjustments to property, plant and equipment stated at R633 206 330 (2014: R666 226 615) in note 10 in the financial statements where necessary.

Investment properties

5. The municipality did not value investment properties in accordance with GRAP 16, *Investment Property* and Directive 7, *The application of deemed cost*. I was not able to determine the impact on the net carrying amount of investment properties, as it was impractical to do so. In addition I was unable to obtain sufficient appropriate audit evidence for investment properties recorded, as the municipality did not have adequate systems in place and I could not confirm this by alternative means. Consequently I was unable to determine whether any further adjustments to investment properties stated at R2 266 012 (2014: R2 266 013) in note 9 to the financial statements where necessary.

6. The municipality did not recognise investment properties in accordance with GRAP 16, *Investment Property,* as properties leased to municipal officials and public are not classified as part of investment property. I was not able to determine the impact on the net carrying amount of investment properties for the current and prior year, as it was impracticable to do so.

Consumer receivables

7. I was unable to obtain sufficient appropriate audit evidence for consumer receivables, as the municipality did not have adequate systems in place and I could not confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments to consumer receivables stated as R252 251 191 and the allowance for impairment stated at R231 459 786 in note 6 in the financial statements were necessary.

8. The municipality did not account for revenue from exchange transactions in accordance with GRAP 9, *Revenue from exchange transactions and GRAP 23, Revenue from non-exchange transactions.* Consequently, consumer receivables and revenue for exchange and non-exchange transactions was understated by R3 605 122, due to incorrect meter readings and tariffs used, consumers not billed for services and rates and employees not charged rent. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus in the financial statements.

Long-term receivables

9. I was unable to obtain sufficient appropriate audit evidence for long-term receivables, as the municipality did not have adequate systems in place and I could not confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments to long-term receivables stated as R2 220 712 and the impairment stated at R2 219 337 in note 13 in the financial statements were necessary.

Inventories

10. I was unable to obtain sufficient appropriate evidence that the municipality has properly accounted for all reconstruction and development programme (RDP) land, as the municipality did not provide information to confirm the RDP land. I was unable to confirm the inventories by alternative means. Consequently, I was unable to determine whether any further adjustments to inventories of RDP land, stated at R59 483 000 (2014: R59 483 000) in note 7 to the financial statements were necessary.

Irregular expenditure

11. 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 R6 243 403. 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.

Commitments

12. During 2014, I was unable to obtain sufficient appropriate audit evidence for commitments and to confirm the commitments by alternative means. Consequently, I was unable to determine whether any adjustment to commitments stated at R49 430 476 was necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly.

Contingent liabilities and assets

13. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all contingent liabilities as the municipality did not submit all legal representation letters. I was unable to confirm contingent liabilities and contingent assets by alternative means. Consequently, I was unable to determine whether any further adjustments to contingent liabilities and contingent assets disclosed in note 41 were necessary.

Disclaimer of opinion

14. 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

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

Restatement of corresponding figures

16. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2015 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material losses

17. As disclosed in note 50.2 of the financial statements, material losses amounting to R7 061 733 (26%) for KWh electricity, R19 660 085 (84%) for kVA electricity and R7 299 644 (53%) for mega litres water were incurred.

Additional matters

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

Unaudited supplementary schedules

19. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

20. 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

21. 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

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

    - Development priority: Service delivery and infrastructure developments on pages x to x

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

24. 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).

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

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

Services delivery and infrastructure development

Usefulness of reported performance information

27. Section 41(c) of the Municipal Systems Act and Section 121(4)(d) of the MFMA requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 39% of the reported targets were not consistent with those in the approved SDBIP. This was due to planned targets per the service delivery budget implementation plan (SDBIP) differing from those in the annual performance report.

28. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 33% of the targets were not specific.

29. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 28% of the targets.

30. 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 33% of the indicators were not well defined.

31. 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. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

32. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. A total of 39% of the targets were not relevant to the indicators and therefore the indicators did not relate logically and directly to the realisation of strategic goals and objectives as per the service delivery and budget implementation plan. This was because proper performance planning and management practices had not been developed and implemented to provide for the development of performance indicators and targets included in the service delivery and budget implementation plan.

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. 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 limitations placed on the scope of my work due to the absence of information systems and the fact that the

auditee could not provide sufficient appropriate evidence in support of the reported performance information. The auditee's records not permitting the application of alternative audit procedures.

Additional matter

34. I draw attention to the following matter:

Achievement of planned targets

35. Refer to the annual performance report on page xx to xx for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in 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:

Procurement and contract management

37. 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) & (c).

38. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation 19(a) and 36(1).

39. Contract was awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act (PPPFA) and its regulations.

40. Contract were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA.

41. 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).

42. Awards were made to providers who are in the service of other state institutions or whose directors or principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44.

43. Sufficient appropriate audit evidence could not be obtained that contract and quotations were only 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.

Financial statements, performance and annual reports

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

45. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

46. 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.

47. 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.

Strategic planning and performance management

48. The municipality did not establish a performance management system, as required by section 38(a) of the Municipal Systems Act.

49. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

50. The annual performance report for the year under review did not include a comparison of the performance with set targets and/or comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(b) and (c) of the MSA.

51. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance monitoring, measurement, review and reporting and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Expenditure management

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

53. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

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

Asset and liability management

55. 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.

56. 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

57. Unauthorised, Irregular, Fruitless and wasteful expenditure incurred by the municipality was not investigated timeously 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

58. 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

59. During the previous financial year and the current financial year the municipality had vacancies in key management positions. These vacancies, together with the instability within the mayoral position, resulted in a leadership vacuum. Monitoring of the internal control environment was therefore not done and resulted in the municipality not prioritising compliance to laws and regulations, financial reporting and performance reporting.

60. The municipality did not employ sufficient resources to ensure municipal functions related to financial and performance reporting and compliance to laws and regulations can be executed in good quality and adhering to proper segregation of duties.

61. The leadership did not regularly monitor management's compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.

Financial and performance management

62. Management did not review the financial statements to ensure the achievement of fair presentation, which resulted in material amendments to the financial statements.

63. Records management and maintenance disciplines should be refined, included in the daily key controls, and reviewed and monitored at the appropriate level of management.

64. As the municipality did not have individuals who sufficiently understood the financial reporting framework and the performance and financial management requirements, the municipality engaged a consultant to assist in the compilation of the fixed asset register and financial statements. The underlying accounting records of the municipality did not

facilitate the preparation of financial statements to comply with the accounting framework.

65. Manual or automated controls were not designed to ensure that the transactions had occurred, were authorised, and were completely and accurately processed. Documentation supporting amounts disclosed in the financial statements was not always available.

66. Management did not document and approve internal policies and procedures to address the process of collecting, recording, processing, monitoring and reporting on predetermined objectives. Consequently, performance systems, processes and procedures had not been designed and implemented.

Auditor-General

Kimberley

7 December 2015

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence