

# Report of the auditor-general to the Free State Legislature and the 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 ... to ..., which comprise statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of Grap), the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act, 2015 (Act No. 1 of 2015) (Dora) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the 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.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### Payables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence for the amounts disclosed as trade payables, due to the status of the accounting records. I was unable to confirm trade payables by alternative means. Consequently, I was unable to determine whether any further adjustment to trade payables stated at R155 737 055 in the financial statements was necessary.

## **Qualified opinion**

7. In my opinion, except for the effect of the matters described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Nketoana Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of Grap and the requirements of the MFMA and Dora.

## **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 56 to the financial statements, the municipality incurred unauthorised expenditure of R62 703 108 (2015: R5 361 768). The unauthorised expenditure was the result of an improper budgeting process.

### Irregular expenditure

10. As disclosed in note 58 to the financial statements, the municipality incurred irregular expenditure of R8 674 311 (2015: R26 178 926). The irregular expenditure was a result of the contravention of the supply chain management regulations.

### Material losses

11. As disclosed in note 40 to the financial statements, material losses of R23 583 076 (2015: R50 796 221) were incurred as a result of a write-off of irrecoverable trade debtors.

### Material impairment

12. As disclosed in note 7 to the financial statements, consumer debtors from exchange transactions were impaired by R299 214 761 (2015: R242 648 998) and, as disclosed in note 6 to the financial statements, receivables from non- exchange transactions were impaired by R20 368 866 (2015: R17 127 911).

## Going concern

13. Note 55 to the financial statements indicated that the municipality incurred a net loss of R41 264 760 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R107 117 436. In addition, the municipality owed Eskom R99 407 396 (2015: R58 275 786) as at 30 June 2016, which is long overdue. These conditions, along with other matters set forth in note 55, indicated a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

## Restatement of corresponding figures

14. As disclosed in note 53 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

## Significant uncertainties

15. As disclosed in note 50 to the financial statements, the municipality received claims of R17 887 901. The municipality is opposing these claims. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

## Additional matter

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

## Unaudited disclosure notes

17. 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 on it.

## Supplementary information

18. The supplementary information set out on pages xx 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 on them.

## Report on other legal and regulatory requirements

19. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) 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 them.

## **Predetermined objectives**

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016
- Key performance area 1: water on pages xx to xx
  - Key performance area 2: sanitation on pages xx to xx
  - Key performance area 3: roads and storm water management on pages xx to xx
  - Key performance area 7: refuse removal on pages xx to xx
  - Key performance area 8: electricity reticulation on pages xx to xx
21. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance areas. 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 (FMPPi).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected key performance areas.

## **Adjustment of material misstatements**

24. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of key performance area 3: roads and storm water management. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

## **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 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:

## **Annual financial statements**

26. 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 current assets, non-current assets, and expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, but the uncorrected material misstatement resulted in the financial statements receiving a qualified audit opinion.

## **Expenditure management**

27. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
28. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
29. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
30. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Revenue management**

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

## **Human resource management**

32. Job descriptions were not established for all posts in which appointments were made in 2015-16, in contravention of section 66(1)(b) of the Municipal Systems Act.
33. The municipality's annual report did not reflect information on compliance with prescribed minimum competencies, as required by the municipal regulations on minimum competency levels 14(2)(b).

## **Asset management**

34. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
35. 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.
36. Capital assets were disposed of without the approval of the council, as required by section 14(2)(a) of the MFMA.

## **Consequence management**

37. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
38. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).
39. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

## **Compliance budget**

40. Expenditure was in excess of the approved budget, in contravention of section 87(8) of the MFMA.

## **Procurement and contract management**

41. 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).

## **Internal control**

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

## **Leadership**

43. The leadership did not always take prompt and adequate action to address weaknesses in the finance and supply chain management directorate, which resulted in non-compliance with applicable legislation and gave rise to fruitless and wasteful, and irregular expenditure. Oversight provided by leadership was not adequate to prevent material irregular expenditure and to set the standard of sound corporate governance.
44. Deviations from the expected standards of conduct were not followed up to ensure that remedial or disciplinary action was taken in a timely and consistent manner. Internal controls were overridden, which resulted in high levels of irregular expenditure.
45. Consequence management was not effective as the council neglected to appoint a committee to investigate instances of unauthorised, irregular, fruitless and wasteful expenditure to determine whether any person was liable for the expenditure.
46. Key management positions were vacant during 2015-16. Management did not implement effective human resource management to ensure that competent and sufficiently skilled officials were appointed and that performance was monitored.
47. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evident in management's failure to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause. This resulted in the previous year's audit findings recurring in the current year.
48. The leadership did not evaluate whether management had implemented effective internal controls by understanding how senior management met their responsibilities to ensure proper records management, maintain an asset register and prepare the annual financial statements.

## **Financial and performance management**

49. There was a material breakdown of internal controls at the municipality. The monthly and daily controls were not implemented and monitored, which led to a weak control environment.
50. Compliance with legislation was not monitored regularly and non-compliance was not addressed in a timely manner, as management did not implement the action plan based on the previous year's findings.

## **Governance**

51. The appointment of the head of internal audit as the acting chief financial officer hampered the productivity, reliability and independence of the work of the internal audit section.

## **Other reports**

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

## **Investigations**

53. Independent forensic auditors investigated, at the request of the bank, alleged fraudulent transactions that occurred between 22 and 25 October 2010 on two of the municipality's bank accounts. The bank indicated in a letter, Ref. 2030906 dated 2 August 2013, that they were not liable for the loss. Management did not take any action and no evidence could be provided of efforts by the municipality to recover the money or to follow up on the investigation since August 2013. The amount of R1 780 000 was not recovered.
54. The South African Police Service (SAPS) investigated alleged fraudulent procurement transactions that occurred between the 2009 and 2012 financial years. Supporting documentation was seized by the SAPS. The investigation commenced towards the end of the 2013 financial year and was still ongoing at the date of this report.

55. Case was opened with Directorate Priority Crime Investigation into alleged fraudulent procurement transactions between the 2014 and 2015 financial years.

*Auditor General*

Bloemfontein

30 November 2016



**AUDITOR - GENERAL  
SOUTH AFRICA**

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