

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Masilonyana 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 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 qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. I could not trace all the items of property, plant and equipment to the asset register resulting in an understatement of property, plant and equipment as disclosed in note 9 to the financial statements. Due to the nature of the error, I was not able to determine the full extent of the misstatement in property, plant and equipment as it was impracticable to do so. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Payables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence regarding trade payables and unidentified deposits, as creditor reconciliations were not performed and an appropriate register for unidentified deposits were not in place. I was unable to confirm these trade payables and unidentified deposits by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to trade payables and unidentified deposits stated at R73 578 420 and R2 809 225, respectively, in note 13 to the financial statements.

Qualified opinion

8. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Masilonyana 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

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

Restatement of corresponding figures

10. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material losses

11. As disclosed in note 47 to the financial statements, material electricity and water losses of R2 815 278 (2014: R16 411 857) and R4 206 940 (2014: R2 232 636), respectively, were incurred as a result of line losses, tampering and theft.

Material impairment

12. As disclosed in note 6 to the financial statements, a provision for the impairment of debtors of R339 502 858 (2014: R302 030 875) has been made with regard to consumer debts of R360 953 774 (2014: R309 527 974).

Irregular expenditure

13. Irregular expenditure of R7 685 953 (2014: R28 052 420) was incurred by the municipality, as disclosed in note 46 to the financial statements, mainly due to deviations from supply chain procedures.

Going concern

14. Note 42 to the financial statements indicates that the municipality is experiencing financial difficulties. The current liabilities exceed the current assets by R74 935 096 (2014: R69 094 736). Key indicators of the decrease in liquidity are the under-collection of outstanding debts from consumer debtors and a significant portion of the consumer debtors that had to be impaired as disclosed in note 6. The under-collection of consumer debts caused deferred payments to suppliers during the year, resulting in a significant increase in major supplier balances. These conditions, along with other matters as set forth in note 42, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Additional matter

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

Unaudited disclosure notes

16. 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

17. 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

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Key performance area: Infrastructure development and basic service delivery, 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 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).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected key performance areas are as follows:

Key performance area: Infrastructure development and basic service delivery

Usefulness of reported performance information

23. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (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. All the reported objectives were not consistent with those in the approved integrated development plan. This was because the municipality did not have a performance management system and had not established standard operating procedures.
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 39% 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 22% of the indicators were not verifiable.
26. Performance targets should be specific in clearly identifying the nature and required level of performance, as required by the FMPPi. A total of 50% of the targets were not specific.

27. Performance targets should be measurable, as required by the FMPPI. I could not measure the required performance for 39% of the targets.
28. The period or deadline for delivery of targets should be specified, as required by the FMPPI. A total of 33% of the targets were not time bound.
29. The FMPPI requires indicators to relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives. A total of 33% of the indicators did not relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives as per the three-year service delivery and budget implementation plan. This was because all targets were not included in the annual performance report.

The above was due to a lack of proper systems and processes for predetermined objectives.

Reliability of reported performance information

30. The FMPPI 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 due to a lack of standard operating procedures for the accurate recording of actual achievements and the monitoring of the completeness of source documentation in support of actual achievements.

Additional matter

31. I draw attention to the following matter:

Achievement of planned targets

32. 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 23 to 30 of this report.

Compliance with legislation

33. 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

34. The service delivery and budget implementation plan, used for implementing the municipality's delivery of municipal services and annual budget, did not indicate projections for each month of the revenue to be collected (by source) and the operational and capital expenditure (by vote).

35. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
36. The performance management system was not in line with the priorities, objectives, indicators and targets contained in the integrated development plan; and did not clarify the roles and responsibilities of each role player, determine the frequency of reporting and the lines of accountability, relate to employees' performance management processes, and link to the integrated development planning processes, as required by section 38(a) of the MSA and municipal planning and performance management regulation 7(2)(c), (e), (f) and (g).
37. The performance management system did not provide for the monitoring, measuring and review of performance at least once per year, as required by section 41 of the MSA.
38. The performance management system did not provide for policies and procedures to take steps for improvement where performance targets were not met, as required by section 41(1)(d) of the MSA.
39. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
40. Measurable performance targets for the financial year were not set in the integrated development plan, for each of the key performance indicators and with regard to each of the development priorities or objectives, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e).
41. A performance management system and related controls were not in place, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement as well as how it is to be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Audit committee

42. 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.
43. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Financial statements, performance report and annual report

44. 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, current liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

45. The 2013-14 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
46. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2013-14 annual report had been tabled, as required by section 129(1) of the MFMA.
47. The annual performance report for the year under review did not include the performance of the municipality, a comparison of the performance with set targets and with the previous financial year, and measures taken to improve performance, as required by section 46(1) of the MSA.

Expenditure management

48. Sufficient appropriate audit evidence could not be obtained that money owed by the municipality had always been paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
49. 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.

Procurement and contract management

50. The performance of contractors and providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

Human resource management and compensation

51. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff, in contravention of section 67(d) of the MSA.

Liability management

52. 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.

Asset management

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

Internal control

54. 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 the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

55. The leadership of the municipality did not exercise effective oversight to address the risks in the internal controls of the municipality. Timely and adequate action was not taken to address weaknesses, which resulted in non-compliance with applicable legislation and gave rise to unauthorised, irregular as well as fruitless and wasteful expenditure.
56. Critical vacancies were not addressed, which had a further negative impact on the internal controls. The slow appointment process hindered the filling of vacancies.

Financial and performance management

57. The municipality did not have a proper filing system that supported the reported financial and performance information. This included information that related to the collection, collation, verification, storing and reporting of actual data and reconciliations supporting the financial statements and performance reporting. This was mainly due to a lack of capacity and sufficient office and storage space for the proper filing of documentation. Due to a lack of capacity, there was also a high reliance on the work of consultants.

Governance

58. As the audit committee did not function for the entire financial year, the committee did not promote accountability and service delivery by evaluating and monitoring responses to risks and by providing oversight of the effectiveness of the internal control environment, financial and performance reporting and compliance with laws and regulations.


Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence