



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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Moses Kotane Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget 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 the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (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 entity'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 entity'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. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment due to an inadequate asset management system to record all assets that belong to the municipality, to verify the location of the recorded assets and for amounts disclosed as a prior period correction. I was unable to confirm property, plant and equipment by alternative means. In addition, the municipality did not review the useful lives and residual values, assessed the assets for impairment and properly unbundled all assets as required by GRAP 17 *Property, plant and equipment*. Depreciation and accumulated depreciation was also not calculated correctly as per the accounting policy. I was unable to quantify the full extent of the resulting misstatement to the financial statements as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustment relating to property, plant and equipment of R1 218 665 470 (2015: R1 074 887 527) disclosed in the statement of financial position and note 3, the depreciation and amortisation expense of R46 184 542 (2015: R66 414 822) disclosed in the statement of financial performance and note 27 to the financial statements or prior period errors disclosed in note 35 to the financial statements were necessary.

Consumer debtors

7. I was unable to obtain sufficient appropriate audit evidence for consumer debtors due to the municipality being unable to provide individual consumer statements to verify that all consumer debtors exist and was recorded correctly. I was unable to confirm consumer debtors by alternative means. In addition, the municipality did not correctly calculate the debt impairment using the present value of estimated future cash flows as required by GRAP 104 *Financial instruments*. I was unable to quantify the full extent of the resulting misstatement to the financial statements as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustments relating to consumer debtors of R471 255 815 (2015: R420 132 692) and the related allowance for impairment of R276 547 892 (2015: R192 442 230), disclosed in the statement of financial position and note 8 to the financial statements or the debt impairment expense of R81 824 437 (2015: R60 791 303) disclosed in the statement of financial performance and note 25 to the financial statements were necessary.

Irregular expenditure

8. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R43 002 052 (2015: R39 016 936) in contravention with the supply chain management requirements which were not included in irregular expenditure. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure of R349 781 910 (2015: R296 872 958) as disclosed in note 41 to the financial statements.

Provisions

9. The municipality did not provide for post-employment medical aid obligations as required by GRAP 25 *Employee benefits*. I was unable to quantify the full extent of the resulting misstatement to the financial statements as it was impracticable to do so. Consequently, I was unable to determine whether any adjustment relating to provisions of R40 057 550 (2015: R37 749 345) disclosed in the statement of financial position and note 13 to the financial statements were necessary.

Service charges

10. The municipality did not bill all consumers accurately for services received as required by GRAP 9 *Revenue* as the municipality did not have adequate systems in place to ensure all service charges are accurately billed to consumers. Consequently, service charges as disclosed in the statement of financial performance and note 18 and consumer debtors as disclosed in the statement of financial position and note 8 to the financial statements are understated by R15 096 978 respectively. Additionally, there is a consequential impact on the surplus for the period and on the accumulated surplus.

Commitments

11. The municipality did not accurately disclose capital commitments as required by GRAP 17 *Property, plant and equipment* due to not having an adequate contract management system and not accurately recording commitments in the commitment register. Consequently, commitments as disclosed in note 33 to the financial statements is understated by R10 697 937.
12. During 2015, I was unable to obtain sufficient appropriate audit evidence for commitments due to an inadequate contract management system. Consequently I was unable to determine whether any adjustment to commitments of R38 248 715 as disclosed in note 33 the financial statements, was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm these commitments by alternate means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Cash flow statement

13. I was unable to obtain sufficient appropriate audit evidence for net cash flows from operating activities, net cash flows from investing activities and net cash flows from financing activities as management could not provide calculations to substantiate the amounts used as required by of GRAP 2 *Cash flow statements*. The municipality's records did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustment relating to net cash flows from operating activities of R200 319 010 (2015: R121 345 927), net cash flows from investing activities of R138 565 999 (2015: R190 360 008) and net cash flows from financing activities of R12 209 634 (2015: R11 141 860) in the cash flow statement and notes thereto were necessary.

Qualified opinion

14. 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 Moses Kotane Local Municipality as at 30 June 2016 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 the DoRA.

Emphasis of matters

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

Fruitless and wasteful expenditure

16. As disclosed in note 40 to the financial statements, fruitless and wasteful expenditure of R72 254 was incurred in the current year and fruitless and wasteful from prior years of



R8 893 998 had not yet been dealt with in accordance with section 32 of the MFMA.

Material losses and impairments

17. As disclosed in note 38 to the financial statements, the municipality incurred water losses of R16 694 649 (2015: R12 080 866).
18. As disclosed in note 25 to the financial statements, impairments of R81 824 437 (2015: R60 791 303) were incurred as a result of significant impairment of debtors.

Restatement of corresponding figures

19. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Moses Kotane Local Municipality at, and for the year ended, 30 June 2015.

Material under spending of the grant

20. As disclosed in note 11 to the financial statements, the municipality materially underspent the Municipal Infrastructure Grant by R14 441 346.

Additional matters

21. 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

22. The supplementary information set out on pages XX to XX does not form part of the separate 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

23. 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 key performance areas 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

24. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016:
 - Key performance area 1: Basic service delivery on pages xx to xx
 - Key performance area 3: Local economic development on pages xx to xx



25. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance areas. 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).
26. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
27. The material findings in respect of the selected key performance areas are as follows:

Key performance area 1: Basic service delivery

Usefulness of reported performance information

28. Section 41(c) of the Municipal Systems Act, 2000 (Act 32 of 2000) (MSA) 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. Important reported objectives and indicators and targets were not consistent with those in the approved IDP.
29. The FMPPI requires that the processes and systems that produced the indicator be verifiable, that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. It further requires that the related performance targets should be specific in clearly identifying the nature and required level of performance, measurable and specify the period or deadline for delivery. Important indicators were not verifiable and well defined.
30. Important indicators did not relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives as per the five year IDP, as required by the FMPPI.

Reliability of reported performance information

31. The FMPPI requires the municipality to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not reliable when compared to the source information or evidence provided.

Key performance area 3: Local economic development

Usefulness of reported performance information

32. The FMPPI requires that the processes and systems that produced the indicator be verifiable, that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. It further requires that the related performance targets should be specific in clearly identifying the nature and required level of performance, measurable and specify the period or deadline for delivery. Important indicators were not verifiable and well defined.
33. Important indicators did not relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives as per the five year IDP, as required by the FMPPI.

Reliability of reported performance information

34. The FMPPI requires the municipality to have appropriate systems to collect, collate, verify and

store performance information to ensure reliable 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 our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

35. I draw attention to the following matters:

Achievement of planned targets

36. Refer to the annual performance report on pages XX to XX and 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 key performance areas reported in paragraphs 28 to 34 of this report.

Unaudited supplementary information

37. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Compliance with legislation

38. 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:

Annual financial statements and annual report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets and current assets, non-current liabilities and current liabilities, 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 qualified audit opinion.

Strategic planning and performance management

40. The adopted IDP did not reflect and identify the key performance indicators and targets as required by sections 26 and 41 of the MSA, as well as regulation 2(1)(e) of the Municipal planning and performance management regulations.
41. The performance management system and related controls were inadequate 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 sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.
42. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic level of sanitation as required by section 43(2)



of the MSA and regulation 10(a) of the Municipal planning and performance management regulations.

Expenditure management

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

Revenue management

44. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
45. I could not obtain sufficient appropriate audit evidence that accounts for service charges were prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.

Consequence management

46. 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)(b) of the MFMA.
47. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the MFMA.
48. Allegations of financial misconduct laid against officials of the municipality were not investigated in accordance with the requirements of Municipal regulations on financial misconduct procedures and criminal proceedings 5(4).

Conditional grants

49. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant and Water Services Operating subsidy Grant allocation, as required by section 12(5) of the DoRA.

Asset management

50. 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.
51. An effective system of internal control for assets, as required by section 63(2)(c) of the MFMA was not in place.

Human resource management and compensation

52. The competencies of the supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
53. The municipality did not develop and adopt appropriate systems and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

Procurement and contract management

54. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).



55. Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
56. 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). 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).

Internal control

57. 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 qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

58. Leadership did not adequately exercise their oversight responsibility regarding financial and performance reporting, compliance with legislation as well as related internal controls.

Financial and performance management

59. The enforcement of policies and procedures remains a challenge for the municipality. This is also the underlying reason for the municipality's inability to compile accurate and complete financial statements as several significant amendments were made during the audit. Furthermore the municipality do not have adequately skilled staff and systems in place to support the monitoring and tracking of critical development priorities.

Governance

60. The effectiveness of the audit committee and internal audit's role as an assurance provider was compromised by management's inability to address and react to internal audit's findings and recommendations.

Auditor General

Potchefstroom

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

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