

# Report of the auditor-general to the North West provincial legislature and the council on the Mahikeng Local Municipality

## Report on the financial statements

### Introduction

1. I was engaged to audit the financial statements of the Mahikeng Local Municipality set out on pages XX to XX, 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 with 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 the 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

#### Investment property

4. The municipality did not properly account for Investment Property in accordance with GRAP 16 *Investment property* due to a lack of controls implemented over the management of properties owned by municipality and due to a lack of updated valuation certificates. I was not able to determine the full extent of the understatement of investment property of R167 342 145 in the statement of financial position and disclosed in note 4 to the financial statements or the resultant fair value adjustment in the statement of financial performance.

## **Land inventory**

5. The municipality has not properly accounted for and classified land owned by the municipality in accordance with GRAP 12 *Inventory* and GRAP 16 *Investment property*, due to a lack of controls implemented to establish the planned future use of the land. I was not able to determine the full extent of the misstatement of inventory of R80 026 583 in the statement of financial position and disclosed in note 8 to the financial statement, and investment property of R167 342 145 in the statement of financial position and disclosed in note 4 to the financial statements.

## **Cash and cash equivalents**

6. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents as the municipality could not provide proper substantiating records for reconciling items included in the bank reconciliation and for differences between the amount as per bank reconciliation and amount as disclosed in the statement of financial position. I was unable to confirm cash and cash equivalents by alternative means. Consequently, I was unable to determine whether any adjustment relating to the cash and cash equivalents of R3 479 283 (2014: R30 081 712) disclosed in note 12 to the financial statements or any other accounts affected were necessary.

## **Employee benefits**

7. The municipality did not disclose employee benefits as required by GRAP 25 *Employee benefits*, as the municipality did not obtain an actuarial valuation report for the defined benefit pension fund obligation at year-end. I was unable to quantify the defined benefit pension fund obligation that should have been recognised and the adjustment to the related expenditure on personnel cost as it was impracticable to do so.

## **Accumulated surplus**

8. I was unable to obtain sufficient appropriate audit evidence for the accumulated surplus for the current and prior year due to the lack of proper substantiating accounting records for adjustments included in the restated opening balance. I was unable to confirm the accumulated surplus by alternative means. Consequently, I was unable to determine whether any adjustments to accumulated surplus of R1 139 344 811 (2014: R1 354 902 918) in the financial statements was necessary.

## **Revenue from exchange transactions**

9. The municipality did not account for all revenue from water sales in the current and prior period in accordance with GRAP 9 *Revenue from exchange transactions*, as the municipality did not maintain adequate records of water consumption and accounted for water sales in the incorrect period. I was not able to determine the full extent of the understatement of revenue from the sale of water of R80 028 973 (2014: R62 763 816) included in services charges disclosed in note 21 and the related water debtors of R44 109 908 (2014: R52 338 932) included in consumer debtors disclosed in note 11 to the financial statements.
10. The municipality did not account for all service charges as revenue, in accordance with GRAP 9 *Revenue from exchange transactions*, as the municipality did not maintain adequate records on its indigent debtors and did not implement adequate controls to ensure accurate classification of indigent debtors. I was not able to determine the full extent of the understatement of service charges of R133 277 015 in the statement of financial performance and disclosed in note 21, and the related consumer debtors of R497 503 737 in the statement of financial position and disclosed in note 11 to the financial statements.



## **Revenue from non-exchange transactions**

11. The municipality has not properly levied and accounted for property rates in accordance with GRAP 23 *Revenue from non-exchange transactions* due to the lack of an updated valuation roll, an inadequate billing process and a lack of accurate classification of indigent debtors. I was unable to determine the full extent of the understatement of property rates of R142 189 789 in the statement of financial performance and disclosed in note 20, and the related consumer debtors of R58 600 404 in the statement of financial position and disclosed in note 10 to the financial statements.
12. The municipality did not correctly account for the provision for bad debts in accordance with GRAP 104 *Financial Instruments* as the municipality did not maintain adequate records of debtors payments received. I was unable to determine the full extent of the misstatement of the provision for bad debts of R185 635 757 included in receivables from non-exchange transactions disclosed in note 10 to the financial statements and the related impairment expense in the statement of financial performance.

## **Trade and other payables**

13. The municipality did not recognise all outstanding amounts meeting the definition of a liability in accordance with GRAP 1 *Presentation of financial statements* as the municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end. I was unable to determine the full extent of the understatement in trade payables of R227 217 587 and the related expenditure items disclosed in note 16 to the financial statements as it was impracticable to do so.

## **Receivables from exchange transactions**

14. I was unable to obtain sufficient appropriate audit evidence for expenditure credits of R30 646 626, salary error suspense of R20 336 922 and payments of R2 145 853 included in receivables from exchange transactions of R64 759 924 as the municipality has an inadequate system of internal control to account for trade and other receivables and did not keep proper records. I was unable to confirm these receivables by alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables from exchange transactions of R64 759 924 disclosed in note 9 to the financial statements were necessary.
15. The municipality did not correctly account for the provision for bad debts in accordance with GRAP 104 *Financial Instruments* as the municipality did not maintain adequate records of debtors payments received. I was unable to determine the full extent of the misstatement of the provision for bad debts of R5 274 449 included in receivables from exchange transactions disclosed in note 9 to the financial statements and the related impairment expense in the statement of financial performance.

## **Consumer debtors**

16. The municipality did not correctly account for the provision for bad debts in accordance with GRAP 104 *Financial Instruments* as the municipality did not maintain adequate records of debtors payments received. I was unable to determine the full extent of the misstatement of the allowance for impairment of R376 610 441 included in consumer debtors as disclosed in note 11 to the financial statements and the related impairment expense in the statement of financial performance.

## **Expenditure**

17. During 2014, the municipality did not implement adequate controls to comply with GRAP, GRAP 1 *Presentation of financial statements* over the recording and classification of



transactions for goods and services. I was therefore unable to determine the full extent of the misstatement of trade creditors, general expenses, repairs and maintenance and value added tax (VAT), as it was impracticable to do so. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the effect of this matter on the comparability of the current period's figures.

## **Irregular expenditure**

18. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments R28 217 524 (2014: R14 452 671) in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm that awards of R9 314 982 were made in terms of the supply chain management requirements. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement to irregular expenditure of R180 476 797 (2014: R145 507 910) disclosed in note 45 to the financial statements.

## **Cash flow statement**

19. I was unable to obtain sufficient appropriate audit evidence that the cash flow statement is correct due to the limitations and disagreement misstatements as included in the basis for disclaimer opinion paragraphs. 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 or the notes thereto were necessary.

## **Disclaimer of opinion**

20. 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 matter**

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

## **Unauthorised and fruitless and wasteful expenditure**

22. As disclosed in note 43 to the financial statements, unauthorised expenditure of R226 384 736 was incurred in the current year and the unauthorised expenditure in respect of prior years of R217 384 305 had not yet been dealt with in accordance with section 32 of the MFMA.
23. As disclosed in note 44 to the financial statements, fruitless and wasteful expenditure of R974 725 was incurred in the current year and fruitless and wasteful from prior years of R6 186 710 had not yet been dealt with in accordance with section 32 of the MFMA.

## **Material losses**

24. As disclosed in note 46 to the financial statements, material losses to the amount of R21 549 983 (2014: R14 071 200) were incurred as a result of losses on water.

## **Going concern**

25. The statement of financial performance indicates that municipality incurred a deficit of R221 149 284 (2014: R86 033 066) during the year ended 30 June 2015 and, as of that date,



the municipality's current liabilities exceeded its current assets by R35 124 504. These conditions, along with other matters as set forth in note 47, indicate the existence of a material uncertainty that may cast doubt on the municipality's ability to operate as a going concern.

## **Restatement of corresponding figures**

26. As disclosed in note 39 and note 40 to the financial statements, the corresponding figures for 2014 have been restated as a result of an error discovered during 2015 and reclassification of amounts disclosed in the financial statements of the Mahikeng Local Municipality and for the year ended, 2014.

## **Additional matters**

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

## **Unaudited disclosure notes**

28. 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**

29. 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.

## **Report on other legal and regulatory requirements**

30. 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**

31. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPA) presented in the annual performance report of the municipality for the year ended 30 June 2015:
  - KPA: Basic service delivery and infrastructure development on pages x to x
  - KPA: Local economic development and spatial development x to x
32. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
33. 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).



34. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
35. The material findings in respect of the selected development priorities are as follows:

## **Basic service delivery and infrastructure development**

### **Usefulness of reported performance information**

36. Performance targets should be measurable as required by the FMPPI. We could not measure the required performance for significantly important targets in relation to KPA: Basic service delivery and infrastructure investment.
37. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. Significantly important indicators in relation to KPA: Basic service delivery and infrastructure investment were not verifiable.

### **Reliability of reported performance information**

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

## **Local economic development and spatial development**

### **Usefulness of reported performance information**

39. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. Significantly important indicators in relation to KPA: Local economic development and spatial development were not verifiable.

### **Reliability of reported performance information**

40. 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. Adequate and reliable corroborating evidence could not be provided for significantly important targets to assess the reliability of the reported performance information. The auditee's records did not permit the application of alternative audit procedures. This was due to limitations placed on the scope of my work by the auditee

## **Additional matters**

41. I draw attention to the following matters:

### **Achievement of planned targets**

42. Refer to the annual performance report on pages 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 priorities reported in paragraphs XX to XX of this report.

## **Adjustment of material misstatements**

43. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for KPA: Local economic development and spatial 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**

44. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material 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**

45. The 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, improvement and how it is conducted, organised and managed, including determining the roles of the different role-players, as required by section 38 of the Municipal System Act, 2000 (Act No. 32 of 2000) (MSA) and regulation 7 of the Municipal planning and performance management regulations (MPPMR).
46. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
47. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.
48. The municipality did not provide evidence that verified that they afforded the local community at least 21 days to comment on the final draft of its integrated development plan before the plan is submitted to council for adoption in accordance with regulation 15(3) of the MPPMR.

## **Annual report and financial statements**

49. 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 assets, liabilities 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.
50. 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.

## **Audit committee**

51. An audit committee was not in place, as required by section 166(1) of the MFMA.
52. A performance audit committee was not in place as required by regulation 14(2)(a) of the MPPMR.



## **Procurement and contract management**

53. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as management could not provide evidence of the procurement processes followed.
54. 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) regulations 17(a) and (c).
55. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
56. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
57. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
58. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
59. 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 and SCM regulation 28(1)(a).
60. Contracts and quotations were awarded to bidders based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
61. Construction contracts were awarded to contractors that did not qualify for the contract, in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A)
62. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
63. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore the provider failed to declare that he/she was in the service of the municipality as required by SCM regulation 13(c).
64. Awards were made to providers whose directors are in service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 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).
65. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
66. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

## **Human resource management and compensation**

67. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of MSA.
68. 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



MSA.

69. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by regulation 14(2)(a) of the Municipal Regulations on Minimum Competency Levels.

## Revenue management

70. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
71. An adequate management, accounting and information system which accounts for revenue debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
72. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

## Expenditure management

73. 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.
74. An adequate management, accounting and information system was not in place which recognised expenditure and account for creditors when it was incurred, as required by section 65(2)(b) of the MFMA.
75. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

## Conditional grants received

76. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant, Municipal Systems Improvement Grant and Local Government Financial Management Grant allocations, as required by section 12(5) of the DoRA.

## Asset management

77. An adequate management and accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
78. 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.

## Liability management

79. An adequate management and accounting which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
80. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

## Consequence management

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



## **Environmental management**

82. The municipality operated its wastewater treatment facilities without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
83. The municipality's operational activities at its waste disposal site contravened or failed to comply with the regulations norms and standards as required by sections 67(1)(f) and (h) of the NEMWA and section 151(1)(c) and (i) of the NWA.
84. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.
85. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

## **Internal control**

86. I considered internal control relevant to my audit of the financial statements, the 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**

87. Management did not adequately exercise appropriate oversight over financial and performance reporting and related internal controls, while decisive actions to address risks relating to the achievement of complete and accurate financial and performance reporting was not taken. A lack of stable leadership contributed to a poor control environment over financial and performance management. The municipality did not have the requisite skills and capacities required to design and develop the necessary policies and procedures and also had no approved IT structure and an IT department.

## **Financial and performance management**

88. Management did not implement effective controls to ensure that information presented in the financial statements is reliable before submission for audit. Regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information were not properly prepared. Further, management did not adequately review and monitor compliance with applicable laws and regulation.

## **Governance**

89. The risks identified during the risk assessment process relating to financial and performance reporting and compliance with laws and regulations were not adequately monitored by management. Although the internal audit fulfilled their functions they had limited impact due to the lack of adequate implementation of their recommendations by the municipality resulting in a weak control environment over financial and performance reporting and compliance with laws and regulations. The audit committee was only established after the financial year end.



## Other reports

### Investigations

90. An investigation was prompted by the municipal manager for transactions that were processed fraudulently by unknown persons from the municipal bank account. A case was opened with the South African Police Service. The investigation was still on-going at the reporting date.
91. Investigations were prompted by the municipal manager, undertaken by an independent firm on the alleged irregular sale of property to an external party without following the correct disposal processes, the irregular appointment of service providers and on irregular payments of allowances to employees. The investigations were still on-going at the reporting date.
92. Investigations were prompted by the municipal manager and the council, undertaken by an independent firm, on senior managers on alleged financial misconduct, maladministration, fraud and corruption. The investigations were still on-going at the reporting date.

Rustenburg

30 November 2015



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