

Report of the auditor-general to the Free State Legislature and the council on the Nala Local Municipality

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Nala Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2017, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Nala Local Municipality as at 30 June 2017 and its financial performance and cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Financial Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Material uncertainty related to going concern

6. I draw attention to the matter below. My opinion is not modified in this respect of this matter:
7. Note 40 to the financial statements indicates that the municipality's current liabilities (R385 741 209) exceeded its current assets (R130 737 319). This, along with other matters set forth in note 40 indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern and to meet its service delivery objectives.

Emphasis of matters

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

Unauthorised expenditure

9. As disclosed in note 41 to the financial statements, the municipality incurred unauthorised expenditure of R79 619 678 (2016: R9 984 054), due to the overspending of the approved budget.

Irregular expenditure

10. As disclosed in note 43 to the financial statements, the municipality incurred irregular expenditure of R16 407 832 (2016: R20 182 168), mainly due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

11. As disclosed in note 42 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R26 094 526 (2016: R39 493 521), mainly due to interest and penalties on accounts that were not paid timeously.

Restatement of corresponding figures

12. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2016 had been restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2017.

Material losses

13. As disclosed in note 47 to the financial statements, material electricity and water losses of R5 342 032 (2016: R6 919 717) and R17 635 232 (2016: R13 076 807), respectively, were incurred as a result of line losses, tampering and theft.

Material impairments

14. As disclosed in notes 4 and 5 to the financial statements, receivables from exchange and non-exchange transactions were impaired by R445 509 983 (2016: R355 729 848).

Other matter

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

Unaudited disclosures

16. 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.

Responsibilities of the accounting officer for the financial statements

17. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and 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.
18. In preparing the financial statements, the accounting officer is responsible for assessing the Nala Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the intention is to liquidate the municipality or cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

19. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
20. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance areas (KPA's) presented in the annual performance report. I performed procedures to raise findings but not to gather evidence to express assurance.
22. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

23. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2017:

KPA	Pages in the annual performance report
KPA 1: Basic service delivery	x – x

24. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA 1: Basic service delivery

Various indicators

26. Changes were made to the indicators, however changes to the following indicators were not approved:

Indicator	Planned objective	Reported objective
TL6: Number of formal households connected to the municipal electrical infrastructure network (credit and prepaid electrical metering) (excluding Eskom areas) at 30 June 2017	To ensure that all households in the urban area of the municipality have access to refuse removal at least once a year	To ensure that all households 100% in the municipal area have access to electricity by 2020
TL7: Number of formal households connected to the municipal waste water sanitation/sewerage network for sewerage services, irrespective of the number of water closets (toilets) at 30 June 2017	To ensure that all registered indigents have access basic sanitation end of financial year	To ensure that all households in the urban area of the municipality have access to refuse removal at least once a year in the SDBIP
TL63: Number of households without access to minimum electricity standards	To ensure that all registered indigents have access basic electricity end of financial year	To ensure that all registered indigents have access basic sanitation end of financial year
TL64: Number of households without access to minimum refuse standards	To ensure that all registered indigents have access basic refuse removal end of financial year	To ensure that all registered indigents have access basic sanitation end of financial year in the SDBIP

TL62: number of households without access to minimum sanitation standards

27. I was unable to obtain sufficient appropriate audit evidence for the reported achievements for the indicator TL62: number of households without access to minimum sanitation standards due to the unavailability of requested information. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 2 149.

Various indicators

28. The reported achievements of the indicators listed below were misstated, as it did not agree to the supporting information provided.

Performance indicator	Reported achievement	Audited value
TL3: % households with access to basic electricity service standard (credit and/or prepaid meters but excluding Eskom)	55,6%	66,1%
TL6: number of formal households connected to the municipal electrical infrastructure network (credit and prepaid electrical metering) (excluding Eskom areas) at 30 June 2017	10 906	8 850

Other matters

29. I draw attention to the matters below.

Achievement of planned targets

30. Refer to the annual performance report on pages to xx to xx for information on the achievement of planned targets for the year and explanations provided for the under- or overachievement of a number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 26 to 28 of this report.

Adjustment of material misstatements

31. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1: basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Introduction and scope

32. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to raise findings but not to gather evidence to express assurance.
33. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements and annual report

34. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.
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 assets, current assets and liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records provided, resulting in the financial statements receiving an unqualified audit opinion.

Budget

36. Reasonable steps were not taken to prevent unauthorised expenditure of R79 619 678, as disclosed in note 41 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The unauthorised expenditure was incurred due to the overspending of the approved budget.

Procurement and contract management

37. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was also reported in the previous year.
38. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the previous year.
39. Some goods and services with a transaction value above R200 000 were procured without inviting competitive bids, contrary to 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). Similar non-compliance was also reported in the previous year.
40. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the previous year.

41. 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.
42. Awards were made to providers whose directors were in the service of another state institution, in contravention of section 112(j) of the MFMA and SCM regulation 44.
43. 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, in contravention of SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000).

Expenditure management

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
45. Effective steps were not taken to prevent irregular expenditure of R16 407 832, as disclosed in note 43 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was the result of procurement in terms of SCM regulation 32 that did not meet all the requirements.
46. Effective steps were not taken to prevent fruitless and wasteful expenditure of R26 094 526, as disclosed in note 42 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was the result of interest and penalties on payables not settled within the payment terms.

Strategic planning and performance management

47. A mid-year performance assessment was not performed, as required by section 72(1)(a)(ii) of the MFMA.

Consequence management

48. Some of the unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a) and (b) of the MFMA.

Other information

49. The Nala Local Municipality's accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected KPAs presented in the annual performance report that have been specifically reported in the auditor's report.
50. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

51. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPAs presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
52. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

Internal control deficiencies

53. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.
54. Management failed to implement appropriate follow-up actions that adequately addressed the root causes of reported findings. No consequence management was in place to hold individuals accountable for the non-performance of internal control responsibilities or to establish and communicate adequate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities. Furthermore, an effective human resource plan had not been established to identify and address organisational staff needs.
55. Management did not regularly review and monitor compliance with laws and regulations and internally designed policies and procedures. This resulted in significant non-compliance issues that could have been prevented.
56. The internal audit unit and the audit committee did not function properly, resulting in various internal control weaknesses in financial and performance reporting not being detected and corrected timeously.

Other reports

57. I draw attention to the following engagement that could have an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. This report did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

58. The National Prosecuting Authority is investigating findings relating to procurement as contained in the report of the Public Protector of South Africa issued during September 2010. The investigation was still ongoing at the reporting date.

Auditor General

Bloemfontein

30 November 2017



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for select KPAs and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit 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.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Nala Local Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.