

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

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Ngwathe 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), 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 my audit. I conducted my audit in accordance with 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 municipality'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 municipality'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 audit opinion.

## Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Ngwathe Local Municipality as at 30 June 2015 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

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

### Irregular expenditure

8. As disclosed in note 49 to the financial statements, irregular expenditure of R35 466 024 was incurred, which was mainly due to non-compliance with supply chain management requirements in respect of procurement transactions.

### Material impairments

9. As disclosed in note 10 to the financial statements, a provision for impairment of debtors amounting to R375 018 193 (2014: R338 445 584) has been made with regard to irrecoverable receivables from exchange transactions

### Material losses

10. As disclosed in note 50 to the financial statements, material water and electricity losses of R310 221 368 (2014: R 156 882 284) and R 156 882 284 (2014: R 56 738 418) respectively were incurred as a result of incorrect and inconsistent billing that occurred in previous years.

### Going concern

11. Note 45 to the financial statements indicates that the Ngwathe Local Municipality incurred a net loss of R277 703 950 during the year and total liabilities exceed total assets by R223 942 830 for 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

### Restatement of corresponding figures

12. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2015 in the financial statements of the Ngwathe Local Municipality at, and for the year ended, 30 June 2014.

## **Additional matter**

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

### Unaudited disclosure notes

14. 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**

15. 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**

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPAs) presented in the annual performance report of the municipality for the year ended 30 June 2015:

- KPA 3 : Economic and environmental services on pages xx to xx
- KPA 4: Trading services on pages xx to xx.

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

18. 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 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* (FMPPPI).

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

20. The material findings in respect of the selected key performance areas are as follows:

### **KPA 3: Economic and environmental services**

#### Usefulness of reported performance information

21. Section 41(c) of the Municipal Systems Act (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 20% of the reported objectives were not consistent with those in the approved integrated development plan. This was due to failure to implement the approved policies and procedures.
22. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 100% of the targets were not specific.
23. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 100% of the targets.
24. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 100% of the indicators were not well defined.
25. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.

This was due to inadequate monitoring and review by management in compiling planning and reporting documentation.

#### Reliability of reported performance information

26. The FMPPI requires municipalities 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. Adequate and reliable corroborating evidence could not be provided for any (100%) of the targets to assess the reliability of the reported performance information. The municipality's records did not permit the application of alternative audit procedures.

### **KPA 4: Trading services**

#### Usefulness of reported performance information

27. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 100% of the targets were not specific.
28. Performance targets should be measurable as required by the FMPPI. I could not measure the required performance for 100% of the targets.
29. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 100% of the indicators were not well defined.
30. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.

This was due to inadequate monitoring and review by management in compiling planning and reporting documentation.

## Reliability of reported performance information

31. The FMPPI requires municipalities 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. Adequate and reliable corroborating evidence could not be provided for any (100%) of the targets to assess the reliability of the reported performance information. The municipality's records did not permit the application of alternative audit procedures.

## Additional matters

32. I draw attention to the following matters. Our conclusion is not modified in respect of these matters:

### Achievement of planned targets

33. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the 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 for the selected key performance areas reported in paragraphs x to xx of this report.

### Unaudited supplementary schedules

34. The supplementary information set out on pages XX to XX does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

## Compliance with legislation

35. 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

36. The performance management system and related controls were inadequate as they did not describe and represent the processes of performance reporting and how it is conducted, organised and managed, including determining the roles of the different role players, as required by sections 38 of the MSA and regulation 7 of the *Municipal planning and performance management regulations*.

## Annual financial statements, performance and annual reports

37. 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

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

38. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
39. The oversight report containing comments on the annual report was not adopted by council within two months from the date on which the 2013-14 annual report was tabled, as required by section 129(1) of the MFMA.

## **Procurement and contract management**

40. 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 supply chain management (SCM) regulations 21(b) and 28(1)(a) and the *Preferential procurement regulations*.
41. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

## **Expenditure management**

42. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

## **Human resource management**

43. An acting chief financial officer was appointed for a period of more than three months without the approval by the MEC, in contravention of section 54A(2A) of the MSA.
44. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff, in contravention of section 67(d) of the MSA.

## **Internal control**

45. 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 findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

46. The leadership did not always take timely and adequate action to address weaknesses in the performance management directorate, which resulted in non-compliance with applicable legislation and gave rise to compliance matters identified. 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 audit findings in the prior year report recurring in the current year for performance information.

## Financial and performance management

47. The municipality did not implement proper record keeping ensuring that complete, relevant and accurate information is accessible and available to support performance reporting. This is due to lack of competence from staff in finance and performance. The municipality did not prepare regular, accurate and complete performance reports that are supported and evidenced by reliable information. The municipality also did not review and monitor compliance with applicable laws and regulations.
48. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure and non-disclosure. In certain instances the municipality did not prioritise the submission of adequate supporting documentation and replies to audit queries during the audit. Certain material audit findings communicated to the municipality during the audit were corrected by management, which resulted material adjustments to the financial statement.

## Governance

49. The municipality did not institute steps based on the risk assessment performed to address risks relating to the performance management system.

*Auditor - General*

Bloemfontein

29 February 2015



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