

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

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Matjhabeng Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, 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, 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, 2014 (Act No. 10 of 2014) (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 conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment as the municipality did not provide me with evidence to support the cost prices of assets. This was also due to shortcomings noted in the adequacy of the fixed asset register which resulted in assets that could not be physically verified and that could not be traced to the fixed asset register. I was unable to confirm property, plant and equipment by other means as it was impracticable to do so. Consequently, I was unable to confirm whether any adjustment to property, plant and equipment, stated at R5 354 538 795 (2014: R5 483 902 378) in note 10, and the depreciation and

impairment stated at R260 345 609 (2014: R282 950 593) in note 27 to the financial statements, were necessary.

Unauthorised expenditure

5. The municipality did not disclose all unauthorised expenditure in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA, as all overspending of the budget was not included in the amount disclosed. This resulted in unauthorised expenditure being understated by R175 639 689. I was unable to obtain sufficient appropriate audit evidence for the opening balance of unauthorised expenditure due to the lack of evidence to support the unauthorised expenditure incurred during the years preceding the 2012-13 financial year. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to unauthorised expenditure, stated at R4 141 432 582 (2014: R3 698 128 927) in note 44 to the financial statements, were necessary.

Trade and other payable

6. I was unable to obtain sufficient appropriate audit evidence that trade and other payables had been properly accounted for as the municipality could not provide supporting documentation, nor explanations, for debit transactions processed in the trade and other payables accounts. I was unable to confirm trade and other payables by other means as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments to trade and other payables, stated at R2 192 632 825 (2014: R1 606 120 303) in note 12 to the financial statements, were necessary. In addition, the municipality did not recognise all outstanding amounts meeting the definition of a liability in accordance with SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, as it did not maintain adequate records of goods and services received but not yet paid at year-end. Consequently, trade and other payables as well as expenditure were understated by R112 127 302. Additionally, there was a consequential impact on the deficit for the period and on the accumulated surplus.

Service charges

7. I was unable to obtain sufficient appropriate audit evidence that revenue from service charges had been properly accounted for, due to inadequate accounting records. I was unable to confirm the revenue from service charges by alternative means. Consequently, I was unable to determine whether any adjustment to revenue from service charges, stated at R942 577 378 (2014: R825 232 349) in note 24 to the financial statements, was necessary. In addition, the municipality recognised deferred estimates that did not meet the definition of revenue in accordance with SA Standards of GRAP, GRAP 9, *Revenue from exchange transactions*, and also did not measure revenue at the fair value of the consideration received or receivable, as required by the standard. Consequently, service charges revenue and consumer receivables were overstated by R212 758 667, respectively.

Irregular expenditure

8. I was unable to obtain sufficient appropriate audit evidence for the opening balance of irregular expenditure due to the lack of evidence to support the irregular expenditure transactions incurred during the years preceding 2012-13. I was unable to determine whether any further adjustments to irregular expenditure, stated at R710 713 834 (2014: R484 659 738) in note 46 to the financial statements, were necessary.

Fruitless and wasteful expenditure

9. I was unable to obtain sufficient appropriate audit evidence for the opening balance of fruitless and wasteful due to the lack of evidence to support the fruitless and wasteful expenditure transactions incurred during the years preceding 2012-13. I was unable to confirm fruitless and wasteful expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to fruitless and wasteful expenditure amounting to R489 527 242 (2014: R337 705 181) in note 45 to the financial statements was necessary.

Inventory

10. I was unable to obtain sufficient appropriate audit evidence regarding inventory as the municipality did not keep accurate records for consumables and RDP inventory. In addition, the municipality did not account for its inventory as outlined in terms of the requirements in SA standards of GRAP, GRAP 12, *Inventory*, as it did not value inventory items correctly, a provision was not made for obsolete stock and the counted inventory was not included in the inventory balance. I was unable to confirm inventory by alternative means. Consequently, I was unable to determine whether any adjustments to inventory, stated at R275 654 410 (2014: R275 225 450) in note 3 to the financial statements, were necessary.

General expenditure

11. I was unable to obtain sufficient appropriate audit evidence for general expenditure as supplier statements and support for the debit orders charged to the municipal bank account could not be provided. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to general expenditure, stated at R206 232 700 (2014: R178 906 990) in note 33 to the financial statements, were necessary.

Consumer receivables

12. The municipality did not account for consumer receivables, as required by SA Standards of GRAP, GRAP 104, *Financial instruments* and GRAP 1. The municipality charged services to invalid debtors. Consequently, consumer receivables from exchange transactions and service charges were overstated by R186 748 454 (2014: R167 275 010) and R212 758 667(2014: R469 009 172), respectively. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus. The municipality also did not distinguish between receivables from exchange and non-exchange transactions in the statement of financial position as required in terms of GRAP 1

Contracted services

13. I was unable to obtain sufficient appropriate audit evidence for contracted services due to the invoices that could not be submitted. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to contracted services, stated at R100 063 466 (2014: R120 425 649) in note 31 to the financial statements, were necessary.

Rental of facilities

14. I was unable to obtain sufficient appropriate audit evidence for revenue generated from the rental of facilities due to the municipality that could not provide application forms, rental agreements and adequate registers. I was unable to confirm the revenue from the rental of facilities by alternative means. Consequently, I was unable to determine whether any adjustments to revenue from the rental of facilities, stated at R11 203 009 (2014: R10 303 659) in note 23 to the financial statements, were necessary.

Cash flow statement

15. The municipality did not accurately disclose the cash flow movements for the year in accordance GRAP 2, *Cash flow statements*. Cash receipts from property rates and service charges were understated by R32 111 541. Cash payments to suppliers were overstated by R31 929 811.

Aggregation of immaterial uncorrected misstatements

16. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position and the statement of financial performance:
 - Repairs and maintenance disclosed as R26 882 267 was understated by R19 583 545
 - Provisions disclosed as R50 144 032 was understated by R15 286 472.

In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the following items by alternative means:

- Property rates of R17 115 478 as included in the disclosed total of R192 549 129 (2014:R192 976 982)
- Non-current consumer receivables of R17 598 390 was included in the disclosed balance of R21 059 890.

Consequently, I was unable to determine whether any further adjustment to these items was necessary.

Disclaimer of opinion

17. 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 these financial statements.

Emphasis of matters

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

Restatement of corresponding figures

19. As disclosed in note 37 to the financial statements, the corresponding figures for 2014 were restated as a result of an error discovered during 2014-15 in the financial statements of the Matjhabeng Local Municipality at, and for the year ended, 30 June 2014.

Material losses

20. As disclosed in note 48 to the financial statements, material losses to the amount of R125 272 583 (2014:R107 189 324) and R80 767 714 (2014: R91 916 893) were incurred as a result of water and electricity distribution losses, respectively.

Impairments and write offs

21. As disclosed in note 7 to the financial statements, material losses to the amount of R1 028 322 181 were incurred as a result of a write off of irrecoverable consumer receivables.
22. As disclosed in note 10 to the financial statements, material losses to the amount of R41 026 676 were incurred as a result of a disposal of property, plant and equipment.

Financial sustainability

23. Note 42 to the financial statements indicate that the Matjhabeng Local Municipality incurred a net loss of R323 331 190 during the year ended 30 June 2015. These and the other conditions disclosed indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to meet its financial obligations as they fall due and to achieve service delivery objectives as outlined in the service delivery business implementation plan.

Additional matter

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

Additional disclosure

25. 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

26. 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

27. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area (KPA) presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - KPA1: Basic service delivery on pages xx to xx; xx to xx
28. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
29. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned KPA. 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 (FMPP)*.
30. I 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 selected KPA are as follows:

KPA1: Basic service delivery

Reliability of reported performance information

32. The FMPP requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because the auditee could not provide sufficient appropriate evidence in support of the reported performance.

Additional matters

33. I draw attention to the following matters:

Achievement of planned targets

34. Refer to the annual performance report on pages xx to xx; 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 reliability of the reported performance information for the selected KPA in paragraph 32 of this report.

Adjustment of material misstatements

35. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for KPA1 – basic service delivery. As management subsequently corrected the misstatements, I did not identify material findings on the usefulness of the reported performance information.

Material inconsistencies in other information included in the annual report

36. I was not provided with the draft annual report. As a result, I could not confirm whether the details in the draft annual report were consistent with the information presented in the annual performance report.

Compliance with legislation

37. 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

38. The annual performance report for the year under review did not include the performance of the municipality and each external services provider, a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(a),(b) and (c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).
39. The KPAs set by the municipality did not include indicators on the percentage of households with access to basic level of water, sanitation, electricity and solid waste removal, as required by section 43(2) of the MSA and regulation 10(a) of the *Municipal planning and performance management regulations*.
40. The annual performance agreements for all senior managers were not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan, as required by section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
41. The performance management system did not provide for policies and procedures to take steps of improvement where performance targets were not met, as required by section 41 (1)(d) of the MSA.
42. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

Annual report and annual financial statements

43. 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, revenue, expenditure, disclosure items identified by the auditors in the submitted financial statements were subsequently

corrected and the supporting records were provided subsequently. However, the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.

Audit committee

44. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management, and performance evaluation, as required by section 166(2)(a) of the MFMA.
45. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
46. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
47. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.
48. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii).
49. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
50. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).
51. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

52. The internal audit unit did not function as required by section 165(2) of the MFMA, in that, it did not report to the audit committee on the implementation of the internal audit plan. It also did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
53. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Procurement and contract management

54. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).

55. Sufficient appropriate audit evidence could not be obtained that contracts were awarded only to bidders who submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
56. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
57. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulation 19(a).
58. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
59. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which was fair, equitable, transparent and competitive, due to improper record keeping.
60. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
61. Awards were made to providers who 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, in contravention of SCM regulation 38(1).
62. Persons in 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, as required by the code of conduct for staff members issued in terms of the MSA.

Human resource management

63. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
64. Job descriptions were not established for all posts in which appointments were made in the year under review, in contravention of section 66(1)(b) of the MSA.
65. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Municipal regulations on minimum competency levels 14(2)(a).
66. The senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.

Expenditure management

67. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
68. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, and accounted for creditors, as required by section 65(2)(b) of the MFMA.
69. 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

70. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
71. 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.

Asset management

72. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 96(2)(a) of the MFMA.
73. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

74. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

75. 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)(ii) of the MFMA.

Internal control

76. I considered internal control relevant to my audit of the financial statements, 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 of opinion, the findings on the service delivery report and the findings on compliance with legislation included in this report.

Leadership

77. Although leadership partially addressed capacity constraints within the finance division by appointing skilled and competent personnel, these actions were not adequate to enable the municipality to improve its general control environment. The municipality did not always take timely corrective action to address internal control weaknesses as well as to ensure compliance with legislation. This resulted in non-compliance with applicable legislation and gave rise to unauthorised, irregular and fruitless and wasteful expenditure.
78. The council did not approve an organisational structure that is aligned to the municipality's needs. As a result, personnel that needed to address the municipality's needs were employed outside the approved organisational structure.
79. The municipal manager was not consistently available to attend weekly steering committee meetings held during the course of the audit. This resulted in the corrective action not being timely implemented to ensure the submission of appropriate audit evidence.

Financial and performance management

80. Inadequate communication and a lack of integration between the different directorates resulted in information in the asset registers relating to the physical location of the assets not being updated on a regular basis. There was a lack of reconciliations between the accounting system and the supporting documents for trade payables and inventory.
81. Inadequate record keeping at various directorates within the municipality resulted in findings on inventory, procurement and contract management, expenditure, consumer receivables and revenue. This resulted in a lack of accountability and commitment by staff, as well as corrective action not being taken.

Governance

82. The governance structures did not influence an improvement in the control environment of the local municipality which is mainly attributable to the fact that the audit committee was not entirely functional in the financial year and the internal audit division did not plan and execute risk-based audits.
83. The draft annual financial statements were not timeously reviewed by the audit committee as they were only submitted at a late stage. This thus resulted in numerous errors being identified in the annual financial statements submitted for auditing.
84. The implementation of recommendations made by the internal audit division based on findings raised on quarterly and mid-year performance reporting was not adequately monitored by the executive management. This resulted in the report on predetermined objectives being subject to material adjustments. This was also due to the fact that the internal audit did not have an audit committee to report to.

Auditor-General

Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

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