



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 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with 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, 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 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

Receivables from exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for expenditure credits of R3 086 489, salary error suspense of R8 865 893 (2015: R20 336 922), other debtors of R7 977 501 (2015: R7 882 173) and the provision for bad debt of R5 560 262 (2015: R5 274 449) included in receivables from exchange transactions, as the municipality did not have an adequate system of internal control and did not keep adequate 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 R24 135 036 (2015: R36 195 416) as disclosed note 8 and in the statement of financial

position were necessary.

Receivables from non-exchange transactions

5. The municipality did not correctly account for the provision for bad debts in accordance with GRAP 104 *Financial Instruments* as the calculation was based on information where various payments received was not allocated to the correct debtors. I was unable to determine the full extent of this misstatement as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments relating to the provision for bad debts of R217 509 186 (2015: R185 635 757) included in receivables from non-exchange transactions as disclosed in note 9 to the financial statements and the related debt impairment expense in the statement of financial performance were necessary.

Consumer debtors

6. The municipality did not correctly account for the allowance for impairment in accordance with GRAP 104 *Financial Instruments* as the calculation was based on information where various payments received was not allocated to the correct debtors. I was unable to determine the full extent of this misstatement as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments relating to the allowance for impairment of R493 586 377 (2015: R376 610 441) included in consumer debtors as disclosed in note 10 to the financial statements and the related debt impairment expense in the statement of financial performance were necessary.

Cash and cash equivalents

7. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents as the municipality could not provide adequate substantiating records for differences between the trial balance, the cash book balance, the amount as per bank reconciliation and the 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 adjustments relating to cash and cash equivalents of R22 290 959 (2015: R8 297 671) or bank overdraft of R13 886 394 (2015: R4 007 613) disclosed in the statement of financial position and note 11 to the financial statements or any other accounts affected were necessary.

Payables from exchange transactions

8. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions due to the status of the accounting records. I was unable to confirm these payables by alternative means. Consequently, I was unable to determine whether any adjustments relating to payables from exchange transactions of R293 988 841 (2015: R358 960 039) as disclosed in the statement of financial position were necessary.

Accumulated surplus

9. I was unable to obtain sufficient appropriate audit evidence for adjustments to the accumulated surplus for the current and prior year due to the lack of proper substantiating accounting records. I was unable to confirm these adjustments by alternative means. Consequently, I was unable to determine whether any adjustments relating to accumulated surplus of R928 714 771 (2015: R958 856 496) in the financial statements were necessary.

Revenue from exchange transactions

10. 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 did not account for all water to RDP houses. I was unable to determine the full extent of this misstatement of revenue from the sale of water of R99 729 000 (2015: R80 028 973) included in services charges disclosed in note 20 and the related water debtors of R32 925 564 (2015: R44 109 908) included in consumer debtors as disclosed in note 10 to the financial statements.

Revenue from non-exchange transactions

11. During 2015, the municipality did not properly levy and account 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 19, and the property rates receivable of R58 600 404 included in receivables from non-exchange transactions as disclosed in note 9 to the financial statements.

Expenditure

12. The municipality did not have adequate systems to maintain records of expenditure for goods and services paid for. This resulted in payables from exchange transactions being understated by R38 948 598, finance cost understated by R2 580 174, contracted services understated by R31 069 421, repairs and maintenance overstated by R20 462 681, property, plant and equipment understated by R19 131 872 and VAT payable understated by R4 466 297. In addition, I was unable to obtain sufficient appropriate audit evidence for certain amounts disclosed as expenditure due to unexplained differences between the underlying accounting records and the annual financial statements. I could not confirm these expenses by alternative means. Consequently, I was unable to determine whether any further adjustment to expenditure stated at R741 044 352 in the financial statements was necessary. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Disclaimer of opinion

13. 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

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

Restatement of corresponding figures

15. As disclosed in notes 38 and 39 to the financial statements, the corresponding figures for 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the Mahikeng Local Municipality at, and for the year ended 30 June 2015.

Unauthorised, irregular and fruitless and wasteful expenditure

16. As disclosed in note 42 to the financial statements, unauthorised expenditure of R133 445 207 was incurred in the current year and the unauthorised expenditure in respect of prior years of R443 769 042 had not yet been dealt with in accordance with section 32 of the MFMA.
17. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R370 769 was incurred in the current year and fruitless and wasteful expenditure from prior years of R7 161 435 had not yet been dealt with in accordance with section 32 of the MFMA.



18. As disclosed in note 44 to the financial statements, irregular expenditure of R133 584 146 was incurred in the current year and irregular expenditure from prior years of R350 877 704 had not yet been dealt with in accordance with section 32 of the MFMA.

Material losses

19. As disclosed in note 45 to the financial statements, material water losses to the amount of R14 184 114 (2015: R21 159 414) were incurred.

Going concern

20. Note 48 to the financial statements indicates that the municipality has experienced difficulties in settling its current liabilities. These conditions, along with other matters as set forth in note 48, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matters

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

Unaudited disclosure notes

22. 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

23. 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

24. 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

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2016:
- KPA 1: Service delivery and infrastructure development on pages XX to XX
26. 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).

27. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
28. I did not identify any material findings on the usefulness and reliability of the reported performance information on any of the selected key performance areas of the municipality.

Additional matters

29. Although I identified no material findings on the usefulness and reliability of the reported performance information for the selected KPA, I draw attention to the following matters:

Achievement of planned targets

30. Refer to the annual performance report on page XX to XX for information on the achievement of the planned targets for the year.

Adjustment of material misstatements

31. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for KPA 1: Service delivery and infrastructure development. As management subsequently corrected the misstatements, we did not raise any material findings on the reliability of the reported performance information.

Compliance with legislation

32. 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

33. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).
34. The performance management system and related controls were inadequate as the described processes of performance review and reporting and how it is conducted, organised and managed were not implemented, as required by section 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Financial statements

35. 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 and current assets, non-current and current liabilities, revenue, expenses and disclosure items identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer audit opinion.

Procurement and contract management

36. I could not obtain sufficient appropriate audit evidence that all quotations and contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as an adequate document management system

was not in place.

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) regulations 17(a) and (c).
38. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
39. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of preferential procurement regulation 9.
40. 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 (PPPFA) and SCM regulation 28(1)(a).
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. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
43. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
44. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

Human resource management

45. 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.

Expenditure management

46. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
47. 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.
48. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.

Revenue management

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

Asset management

52. 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.

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

Liability management

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

Consequence management

56. 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) and (b) of the MFMA.

Environmental management

57. The municipality did not exercise its legislative and executive authority of managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment as required by section 11(3)(l) and (m) of the MSA by.
58. The municipality operated its wastewater treatment facilities without a license in contravention of 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).
59. The municipality's operational activities at its waste disposal site contravened or failed to comply with the requirement of a waste management license or the norms and standards as prescribed by sections 67(1)(f) and (h) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA).
60. 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.

Internal control

61. 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 opinion and the findings on compliance with legislation included in this report.

Leadership

62. The leadership did not adequately exercise appropriate oversight over financial and performance reporting, compliance with laws and regulations and related internal controls. This has led to material misstatements and control deficiencies identified in financial and performance reports. Policies and procedures did not adequately guide financial and performance reporting activities and inadequately address the shortcomings in the internal controls that resulted in the above findings reported. Furthermore the IT structure was not approved by leadership.

Financial and performance management

63. The accounting officer did not ensure that adequate monitoring controls were implemented to ensure that reliable financial and performance reports were collated throughout the year as part of his periodic reporting responsibilities. Regular, accurate and complete financial reports that are supported and evidenced by reliable information were not properly prepared. Furthermore, management did not adequately review and monitor compliance with applicable laws and regulations. The municipality did not have the requisite skills and capacity required to design and develop the necessary policies and procedures and also had no IT department.

Governance

64. Appropriate risk management activities to ensure that regular risk assessments, including consideration of all risks and fraud prevention, are conducted and that a risk strategy to address these risks is developed and monitored regularly, was not implemented. The internal audit function was only operational for three months of the year. The audit committee did not effectively monitor action plans to address prior year audit findings.

Other reports

65. I draw attention to the following engagement that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of this engagement that is in progress.

Investigation

66. An investigation was prompted by the previous municipal manager, undertaken by the Hawks on the alleged irregular sale of property to an external party without following the correct disposal processes. The investigation was still on-going at the reporting date.

Auditor General

Rustenburg

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence