

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Mantsopa 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 the 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 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 was unable to obtain sufficient appropriate audit evidence regarding land included in property, plant and equipment as the municipality did not provide me with adequate documentation to support the values of the land. I was unable to confirm the land by alternative means. Consequently, I was unable to determine whether any adjustment relating to land included in property, plant and equipment stated at R66 202 690 (2014: R66 202 690) in note 12 to the financial statements was necessary. In addition, the municipality did not recognise property, plant and equipment in accordance with SA Standards of GRAP, GRAP 17 *Property, plant and equipment*. The municipality did not recognise all its items of property, plant and equipment on the asset register and also incorrectly impaired assets that were still in use, resulting in property, plant and equipment being understated by R128 359 814. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Service charges

7. I was unable to obtain sufficient appropriate audit evidence for income from service charges as the municipality did not have adequate systems in place for the correct monthly billing of all consumers. I could not confirm service charges income by alternative means. Consequently, I was unable to determine whether any adjustment relating to service charges income stated at R89 301 352 (2014: R90 971 747) in note 20 to the financial statements was necessary. In addition, the municipality did not recognise revenue from exchange transactions in accordance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions*, due to estimates being charged on meters that were broken as well as incorrect service charges being levied on consumer accounts. This resulted in service charges and receivables from exchange transactions being overstated by R34 714 082, respectively. A similar misstatement was identified in the prior year and I was unable to quantify the amount as it was impracticable to do so. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Trade receivables from exchange transactions

8. I was unable to obtain sufficient appropriate audit evidence for trade receivables from exchange transactions as internal controls had not been established for the correct monthly billing of all consumers. I could also not confirm the calculation of the provision for impairment of receivables. I was unable to confirm the trade receivables by alternative means. Consequently, I was unable to determine whether any adjustments relating to the trade receivables from exchange transaction stated at R38 013 721 (2014: R38 099 111) in note 8 to the financial statements were necessary.

Property rates

9. I was unable to obtain sufficient appropriate audit evidence for income from property rates as the municipality did not have adequate systems of internal control in place for the reconciliation of the valuation roll and the accounting system. I was unable to confirm income from property rates by alternative means. Consequently, I was unable to determine whether any adjustment to property rates stated at R12 437 677 (2014: R12 668 156) in note 23 to the financial statements was necessary.

Distribution losses

10. I was unable to obtain sufficient appropriate audit evidence for water and electricity distribution losses as the municipality did not have adequate systems for the measurement of usage of water and electricity. I was unable to confirm the water and electricity distribution losses by alternative means. Consequently, I was unable to determine whether any adjustments relating to the distribution losses stated at R13 900 766 (2014: R14 197 697) in note 50 to the financial statements were necessary.

Qualified opinion

11. 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 Mantsopa Local Municipality as at 30 June 2015 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

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

Restatement of corresponding figures

13. As disclosed in note 43 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.

Irregular expenditure

14. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R32 029 652 (2014: R7 160 157) during the year under review mainly due to non-compliance with supply chain management requirements.

Going concern

15. Note 56 to the financial statements indicates that the municipality incurred a net loss of R113 919 512 (R2014: R1 138 900) during the year ended 30 June 2015 and the municipality's current liabilities exceeded its current assets by R35 547 937 (2014: R18 719 709). These conditions, along with other matters as set forth in the note 56, 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

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

Unaudited supplementary schedules

17. The supplementary information set out on pages x to x 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.

Unaudited disclosure notes

18. 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

19. 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

20. 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 1: Service delivery and infrastructure development on pages x to x
21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
22. 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).
23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. The material findings in respect of the selected key performance areas are as follows:

Key performance area 1: Basic service delivery and infrastructure development

Usefulness of reported performance information

25. Section 41(1)(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 83% of the reported objectives, indicators and targets were not consistent with those in the approved service delivery and budget implementation plan (SDBIP). This was due to management not implementing the necessary monitoring controls to ensure that planned objectives and indicators are consistent between the SDBIP and planned objectives and indicators as reported in the annual performance report

Reliability of reported performance information

26. FMPPi requires the municipality 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. The reported performance information was not valid, accurate and complete when compared to the source information or evidence provided. This was due to lack of policies and procedures to guide operations in support of the reported performance.

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 usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs 25 to 26 of this report.

Unaudited supplementary schedules

29. The supplementary information set out on pages x to x 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

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:

Strategic planning and performance management

31. The municipality did not fully establish a performance management system, as required by section 38(a) of the MSA.
32. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation, electricity and solid waste removal as required by section 43(2) of the MSA and the municipal planning and performance management regulation 10(a).
33. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting, improvement 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 municipal planning and performance management regulation 7.
34. The SDBIP 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, as required by section 1 of the MFMA.
35. The performance of the municipality were not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.
36. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan, did not clarify the roles and responsibilities of each role-player and did not relate to the employee's performance management processes as required by section 38(a) of the MSA and municipal planning and performance management regulation 7(2)(c) and (f).

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

Expenditure management

- 38. 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.
- 39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Liability management

- 40. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

Revenue management

- 41. An effective system of internal control for revenue and related debtors was not in place, as required by section 64(2)(f) of the MFMA.
- 42. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality was calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

Asset management

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

Consequence management

- 44. The condonation of irregular expenditure was not approved by the appropriate relevant authority as required by section 1 and 170 of the MFMA.
- 45. Authorisation of unauthorised expenditure was not done through an adjustment budget as required by section 32(2)(a)(i) of the MFMA.

Audit committee

- 46. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA as the audit committee did not consist of at least three independent members throughout the financial year.

Procurement and contract management

- 47. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by supply chain management regulation (SCM) 17(a) and (c).
- 48. 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 regulation 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

49. Contracts 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, 2000 (Act No. 5 of 2000) (PPPFA).
50. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
51. Construction contracts were awarded to contractors that did not qualify for the contract, in accordance with section 18(1) of the Construction Industry Development Board Act, 2000 (Act No. 38 of 2000) (CIDB) and CIDB regulations 17 and 25(7A).
52. Persons in service of the municipality whose business partners had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of the MSA.
53. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of PPPFA and SCM regulation 28(1)(a).

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

Leadership

55. Effective oversight responsibility regarding financial and performance reporting, compliance with laws and regulations and the related internal controls was not always exercised mainly due to lack of consequences for poor performance and transgressions as repeat findings were raised in the current year. This has resulted in non-compliance with applicable legislation that gave rise to a significant increase in irregular and fruitless expenditure.
56. The municipality developed a plan to address internal and external audit findings, but adherence to the plan was not always monitored on a timely basis by the appropriate level of management to improve the general control environment, resulting in audit findings reported in the prior year being reported again in the current year. This was mainly due to slow response by leadership as the recommendations made in the prior years were not prioritised for implementation.

Financial and performance management

57. Ongoing monitoring and supervisory reviews over financial, performance and compliance reporting were not adequate. Internal controls weaknesses were thus not identified and corrected in time to ensure accurate and complete reporting. This was due to lack of consequences as the municipality has not implemented a performance management system that holds employees accountable for poor performance and lack of commitment to assigned responsibilities. Supervisory reviews over the work

performed by consultants and implementation of daily and monthly disciplines and were not adequate resulting in material corrections to financial statements.

Governance

58. The governance structures did not influence an improvement in the control environment of the local municipality which is mainly due to the fact that the audit committee was not appropriately constituted during the financial year.
59. The draft annual financial statements were not adequately reviewed by the audit committee which resulted in material errors being identified in the annual financial statements submitted for auditing.
60. The implementation of recommendations made by the internal audit division and Auditor General based on findings raised in the current and prior year respectively were not adequately monitored by the executive management. This resulted in findings reported in the prior year being reported in the current year.

Auditor - General

Bloemfontein

15 December 2015



AUDITOR - GENERAL
SOUTH AFRICA

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