

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 was engaged to audit the financial statements of the Masilonyana Local Municipality set out on pages xx to xx, which comprise the 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 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of Grap) and the requirements of the Municipal Finance Management Act, 2003 (Act no.56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act no.15 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 conducting the audit in accordance with the International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable 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 for work in progress included in property, plant and equipment due to insufficient record keeping by the municipality. Furthermore, not all infrastructure assets and work in progress projects accounted for in the asset register could be verified, while certain land, infrastructure assets and movable assets were not included in the asset register. I was unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment relating to property, plant and equipment, stated at R634 078 239 (2015: R600 794 937) in note 10 to the financial statements, was necessary. In addition, the

municipality classified land and buildings as property, plant and equipment, although it was uncertain that the future economic benefits or service potential associated with the buildings will flow to the municipality in accordance with SA Standards of GRAP, GRAP 17, *Property plant and equipment*. Consequently, land included in property, plant and equipment was overstated by R14 346 320 and accumulated surplus understated by R14 346 320.

Payables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence regarding trade payables included in payables from exchange transactions, as creditor reconciliations were not performed. I was unable to confirm these trade payables by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to trade payables, stated at R99 174 704 (2015: R74 661 899) in note 14 to the financial statements. In addition, the municipality did not record all invoices received from suppliers before the year end as trade payables in accordance with SA Standards of GRAP, GRAP 1, *Presentation of financial statements*. Consequently, trade payables and expenditure were understated by R18 329 298 (2015: R5 458 743). There was a consequential impact on the deficit for the period and on the accumulated surplus.

Service charges

6. I was unable to obtain sufficient appropriate audit evidence that all service charges were accounted for on the billing system for 2015-16, due to insufficient record keeping. I was unable to confirm the income by alternative means. Consequently, I was unable to determine whether any adjustment to service charges, stated at R88 250 813 in note 20 to the financial statements, was necessary. In addition, incorrect tariffs and consumption were levied to consumer accounts, resulting in service charges and consumer debtors being overstated by R45 863 428. There was a consequential impact on the deficit for the period and on the accumulated surplus.

Investment property

7. I was unable to obtain sufficient appropriate audit evidence for investment properties as it is unclear whether a formal decision was taken relating to the use of these properties. I was unable to determine how these properties should be accounted for by alternative means. Consequently, I was unable to determine whether any adjustment relating to investment properties, stated at R68 183 789 (2015: R69 034 281) in note 9 to the financial statements, was necessary. In addition, the municipality classified land and buildings as investment properties, although it was uncertain that the future economic benefits or service potential that are associated with the building will flow to the municipality in accordance with SA Standards of GRAP, GRAP 16, *Investment property*. Consequently, investment properties were overstated by R18 808 129 (2015: R19 254 428) and accumulated surplus understated by R18 808 129 (2015: R19 254 428).

Property rates

8. I was unable to obtain sufficient appropriate audit evidence that all property rates were accounted for on the billing system for 2015-16, as evidence that all properties were included on the valuation roll could not be provided and proper reconciliations between the valuation roll and the billings system were not done. I was unable to confirm the property rates by alternative means. Consequently I was unable to determine whether

any adjustment relating to property rates, stated at R35 060 357 in note 24 to the financial statements, was necessary.

Provisions

9. I was unable to obtain sufficient appropriate audit evidence for the environmental rehabilitation included in provisions, as the municipality did not consider the contaminated area and the useful lives could not be determined accurately due to a shortage of available field data. I was unable to confirm the provision for environmental rehabilitation by alternative means. Consequently, I was unable to determine whether any adjustment relating to the environmental rehabilitation, stated at R27 036 766 (2015: R28 499 921) in note 18 to the financial statements, was necessary.

VAT receivable

10. I was unable to obtain sufficient appropriate audit evidence for the VAT receivable, as VAT reconciliations were not performed. I was unable to confirm the correctness of the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustment to the VAT receivable, stated at R11 177 593 (2015: R15 795 107) in note 6 to the financial statements, was necessary.

Consumer debtors

11. The municipality did not recognise all consumer debtors in accordance with SA Standards of GRAP, GRAP 9, *Revenue from exchange transactions*, as debtors that were in the name of the municipality was incorrectly included in consumer debtors. Consequently, consumer debtors and accumulated surplus were overstated by R5 897 061 in note 7 to the financial statements.

Disclaimer of opinion

12. 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 the financial statements.

Emphasis of matters

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

Restatement of corresponding figures

14. As disclosed in note 46 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

15. As disclosed in note 44 to the financial statements, material electricity and water losses of R16 635 257 (2015: R2 815 278) and R2 230 407 (2015: R4 206 940), respectively, were incurred as a result of line losses, tampering and theft.

Material impairment

16. As disclosed in note 7 to the financial statements, a provision for the impairment of debtors of R417 332 805 (2015: R339 502 858) had been made with regard to irrecoverable consumer debtors.

Going concern

17. Note 48 to the financial statements indicates that the municipality's current liabilities exceeded its current assets by R110 264 367 as at 30 June 2016. In addition, unspent conditional grants were not cash-backed and creditors were not paid on time. These conditions, along with other matters as set forth in note 48, indicated a material uncertainty that may cast significant doubt on the municipality's ability to meet its service delivery objectives.

Irregular expenditure

18. Irregular expenditure of R27 838 704 (2015: R7 685 953) was incurred by the municipality, as disclosed in note 43 to the financial statements, mainly due to non-compliance with supply chain management (SCM) requirements.

Additional matters

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

Unaudited disclosure notes

20. 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.

Report on other legal and regulatory requirements

21. In accordance with the Public Audit Act, 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 of 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

22. 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: basic service delivery on pages x to x
23. 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).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected key performance area are as follows:

Key performance area: basic service delivery

Reliability of reported performance information

26. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable 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 information, and the auditee's records not permitting the application of alternative audit procedures.

Additional matters

27. I draw attention to the following matters:

Achievement of planned targets

28. Refer to the annual performance report on pages 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 reliability of the reported performance information in paragraph 22 of this report.

Adjustment of material misstatements

29. 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 1: basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information.

Compliance with legislation

30. 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

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

Procurement and contract management

32. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements and in a procurement process which is fair, equitable, transparent and competitive, as not all tender documents were provided for audit.
33. Thresholds for local content on designated sectors' procurement were not properly applied in accordance with the requirements of preferential procurement regulation 9.
34. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) and did not qualify for the contract, in contravention of section 18(1) of the CIDB Act, 2000 (Act No.38 of 2000) and CIDB regulations 17 and 25(7A).
35. The performance of contractors or providers was not monitored monthly, as required by section 116(2)(b) of the MFMA.
36. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
37. Awards were made to providers who were in the service of other state institutions or whose directors or principal shareholders 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, as required by SCM regulation 38(1).
38. Persons in the 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. This was in contravention of SCM regulation 46(2)(e), the code of conduct for councillors and the code of conduct for staff members issued in terms of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

Expenditure management

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

Conditional grants received

43. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the Dora.
44. The regional bulk water infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of the Dora.

Revenue management

45. Revenue due to the municipality was not calculated monthly, as required by section 64(2)(b) of the MFMA.
46. Accounts for municipal tax and charges for municipal services were not prepared monthly, as required by section 64(2)(c) of the MFMA.

Asset management

47. 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.

Liability management

48. 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.

Internal control

49. I considered internal control relevant to my audit of the financial statements, annual 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 annual performance report and the findings on compliance with legislation included in this report.

Leadership

50. The leadership of the municipality did not effectively oversee the internal controls of the municipality to address their risks. Prompt and adequate action was not taken to address weaknesses, which resulted in material misstatements in the financial statements and non-compliance with applicable legislation, and gave rise to unauthorised, irregular, and fruitless and wasteful expenditure.
51. Critical vacancies were not addressed, which had a further negative impact on the basic daily and monthly internal controls. The slow appointment process hindered the filling of vacancies.

Financial and performance management

52. 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 skills and sufficient office and storage space to properly file documentation. Due to a lack of capacity, there was also a high reliance on the work of consultants for financial reporting.
53. The financial statements were not properly reviewed for completeness and accuracy prior to their submission for auditing. Audit findings communicated to the municipality during the audit were corrected by management, which resulted in material adjustments to the financial statements.

Governance

54. Although there was a functioning audit committee and internal audit unit, they provided limited assurance over financial and performance reporting.

Auditor General

Bloemfontein

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence