

# **REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND COUNCIL ON THE NKETOANA LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Nketoana Local Municipality set out on pages x to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, and cash flow statement and appropriation statement for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (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 the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and 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 entity'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 entity'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.

### **Opinion**

5. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Nketoana Local Municipality as at 30 June 2014 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**

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

### **Unauthorised expenditure**

7. As disclosed in note 51 to the financial statements, the municipality incurred unauthorised expenditure of R13 227 353 (2013: R31 166 223). The unauthorised expenditure was as a result of the budgeting process not being properly organised.

### **Irregular expenditure**

8. As disclosed in note 53 to the financial statements, the municipality incurred irregular expenditure of R14 622 396 (2013: R15 757 579). The irregular expenditure was as a result of contravention of the supply chain management (SCM) regulations.

### **Material losses**

9. As disclosed in note 32 to the financial statements, the municipality incurred material losses to the amount of R41 712 998 (2013: R29 608 495) as a result of a write-off of irrecoverable trade debtors.
10. As disclosed in note 55 to the financial statements, the municipality incurred material losses to the value of R607 769 (2013: R479 463) as a result of water distribution loss.
11. As disclosed in note 55 to the financial statements, the municipality incurred material losses to the value of R4 318 449 (2013: R5 084 776) as a result of electricity distribution loss.

### **Going concern**

12. Note 49 to the financial statements indicates that the Nketoana Local Municipality incurred a net loss of R75 071 342 (R43 243 511) during the year ended 30 June 2014 and, as of that date. These conditions, along with other matters as set out in note 49, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

### **Restatement of corresponding figures**

13. As disclosed in note 46 to the financial statements, the corresponding figures for 30 June 2013 were restated as a result of an error discovered during 30 June 2014 in the financial statements of the Nketoana Local Municipality at, and for the year ended, 30 June 2013.

### **Additional matter**

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

### **Unaudited disclosure notes**

15. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

### **Unaudited supplementary schedules**

16. The supplementary information set out on pages x to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation as well as 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**

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Vote 6: Roads and storm water on pages x to x
- Vote 7: Water services on pages x to x
- Vote 8: Electricity on pages x to x
- Vote 9: Sewerage on pages x to x

19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

20. 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 development priorities. 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*.

21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

22. I did not raise any material findings on the usefulness and reliability of the reported performance information for roads and storm water; water services; electricity; and sewerage.

### **Additional matter**

23. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected priorities, I draw attention to the following matter:

### **Achievement of planned targets**

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

### **Compliance with legislation**

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

### **Strategic planning and performance management**

26. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

### **Budgets**

27. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

### **Financial statements, performance and annual reports**

28. 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 and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

### **Audit committees**

29. The audit committee did not advise the council on matters relating to performance management, as required by section 166(2)(a) of the MFMA.
30. 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).

### **Procurement and contract management**

31. 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).
32. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
33. Bids were not always evaluated by bid evaluation committees which were composed of at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
34. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
35. 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, 2000 (Act No. 5 of 2000) and SCM regulation 28(1)(a).

36. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the *Preferential procurement regulations*.
37. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
38. Contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
39. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
40. Other SCM role players whose partners had a private or business interest in contracts awarded by the municipality participated in the process relating to that contract, in contravention of SCM regulation 46(2)(f).
41. 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 accordance with SCM regulation 38(1).

#### **Human resource management and compensation**

42. Sufficient appropriate audit evidence could not be obtained that the senior managers dismissed for financial misconduct in a previous position and re-appointed before the expiry of 10 years, in contravention of section 57A of the MFMA.

#### **Expenditure management**

43. Reasonable steps were not taken to prevent unauthorised, irregular, as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

#### **Conditional grants received**

44. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal infrastructure grant allocation, as required by section 12(5) of DoRA.
45. The municipality did not evaluate its performance in respect of programmes or functions funded by the municipal systems improvement grant allocation, as required by section 12(5) of DoRA.
46. The municipality did not evaluate its performance in respect of programmes or functions funded by the local government financial management grant allocation, as required by section 12(5) of DoRA.

#### **Revenue management**

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

### **Asset and liability management**

48. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA .
49. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.
50. The municipality did not establish an investment policy that was adopted by the council, as required by section 13(2) of the MFMA and municipal investment regulation 3(a).

### **Environmental management**

51. The municipality operated three waste disposal sites without a waste management licence or permit, in contravention of section 20(b) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008).

### **Consequence management**

52. Unauthorised, irregular as well as 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.
53. Unauthorised, irregular as well as fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
54. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

### **Internal control**

55. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

### **Leadership**

56. The accounting officer did not ensure that, in all instances, the necessary disclosures made in the financial statements submitted were accurate, and in accordance with the requirements of the standards. The non-compliance with laws and regulations could have been prevented had proper oversight been exercised on compliance.

### **Financial and performance management**

57. There were numerous material misstatements to the financial statements; this was mainly due to management not adequately reviewing the financial statements before submission for auditing to ensure that it complied with the financial reporting framework.

## Governance

58. The audit committee did not review the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).

## OTHER REPORTS

### Investigations

59. At the time of this report, an ongoing investigation was being conducted by independent forensic auditors on request of the bank regarding alleged fraudulent transactions which occurred between 22 and 25 October 2010 from two bank accounts of the municipality. The investigation commenced in the previous financial year. A charge was laid at a police station and suspects were arrested in the previous year. The money that was defrauded was partially recovered. The amount that was not recovered was R1 780 000. The hacking of the cash focus system was being investigated to determine if the bank could be held responsible for the failure in internal controls. The investigation was still ongoing at the reporting date.
60. An investigation was being conducted by the South African Police Service regarding alleged fraudulent procurement transactions from the 2009 to the 2012 financial years. Supporting documentations have been seized by the South African Police Service. The investigation commenced towards the end of the 2013 financial year. The investigation was still ongoing at the reporting date.

*Auditor - General*

Bloemfontein

28 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

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