

# Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Dr JS Moroka Local Municipality

## Report on the audit of the financial statements

### Adverse opinion

1. I have audited the financial statements of the Dr JS Moroka Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2018, 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, because of the significance of the matters described in the basis for adverse opinion section of this auditor's report, the financial statements do not present fairly, in all material respects, the financial position of the municipality as at 30 June 2018, 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 Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora).

### Basis for adverse opinion

#### Property, plant and equipment

3. The municipality did not transfer all the completed infrastructure assets from assets under construction to property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. This resulted in property, plant and equipment being understated by R11 293 913. In addition, I was unable to obtain sufficient appropriate audit evidence for the write-off of assets. I could not confirm the write-off of assets by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the infrastructure assets of R1 239 238 116 disclosed in note 11 to the financial statements.
4. In addition, I was unable to obtain sufficient appropriate audit evidence for the valuation of land, as the municipality did not have an adequate system in place to account for the valuation of land. I could not confirm the land by alternative means. Furthermore, land reflected in the name of the municipality in the valuation roll could not be traced to the asset register, due to the asset register not containing unique identifiers to enable verification. Consequently, I was unable to determine whether any adjustments were necessary relating to the land amounting to R334 819 504 disclosed in note 11 to the financial statements.

## Revenue and receivables

5. The municipality did not reliably measure revenue in accordance with GRAP 9, *Revenue from exchange transactions* and GRAP 23, *Revenue from non-exchange transactions*. The municipality did not charge service charges and property rates in terms of its policy. As a result, service charges and property rates were overstated by R23 273 990 (2016-17: R54 495 419) and R20 695 094 (2016-17: R42 864 840), respectively. Consequently, consumer debtors was overstated. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.
6. During 2017, the municipality did not reliably measure revenue in accordance with GRAP 9, *Revenue from exchange transactions*. The municipality did not charge interest on receivables (trading) in terms of its policy. As a result, interest on receivables (trading) was overstated by R20 837 502. Consequently, consumer debtors was also overstated. Additionally, there was a resultant impact on the accumulated surplus for the period.

## Expenditure

7. The municipality did not fairly present the cash flow statement in accordance with the requirements of GRAP 1, *Presentation of financial statements*, as the municipality paid for expenses on expired contracts and incorrectly accounted for invoices that related to the prior year in the current year. Consequently, operational cost and contracted services were overstated by R20 619 745 and R5 909 621, respectively. This had an impact on the surplus for the period and on the accumulated surplus.

## Cash flow statement

8. As the municipality did not prepare a cash flow statement in accordance with GRAP 2, *Cash flow statement*, the cash flow statement was misstated by R8 081 298. I was unable to obtain sufficient appropriate audit evidence to determine the further extent of the misstatement relating to the cash flow statement, due to the items contributing to the basis for the adverse audit opinion.

## Irregular expenditure

9. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure, as internal controls had not been established to recognise and investigate irregular expenditure identified in the previous year, as required by section 125(2)(d)(i) of the MFMA. I could not confirm whether all irregular expenditure had been recorded and investigated by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the irregular expenditure of R551 797 514 disclosed in note 49 to the financial statements.

## Commitments

10. The municipality did not have adequate systems in place to appropriately account for commitments, as required by GRAP 1, *Presentation of financial statements*, resulting in the commitments balance being overstated by R21 758 466. Consequently, I was unable to determine whether any further adjustments were necessary to commitments stated at R36 520 874 in note 40 to the financial statements.

## Context for the opinion

11. 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 this auditor's report.
12. 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.
13. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

## 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 note 42 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

## Impairments – trade debtors

16. As disclosed in note 8 to the financial statements, the receivables balance was significantly impaired. The total impairment of consumer debtors amounted to R264 706 167 (2016-17: R221 761 128), which represented 72% (2016-17: 79%) of the total consumer debtors. The contribution to the provision for debt impairment was R46 405 007 (2016-17: R62 170 784).

## Unauthorised expenditure

17. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R14 888 081. In addition, unauthorised expenditure of R74 875 779 incurred in previous years was not investigated.

### **Fruitless and wasteful expenditure**

18. As disclosed in note 48 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R431 324. In addition, fruitless and wasteful expenditure of R3 890 783 incurred in previous years was not investigated.

### **Irregular expenditure**

19. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R27 804 021, as it did not follow a proper tender process. In addition, irregular expenditure of R273 993 493 incurred in previous years was not investigated.

### **Material losses – water**

20. As disclosed in note 50 to the financial statements, material water losses of R11 683 723 (2016-17: R13 833 087) was incurred, which represented 16,5% (2016-17: 25,4%) of the total water pumped.

### **Other matter**

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

### **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 in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

### **Responsibilities of the accounting officer for the financial statements**

23. 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.
24. In preparing the financial statements, the accounting officer is responsible for assessing the 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 appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

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

25. 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.
26. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

### **Report on the audit of the annual performance report**

#### **Introduction and scope**

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 material findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report. I was engaged to perform procedures to raise findings but not to gather evidence to express assurance.
28. 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.
29. 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 objective presented in the annual performance report of the municipality for the year ended 30 June 2018:

<b>Objective</b>	<b>Pages in the annual performance report</b>
KPA 5 – basic services delivery - infrastructure development	xx – xx

30. I performed procedures to determine whether the reported performance information was properly presented and whether performance 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.
31. The material findings in respect of the usefulness and reliability of the selected objective are as follows:

#### **KPA 5 – basic services delivery - infrastructure development**

32. I was unable to obtain sufficient appropriate audit evidence regarding the selected objective, as the annual performance report was presented without accurate and complete underlying records. I was therefore unable to audit the usefulness and reliability of the reported performance information. This was due to limitations placed on the scope of my work. I was unable to audit the reported performance information relating to this objective by alternative means.

#### **Other matters**

33. I draw attention to the matters below.

#### **Achievement of planned targets**

34. Refer to the annual performance report on pages xx to xx for information on the achievement of 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 in paragraph 32 of this report.

#### **Adjustment of material misstatements**

35. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 5 – basic services delivery - infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

### **Report on the audit of compliance with legislation**

#### **Introduction and scope**

36. 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 identify findings but not to gather evidence to express assurance.

37. The material findings on compliance with specific matters in key legislation are as follows:

#### Annual financial statements, performance report and annual report

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were subsequently provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving an adverse audit opinion.

#### Expenditure management

39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

40. Reasonable steps were not taken to ensure that the municipality implemented and maintained an effective system of expenditure control, including procedures for the approval, authorisation and payment of funds, as required by section 65(2)(a) of the MFMA.

41. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred, as indicated in the basis for adverse paragraph. The majority of the disclosed irregular expenditure was caused by the bid adjudication committee that was not composed in accordance with supply chain management (SCM) regulation 29(2). Irregular expenditure amounting to R6 321 821 was incurred on the upgrading and extension of the reticulation network in the Bloedfontein village cluster A: Allemansdrift C section and the upgrading of roads and storm water in the Mbibane village cluster.

42. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R431 324, as disclosed in note 48 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest incurred on long-outstanding debts.

43. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R14 888 081, as disclosed in note 47 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by the overspending of the budgeted amount.

#### Revenue management

44. An adequate management, accounting and information system was not in place to account for revenue and debtors, as required by section 64(2)(e) of the MFMA.

45. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

46. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

#### **Asset management**

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

48. Funds were invested in a bank account that was not registered in terms of the Banks Act of South Africa, 1990 (Act No. 94 of 1990) in contravention of municipal investment regulation 6.

#### **Human resource management**

49. Appropriate systems and procedures to monitor, measure and evaluate the performance of staff were not developed and adopted, as required by section 67(1)(d) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000).

#### **Consequence management**

50. Unauthorised 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) of the MFMA.

51. The authorisation of unauthorised expenditure amounting to R7 761 793 was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

52. Irregular 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.

53. 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.

#### **Procurement and contract management**

54. 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 prior year.

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

57. Some competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). Similar non-compliance was also reported in the prior year.



58. The performance 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 prior year.
59. Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
60. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

#### **Other information**

61. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the executive mayor's report and the audit committee's report. The other information does not include the financial statements, the auditor's report and the selected objective presented in the annual performance report that has been specifically reported in this auditor's report.
62. 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.
63. 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 objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
64. I did not receive the other information prior to the date of this auditor's report. After I receive and read this information, and if I conclude that there is a material misstatement, 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**

65. 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 on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

66. Management did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
67. Management did not establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities.
68. Management did not develop and monitor the implementation of action plans to address internal control deficiencies.
69. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
70. Management did not implement controls over daily and monthly processing and reconciling transactions.
71. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
72. Management did not review and monitor compliance with applicable legislation.
73. Management did not ensure that there was an adequately resourced and functioning internal audit unit that identified internal control deficiencies and recommended corrective action effectively.

*Auditor-General*

Mbombela

30 November 2018



AUDITOR - GENERAL  
SOUTH AFRICA

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## **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 the selected objective 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 this 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 municipality’s 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 this auditor’s report. However, future events or conditions may cause a municipality to cease continuing 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.