

Report of the auditor-general to the Western Cape Provincial Parliament and the council on the Oudtshoorn Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Oudtshoorn Municipality set out on pages 3 to 72, 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 statement of comparison of budget 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, 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 municipality'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 municipality'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

Investment property

6. I was unable to obtain sufficient appropriate audit evidence for the impairment of investment property as disclosed in note 16 to the financial statements, as not all municipal properties were assessed for impairment. I was unable to confirm by alternative means the effect of not adequately considering the impairment. Consequently I was unable to determine whether any adjustment to investment property, stated at R65,8 million in note 16 to the financial statements, was necessary. In addition there may also be a resultant impact on impairments and the surplus for the year.
7. I was unable to obtain sufficient appropriate audit evidence to verify whether all investment property, as disclosed in note 16 to the financial statements, is owned by the municipality, as title deeds for properties, provided for audit, were not registered in the name of the municipality. I was unable to confirm that these assets were owned by the municipality by alternative means. Consequently I was unable to determine whether any adjustment to investment property, stated at R65,8 million in note 16 to the financial statements, was necessary.

Contingent liabilities

8. I was unable to obtain sufficient appropriate audit evidence to confirm whether all contingent liabilities are disclosed, as not all external confirmations were received. I was unable to confirm the contingent liabilities by alternative means. Consequently, I was unable to determine whether any adjustment to contingent liabilities, stated at R2,7 million in note 50 to the financial statements was necessary.

Trade and other payables

9. I was unable to obtain sufficient appropriate audit evidence to confirm whether all payables from exchange transactions had been properly accounted for. The municipality did not have adequate systems of internal control in place for the recording of all payables. I was unable to confirm the payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to payables from exchange transactions, stated at R88,9 million (2014-15: R56,8 million) in note 8 to the financial statements was necessary. In addition there may also be a resultant impact on expenditure, surplus for the year and accumulated surplus.

Expenditure

10. I was unable to obtain sufficient appropriate audit evidence to confirm that expenditure was recorded in the correct accounting period. I was unable to confirm the recording of expenditure transactions in the correct period, by alternative means. Consequently, I was unable to determine whether any adjustment to expenditure, stated at R217,7 million (2014-15: R293,5 million) as per the statement of financial performance was necessary. In addition there may also be a resultant impact on payables, surplus for the year and accumulated surplus.

Provisions

11. I was unable to obtain sufficient appropriate audit evidence that the provision for alien vegetation was performed accurately as reliance could not be placed on the information and parameters used to perform the calculations. I was unable to confirm the provision for alien vegetation by alternative means. Consequently, I was unable to determine whether any adjustments to the provision for alien vegetation, stated at R11,8 million (2014-15: R11 million) in notes 4 and 7 to the financial statements, was necessary. In addition there is also a resultant impact on surplus for the year and accumulated surplus.
12. The municipality did not classify and calculate the provision for landfill sites in accordance with GRAP19 *Provisions, contingent liabilities and contingent assets*. Consequently the provision for landfill sites is understated by R234 000 and the non-current provisions overstated by R133 000 and the landfill sites is understated by R101 000.

Employee benefits

13. The municipality did not adequately calculate the provision for leave in accordance with GRAP 25 *Employee benefits*. As a result, the provision for leave amount of R10,9 million (2014-15: R9 million) was misstated. I was unable to determine the impact on the provision, as it was impracticable to do so. In addition there is also a resultant impact on the surplus for the year and accumulated surplus.

Value added tax (VAT) payable

14. The municipality did not account for VAT in accordance with the Value added tax Act 89 of 1991 and therefore did not recognise VAT correctly in terms of GRAP 1 *Presentation of Financial Statements*. As a result the VAT payable amount of R7,1 million (2014-15: R6,9 million) was misstated. I was unable to determine the impact on the VAT payable, as it was impracticable to do so. In addition there is also a resultant impact on, expenditure, revenue, property, plant and equipment, the surplus for the year and accumulated surplus.

Restatement of corresponding figure: Receivables from exchange transactions.

15. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for receivables from exchange transactions. As described in note 37 the restatement was made to rectify a prior year misstatement, but the restatement could not be substantiated by supporting audit evidence. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the accounts receivable corresponding figures stated at R61,7 million in note 19 was necessary. This also had an impact on accumulated surplus.

Qualified opinion

16. 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 Oudtshoorn 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 DoRA.

Emphasis of matters

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

Restatement of corresponding figures

18. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during the 2015-16 financial year in the financial statements of the Oudtshoorn Municipality at, and for the year ended, 30 June 2015.

Material losses/impairments

19. As disclosed in note 19 to the financial statements, an impairment to the amount of R60,8 million (2014-15: R55,2 million) was provided for on receivables from exchange transactions.
20. As disclosed in note 20 to the financial statements, an impairment to the amount of R22,0 million (2014-15: R17,1 million) was provided for on receivables from non-exchange transactions.

Material underspending of the conditional grant

21. As disclosed in note 9 to the financial statements, the municipality underspent its conditional grants and receipts by R17,2 million at 30 June 2016.

Material underspending of the capital budget

22. As disclosed on the statement of comparison of budget information for the year ended 30 June 2016, the municipality underspent its capital budget by R21,1 million.

Going concern

23. The statement of financial performance indicates that the Oudtshoorn Municipality incurred a net loss of R42,3 million (2014-15: R15,0 million) for the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R117,9 million (2014-15: R93,7 million). These conditions, along with other matters as set forth in the note 47.2 to the financial statements, 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

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

Unaudited supplementary schedules

25. The supplementary information set out on pages 73 to 78 did 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

26. 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

27. 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 objectives 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

28. I am unable to report on the usefulness and reliability of the performance information, as the annual performance report of the municipality was not prepared as required by section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) and section 121(3)(c) of the MFMA.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

30. The local community was not consulted by means of a municipal wide structure for community participation/through a forum that enhances community participation in drafting and implementing the Integrated development plan (IDP), as required by section

28 of the MSA and Municipal planning and performance management regulation 15(1)(a)(i).

31. The adopted IDP did not reflect and identify the key performance indicators and targets and financial plan as required by sections 26 and 41 of the MSA, as well as Municipal planning and performance management regulation 2(1)(e) and (3)(a) to (c).
32. The IDP was not drafted by taking into account the integrated development processes and proposals submitted by the district municipality as required by section 29(3)(b) of the MSA.
33. Key performance indicators in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).
34. The IDP was not reviewed by the council based on the assessment of its performance measurements and/or changing circumstances, as required by section 34 of the MSA and municipal planning and performance management regulation 3 and 11.
35. The performance management system and related controls were not in place and were not maintained as no processes of performance planning, monitoring, measurement, review, reporting existed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 and 8 of the Municipal planning and performance management regulations.
36. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget was not prepared and approved by the mayor as required by section 1 and 53(1)(c) of the MFMA.

Annual financial statements and annual performance report

37. 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, current liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently. The uncorrected material misstatements and/ or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
38. The annual performance report was not prepared for the financial period under review, as required by section 46 of the MSA.

Conditional grants received

39. Municipal Infrastructure Grant allocations were utilised for purposes other than those stipulated in the grant framework in contravention of section 17(1) of DoRA.
40. The municipality did not evaluate its performance in respect of programmes funded by the Municipal infrastructure grant and Regional bulk infrastructure grant allocation, as required by section 12(5) of the DoRA.

Consequence management

41. Unauthorised, 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)(a) and (b) of the MFMA.

Expenditure management

42. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
43. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
44. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Liability management

45. Short-term debt was not repaid within the financial year, as required by section 45(4) of the MFMA.

Budgets

46. The 2015-16 annual budget was not approved by the council before the start of the financial year, as required by section 16(1) of the MFMA.

Human resource management

47. 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.
48. The annual performance agreements for the senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

Procurement and contract management

49. Sufficient appropriate audit evidence could not be obtained that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive.
50. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).

51. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
52. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
53. 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).
54. 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).
55. 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).
56. Contracts were extended/modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
57. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.
58. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
59. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
60. Awards were made to providers who are in the service of the municipality and/or whose directors/principal shareholders are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c). Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the suppliers/officials involved.
61. Awards were made to providers who are in the service of other state institutions or whose directors/principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 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).
62. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
63. Quotations were awarded to providers that are listed on the National Treasury's database as persons prohibited from doing business with the public sector, in contravention of SCM regulation 38(1)(c).

Internal control

64. I considered internal control relevant to my audit of the financial statements, annual performance information 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 performance information and the findings on compliance with legislation included in this report.

Leadership

65. Although the Administrator took over overall responsibility of the municipality due to council not performing their administrative and legislative duties, effective oversight could not take place due to key positions being vacant, as well as the weaknesses in the control environment.
66. The political instability from the 2014-15 financial period resulted in a lack of ownership by the political and administrative leadership to effectively exercise oversight regarding financial, performance, compliance and governance challenges, which negatively impacted on the audit outcomes of the municipality. Lapses in effective oversight include the following:
- continuing deficiencies in the control environment, as is evidenced by repeat findings;
 - not periodically reviewing the progress made by management to address past external audit findings and internal control deficiencies and, thereby, not addressing the root causes of repeated findings;
 - not validating the credibility of financial reporting;
 - not implementing a performance management system to measure performance of municipal staff;
 - not overseeing compliance with laws and regulations by ensuring that controls are implemented by the various directorates to ensure compliance or ensuring that compliance is monitored centrally; and
 - not implementing adequate consequence management and holding staff accountable for not complying with the policies and regulations.
67. Furthermore, vacancies in key positions in internal audit, finance, supply chain management and the performance unit affected some staff's ability to carry out certain aspects of their duties.

Financial and performance management

68. The poor status of financial and performance management controls at the municipality had a negative impact on the audit outcome resulting from:
- leadership instability to adequately monitor plans to establish formal and reliable system of record keeping and to have documents readily available when requested;
 - vacancies in key positions and lack of consequence management resulting in annual performance indicators and targets not being established and an annual performance report not being produced;
 - no performance management system being in place to monitor performance of employees;

- inadequate daily and monthly processing and reconciliation of transactions which did not assist with early detection and correction of errors and omissions from financial reporting;
- no compliance checklist being designed, implemented and monitored which resulted in various non-compliance with applicable laws and regulations;
- vacancies in key position in the finance section, requiring management to place reliance on consultants to prepare the financial statements which, together with management not performing an adequate review of the financial statements, resulted in the municipality not preparing regular, accurate and complete financial statements that are supported and evidenced by reliable information, resulting in errors and misstatements being identified by the audit; and
- inadequate monitoring by management, including governance and oversight structures, to ensure appropriate controls are in place with a view to consistent compliance with applicable laws and regulations.

Governance

69. The municipality did not implement effective risk management and governance due to the following:

- risks relating to material misstatements, for financial information as well as compliance with laws and regulations were not adequately evaluated by management in order to ensure the achievement of internal control objectives, as the implementation of risk management was not effective during the year; and
- An inadequately resourced internal audit due to vacancies combined with management and leadership not taking action to address the recommendations of internal audit, rendered the audit committee ineffective. Due to the political instability at council and the lack of commitment by administrative leadership no reporting had taken place to enable the audit committee to fulfil its mandate.

Other reports

70. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

Investigations

71. The Oudtshoorn Municipality conducted 24 internal investigations which relate to misconduct committed by employees, such as misuse of sick leave, negligence, alleged assault and failure to adhere to lawful instructions. The outcomes of these investigations resulted in settlement agreements, terminations, resignations and disciplinary actions against certain employees. Furthermore, it was noted that no allegation involving senior officials or relating to SCM was reported to the South African Police Service. Only three internal investigations were pending as at 30 June 2016.

72. The Western Cape provincial forensic services (WCPFS) undertook an investigation at the request of the minister of local government. The scope included an investigation into the appointment of certain employees, allegations of financial misconduct and awarding of tenders and deviations from the procurement process for certain suppliers. The report was issued on 29 February 2016. As a result of this investigation, criminal charges were brought against implicated officials, which are currently being investigated by the HAWKS. The investigation is still in progress.

Auditor-General

Cape Town

30 November 2016



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence