



AUDITOR - GENERAL
SOUTH AFRICA

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FINAL MANAGEMENT REPORT

MANTSOPA LOCAL MUNICIPALITY

30 June 2018

Communicated to the accounting officer on: 29 November 2018





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MANAGEMENT REPORT

Mantsopa Local Municipality

30 June 2018

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MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE MANTSOPA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 June 2018

INTRODUCTION

1. The purpose of the management report is to communicate audit findings and other key audit observations to the accounting officer and does not constitute public information. This management report includes audit findings arising from the audit of the financial statements, performance information and compliance with legislation for the year ended 30 June 2018.
2. These findings were communicated to management and the report details management's response to these findings. The report includes information on the internal control deficiencies that we identified as the root causes of the matters reported. Addressing these deficiencies will help to improve the audit outcome.
3. In accordance with the terms of engagement, our responsibility in this regard is to:
 - express an opinion on the financial statements
 - express a conclusion in the management report on the usefulness and reliability of the reported performance information for selected development objectives, and report the material findings in the auditor's report
 - report on material findings raised on compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

Our engagement letter sets out our responsibilities and those of the accounting officer in detail.
4. This management report consists of the overall message arising from the audit, summary of key findings and observations, annexures containing the detailed audit findings, annexures to the report on the audit of performance information as well as the annexure to internal control deficiencies reported.
5. The auditor's report is finalised only after the management report has been communicated. All matters included in this report that relate to the auditor's report remain in draft form until the final auditor's report is signed. In adherence to section 50 of the PAA, we do not disclose any information obtained during the audit and contained in this management report, unless requested in terms of section 18 (4) of the PAA.
6. Please note that the information contained in these documents is confidential, privileged and only for the information of the intended recipient(s) and may not be used, published or redistributed without the prior written consent of the Auditor-General of South Africa (AGSA). Any form of reproduction, dissemination, copying, disclosure, modification, distribution and or publication of this material is strictly prohibited. Should the information be used or processed in a manner that contravenes any laws in the Republic, the AGSA is fully indemnified from liability that may arise from such contravention.
7. The **figure** that follows provides a pictorial summary of the audit results and our key messages on how to improve the audit outcomes with the focus on the following:
 - Status of the audit outcomes



- Status of the level of assurance provided by key role players
- Status of the drivers of internal controls
- Status of risk areas
- Root causes to be addressed

Movement from the previous year is depicted as follows:

 /  Improved

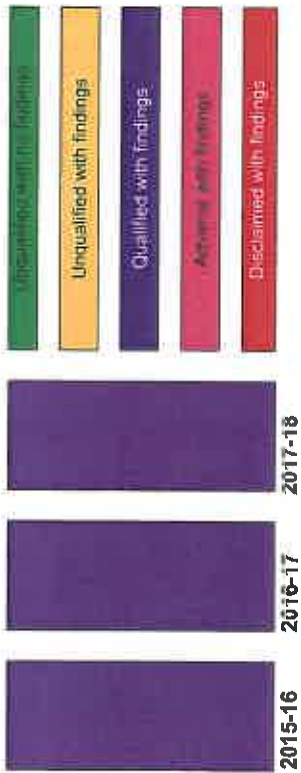
 /  Unchanged/slight improvement/slight regression

 /  Regressed



Stagnation in audit outcomes

Types of audit outcomes



To improve the **audit outcomes** ...
... the **root causes** are addressed...



...the risk areas, and ...



...any role players need to assure that...

... attention is given to the **key controls**, and ...

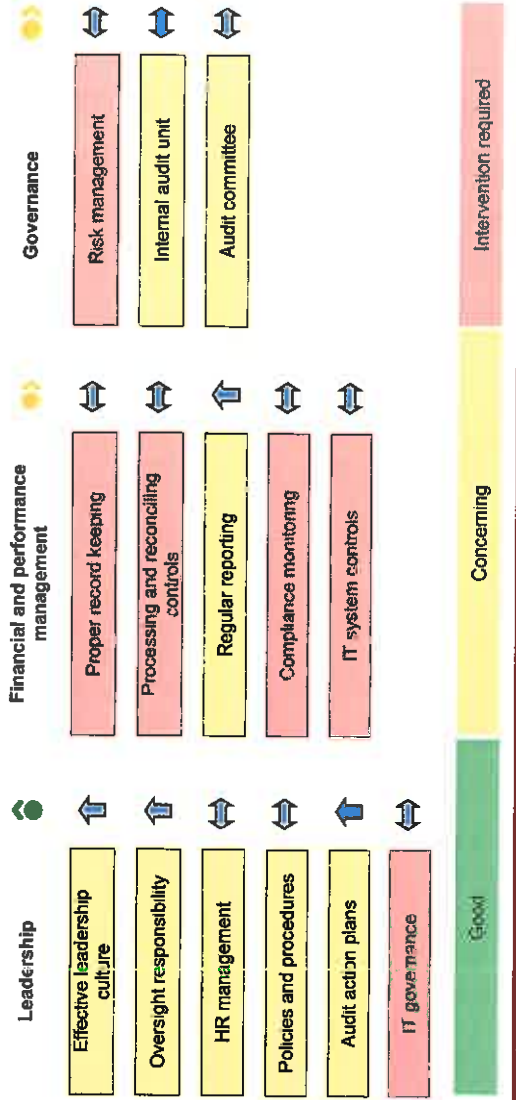
Root causes should be addressed

- Slow implementation of audit action plan.
- Lack of proper record keeping to support financial and performance reporting
- SCM processes not properly followed

Risk areas



Status of the drivers of internal controls



OVERALL MESSAGE

8. The audit outcome of Mantsopa Local Municipality has remained stagnant with the municipality achieving qualified opinion with findings on performance information and compliance with laws and regulations from 2015-16 to 2017-18 financial years.
9. There has also not been an improvement in the quality of the financial statements and performance reports submitted for auditing. The municipality did not address supply chain management challenges reported in the prior year and the status of information systems and financial health remains a cause for concern.
10. This was mainly due to lack of improvements in the status of drivers of key controls to address significant risks to financial and performance reporting as root causes have not been addressed and or assurance levels improved.

SECTION 1: Interactions with stakeholders responsible for oversight and governance

11. During the audit cycle, we met with the following key stakeholders responsible for oversight and governance to communicate matters relating to the audit outcome:

Key stakeholder	Purpose of interaction	Number of interactions
Municipal public accounts committee	Issues impacting audit outcomes	1
Executive mayor	Progress of the audit	1
Municipal manager	Audit steering committee meeting (incl. draft management report and audit report discussion)	5
Audit committee	Discussion of audit strategy and the draft management and auditors reports	2

12. At these interactions, the following key matters affecting audit outcomes and the auditee were discussed.
 - Significant matters affecting the audit outcomes including actual audit outcomes
 - Management and reporting on key infrastructure projects
13. The stakeholders did not make formal commitments to the AGSA with clearly defined timelines on measures to improve the audit outcomes.

SECTION 2: Matters relating to the auditor's report**AUDIT OF THE FINANCIAL STATEMENTS**

14. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the municipality's system of internal control. These material misstatements also constitute non-compliance with section 122 of the Municipal Finance Management Act (MFMA).
15. The misstatements that were not corrected form the basis for the qualified opinion on the financial statements.

Material misstatement				
Financial statement item	Finding	Occurred in prior year (Insert Yes/No)	Impact R current year	Impact R previous year
Material misstatements not corrected				
Revenue				
Revenue from exchange transactions(Services charges) (CoaF -60)	Revenue: Service Charges:(Water & Electricity) - Disagreements due to differences between Consbill and meterbooks readings.	No	22 351 153	0
Material misstatements corrected				
Non-current assets				
Investment property (CoaF- 89)	Investment Property: Recalculation for the valuation of investment properties could not be performed.	Yes	160 832 948	232 527 582,73
Property, Plant and Equipment (CoaF – 71)	PPE - Limitations with regards to the application of Directive 7.	Yes	245 267 008	213 891 026
Property, Plant and Equipment (CoaF – 93)	PPE[Land]: Limitation of scope with regard to the valuation of land.	No	198 273 925	0
Property, Plant and Equipment (CoaF – 93)	PPE[Infrastructure]: Limitation of scope regarding the current replacement cost used for valuation.	No	654 387 259	0
Property, Plant and Equipment (CoaF – 95)	PPE[Community assets]: Limitation of scope: No supporting documentation obtained for the restatement.	No	27 912 634	0



Financial statement item	Material misstatement		Impact R current year	Impact R previous year
	Finding	Occurred in prior year (Insert Yes/No)		
Investment property (CoaF - 89)	Investment Property: Recalculation for the valuation of investment properties could not be performed.	Yes	160 832 948	232 527 582,73
Investment property (CoaF - 89)	Investment Property: Fair value adjustment calculation could not be performed.	No	36 133 869	0
Disclosures				
Irregular expenditure (CoaF -34) (CoaF - 35) (CoaF-36) (CoaF - 55)	Misstatements identified during the audit.	Yes	0	9 191 671

MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS

Emphasis of matter paragraphs

16. The following emphasis of matter paragraphs will be included in our auditor's report to draw the users' attention to matters presented or disclosed in the financial statements:

Unauthorised expenditure

17. As disclosed in note 46 to the financial statements, the municipality incurred unauthorised expenditure of R169 756 083 (2017: R96 701 149) in the year under review, due to the overspending of the approved budget.

Irregular expenditure

18. As disclosed in note 48 to the financial statements, the municipality incurred irregular expenditure of R1 894 934 (2017: R7 344 653), and R9 191 671 was identified in the current year in respect of prior years. The irregular expenditure was mainly due to non-compliance with Supply Chain Management (SCM) Regulations.

Fruitless and wasteful expenditure

19. As disclosed in note 47 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R15 616 019 (2017: R14 234 005) during the year, due to interest and penalty charges on the late payment of suppliers.

Restatement of corresponding figures

20. As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Material losses

21. As disclosed in note 52 to the financial statements, water distribution losses of R1 969 373 (2017: R1 724 285) and electricity distribution losses of R13 348 706 (2017: R13 973 066) were incurred, which represented 49% (2017: 42%) and 32% (2017: 32%) of the total water and electricity purchased, respectively. These losses by the municipality were due to illegal connections, leakages, burst water pipes, line losses, tampering and theft.

Material impairment

22. As disclosed in note 7 to the financial statements, receivables from exchange and non-exchange transactions were impaired by R289 435 060 (2017: R167 607 378).

Material uncertainty relating to going concern

Going concern

23. I draw attention to the matter below. My opinion is not modified in respect of this matter.
24. Note 45 to the financial statements indicates that the municipality incurred a net loss of R107 376 653 during the year ended 30 June 2018 and, as of that date, the municipality's current liabilities exceeded its current assets by R132 657 475. The municipality has been



deducting pension, medical aid and pay as you earn from employees' salaries, but has been unable to pay over R10 270 321 (2017: R4 239 781) of these amounts to the relevant third parties as disclosed in note 48. In addition, the municipality owed Eskom R135 354 844 (2017: R129 699 446) as at 30 June 2018, which is long overdue. These events or conditions, along with other matters as set forth in note 45, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Other matter paragraphs

25. The following other matter paragraphs will be included in our auditor's report to draw the users' attention to matters regarding the audit, the auditor's responsibilities and the auditor's report:

Unaudited disclosure notes

26. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, we do not express an opinion thereon.

Unaudited supplementary schedules


27. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. We have not audited these schedules and, accordingly, we do not express an opinion on them.

AUDIT OF THE ANNUAL PERFORMANCE REPORT

28. In terms of the general notice issued in terms of the PAA, the opinion on the audit of reported information will be included in the management report. The report is included below to enable management and those charged with governance to see what the report will look like once it is published in the auditor's report. We will report all the audit findings included under the basis for opinion and the other matter sections of this report in the auditor's report

Introduction and scope

29. We have undertaken a reasonable assurance engagement on the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2018:

Key Performance Areas	Pages in annual performance report	Opinion	Movement
KPA 1 – basic service and infrastructure development	x – x	Qualified	

30. We conducted our reasonable assurance engagement in accordance with the International Standard on Assurance Engagements, ISAE 3000: *Assurance engagements other than audits or reviews of historical financial information*.

31. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

KPA 1 – basic service and infrastructure development

Basis for Qualified opinion

32. In our opinion, except for the effects of the matter described in the basis for qualified opinion section of our report, the reported performance information for Basic services and development infrastructure is useful and reliable in accordance with the applicable criteria as developed from the performance management and reporting framework set out in annexure D to this report.

Basis for Qualified opinion

Monthly clearing of 35 illegal dumping sites

33. The planned target for this indicator was not specific in clearly identifying the nature and required level of performance or measurable.

Various indicators

34. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators were as follows:

Indicator description	Reported achievement	Audited value
Number of storm water channels maintained	4	8
Square metres of potholes repaired	18 703	0
Kilometres of roads gravelled	8 094	0
Monthly Clearing of 35 illegal dumping sites	760	1 295

Other matters

35. We draw attention to the matters below. Our opinion is not modified in respect of these matters.

Achievement of planned targets

36. Refer to the annual performance report on pages xx to xx for information on the achievement of 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 in paragraphs 28 to 29 of this report.

Adjustment of material misstatements

37. We identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1 – basic service and infrastructure development. As management subsequently corrected only some of the misstatements, we raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.



Responsibilities of the accounting officer for the reported performance information

38. The accounting officer is responsible for the preparation of the annual performance report in accordance with the prescribed performance management and reporting framework, as set out in annexure D to this report and for such internal control as the accounting officer determines is necessary to enable the preparation of performance information that is free from material misstatement in terms of its usefulness and reliability.

Auditor-general's responsibilities for the reasonable assurance engagement on the reported performance information

39. Our objectives are to obtain reasonable assurance about whether the reported performance information for the selected objectives presented in the annual performance report is free from material misstatement, and to issue a management report that includes our opinions. Reasonable assurance is a high level of assurance, but is not a guarantee that the assurance engagement conducted in accordance with the relevant assurance standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the relevant decisions of users taken on the basis of the reported performance information.
40. Our procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. We have not evaluated the appropriateness of the performance indicators established and included in the planning documents. Our procedures do not extend to any disclosures or assertions relating to planned performance strategies and information relating to future periods that may be included as part of the reported performance. Accordingly, our opinion does not extend to these matters.
41. A further description of our responsibilities for the reasonable assurance engagement on reported performance information is included in annexure E to this report.

AUDIT OF COMPLIANCE WITH LEGISLATION

42. Included below are material findings on compliance with selected specific requirements of applicable legislation, as set out in the general notice issued in terms of the PAA.

Annual Financial Statements

43. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were subsequently provided, 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

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
45. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
46. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R15 565 864, as disclosed in note 46 to the annual financial statements, in contravention of

section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest on overdue accounts to suppliers.

47. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R169 756 083, as disclosed in note 45 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Revenue management

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

Asset management

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

Consequence management

50. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
51. Authorisation of unauthorised expenditure amounting to R169 756 083 was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.
52. Irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
53. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Procurement and contract management

54. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
55. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
56. The contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA. Similar non-compliance was also reported in the prior year.
57. Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of MFMA 112(j) 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).

58. Persons in 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, in contravention of SCM regulation 46(2)(e) issued in terms of the Municipal Systems Act.

OTHER INFORMATION

59. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected objectives presented in the annual performance report that have been specifically reported in the auditor's report.
60. Our opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.
61. In connection with our audit, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objectives presented in the annual performance report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

INTERNAL CONTROLS

62. The significant deficiencies in internal control which led to our overall assessment of the status of the drivers of key controls, as included in the figure in paragraph 7, is described below. The detailed assessment of the implementation of the drivers of internal control in the areas of financial statements, performance reporting and compliance with legislation is included in annexure F.

Leadership

Effective leadership culture

63. The accounting officer did not implement adequate processes to review the financial statements and the annual performance report before submitting them for audit, therefore material misstatements were not identified and or timely corrected.

Oversight responsibility

64. The municipality developed an action plan to address the external audit findings raised in the prior year, however the appropriate level of management did not monitor adherence to the plan in a timely manner resulting in several repeat findings identified during the current audit.

Human resource management

65. The municipality has developed an HR plan however the plan was not approved and implemented for the year under review. This issue was raised in the prior year and the municipality did not take the appropriate actions to ensure that the matter is resolved in the current year.

Policies and procedures

66. Although there are documented policies and procedures to guide the operations of the municipality, adherence to compliance with the set policies and procedures are not always monitored, as a result, numerous instances of non-compliance were identified and reported.



Action plans to address internal control deficiencies

67. Although management developed an action plan to address external audit findings, it was not fully implemented which resulted in repeat findings during the current year under review.

Information technology governance framework

68. Lack of consequence management for not resolving prior audit findings, as most prior IT governance audit findings such as IT steering committee was not sitting as required, service providers were not monitored and policies were not approved on time.
69. Instability in the information technology division as the IT manager was not filled (acting capacity).

Financial and performance management

Proper record keeping

70. Management did not implement processes to ensure that adequate and complete records are available to support financial and performance reporting as reported performance could not be corroborated to supporting documents.

Daily and monthly processing and reconciling of transactions

71. Management did not implement monthly reconciliation for payables, assets and investment property which resulted in significant findings being reported in the current year.

Regular, accurate and complete financial and performance reports

72. Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information which resulted in significant finding being reported in financial statements and performance reports.

Compliance monitoring

73. Management did not implement adequate processes to ensure compliance with legislation and HR and SCM regulations are adhered to and monitored regularly.

Information technology systems

74. Lack of consequence management for not resolving prior audit findings such as access controls over the financial systems, security controls to prevent the unauthorised access to IT systems that generate the information used to prepare the financial statements and IT service continuity for managing the availability of hardware, system software, application software and data to enable the municipality to recover/re-establish information systems services in the event of a disaster.
75. Inadequate electronic funds Transfer (EFT) controls were as a result of management assuming that the risk around this process was substantially mitigated by compensating controls such as the review of the bank generated payment files against the original source documents, which was performed by the creditors section.

Governance

Risk management activities and risk strategy

76. Although risk management strategies are prepared, they were not comprehensive enough and were not effectively used by management to mitigate risks pertaining to financial and



performance reporting and the risk committee did not meet four times a year to deal with risk issues effectively.

Internal audit

77. Lack of adequate resources and capacity issues in the internal audit unit to carry out its duties efficiently and effectively for the municipality.

Audit committee

78. The municipality did have an audit committee which met four times during the year under review however its efficiency and effectiveness could not be confirmed this is evidenced by the audit outcomes of the municipality.

Summary

79. The matters above, as they relate to the basis for the qualified opinion, findings on the annual performance report and findings on compliance with legislation, will be summarised in the auditor's report as follows:

80. Leadership did not provide sufficient oversight over financial and performance reporting and compliance and related internal controls, as material repeat findings were identified in the current year.

81. Leadership did not implement adequate and effective monitoring controls over the implementation of actions to address prior year reported matters. This has resulted in repeat findings that have not been addressed.

82. Leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, as no official was held responsible for the unauthorised, irregular, and fruitless and wasteful expenditure incurred by the municipality

83. Management did not prioritise the review and monitoring of compliance with legislation, which resulted in repeat findings being reported. This was due to lack of consequence management as officials were not held accountable for non- compliance.

84. Management did not implement adequate review and supervisory controls over financial and performance reporting so that errors could be timely identified and corrected resulting in significant repeat findings that could have been prevented.

85. Management did not adequately implement risk management strategies to prevent or mitigate risks relating to financial and performance reporting, as risks to financial and performance reporting were not timeously detected or prevented. This was mainly due to the inadequate implementation of risk strategies by management.

SECTION 3: Assurance providers and status of implementation of commitments and recommendations

ASSESSMENT OF ASSURANCE PROVIDERS

86. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance. One of the important oversight functions of the municipal council is to consider auditees' annual reports. To perform this oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report includes our auditor's report, which provides assurance on the credibility of the financial statements and the annual performance report, as well as on the auditee's compliance with legislation.
87. Our reporting and oversight processes reflect on past events, as they take place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.
88. We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in section 2) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

First level of assurance

Senior management: provides some assurance

- Senior management was actively involved in the running of the operations of the municipality and the level of assurance provided was assessed as limited due to the prior year action plan to address audit findings not being implemented timeously, more specifically to revenue and compliance.

Accounting officer: provides some assurance

- The assurance provided by accounting officer was not adequate to ensure that the level of oversight and monitoring required at a leadership level was sufficient to ensure audit matters and internal control deficiencies were adequately addressed and this contributed negatively towards the audit outcomes of the municipality.

Mayor: provides some assurance

- The Municipal Structures Act (MSA) places the development of the performance management system in the hands of the executive mayor. In addition, the Structures Act places the responsibility of evaluating the municipal progress against the key performance indicators, reviewing the performance of the municipality and monitoring of the municipality's administration in the hands of the executive mayor. The overall assurance level by the accounting officer and senior management is indicative of effectiveness of the executive mayor's initiatives aimed at ensuring desired level of governance. The mayor has therefore been assessed as providing some assurance mainly because of the above and the action plan that has not yielded the desired results of improving the audit outcomes of the municipality.

Second level of assurance

Internal audit unit: provides some assurance

- Legislation in South Africa requires the establishment, roles, and responsibilities of internal audit units. Internal audit unit form part of the internal control and governance structures of the municipality and play an important role in its monitoring activities. Internal audit provides an independent assessment of the municipality's governance, risk management and internal control processes.
- The internal audit unit of a municipality must prepare a risk-based audit plan and internal audit programme for each financial year. It must advise the accounting officer and report to the audit committee on implementing the internal audit plan and matters relating to internal audit; internal controls; accounting procedures and practices; risk and risk management; performance management; loss control and compliance with the MFMA. The internal audit unit must also perform such other duties as may be assigned by the accounting officer.
- Although the municipality has an operational internal audit, there's lack of adequate resources and capacity issues in the internal audit unit to carry out its duties efficiently and effectively.

Audit committee: provides some assurance

- The audit committee is an independent advisory body to the council, the accounting officer and the management and staff of the municipality on matters relating to internal financial control and internal audits; risk management; accounting policies; the adequacy, reliability and accuracy of financial reporting and information; performance management; effective governance; the MFMA and any other applicable legislation; performance evaluation; and any other issues.
- The audit committee is also expected to review the annual financial statements to provide an authoritative and credible view of the municipality, its efficiency and effectiveness and its overall level of compliance with the applicable legislation.
- The municipality did have an audit committee which met four times during the year under review however its efficiency and effectiveness could not be confirmed this is evidenced by the audit outcomes of the municipality.

Third level of assurance

Municipal council: provides limited assurance

- The municipal council did not implement adequate oversight over the implementation of action plans to address prior year reported findings. This resulted in significant repeat findings as reported in the prior year.

Municipal public account committee (MPAC): provides limited assurance

- UIF incurred in the previous years was not investigated by the committee during the period under review, the municipality further incurred these expenditures which means the recommendations given by the committee on the previous investigations of UIF incurred were not implemented by the municipality.

STATUS OF IMPLEMENTING COMMITMENTS AND RECOMMENDATIONS¹

89. Below is our assessment of the progress in implementing the commitments made by the municipality to address the previous and current years' audit findings.



No.	Commitment	Made by	Date	Status
No significant commitments were made by management on the prior year audit findings.				

SECTION 4: Specific focus areas

FINANCIAL VIABILITY

90. Our audit included a high-level overview of the Municipality's financial viability as at year-end. The financial viability assessment provides useful information for accountability and decision-making purposes and complements the financial statements by providing insights and perspectives thereon. The financial viability assessment is expected to enhance timely remedial decision-making and policy reforms where financial viability may be at risk. It will also highlight to management those issues that may require corrective action and the urgency and magnitude of the reforms and decisions necessary to maintain operations. The information should be used to complement, rather than substitute, management's own financial assessment.

FINANCIAL VIABILITY ASSESSMENT			
		AS AT 30 JUNE 2018	AS AT 30 JUNE 2017
EXPENDITURE MANAGEMENT			
1.1	Creditor-payment period	450.0Days	444.7Days
REVENUE MANAGEMENT			
2.1	Debtor-collection period (after impairment)	2861.3Days	1375Days
2.2	Debtors impairment provision as a percentage of accounts receivable	77.4%	58%
	• Amount of debtors' impairment provision	R289 435 060	R167 607 378
	• Amount of accounts receivable	R374 076 693	R288 749 570
ASSET AND LIABILITY MANAGEMENT			
3.1	A deficit for the year was realised (total expenditure exceeded total revenue)	Yes	No
	• Amount of the surplus / (deficit) for the year	(R108 296 304)	R745 366
3.2	A net current liability position was realised (total current liabilities exceeded total current assets)	Yes	Yes
	• Amount of the net current assets / (liability) position	(R131 510 851)	(R31 838 007)
3.3	A net liability position was realised (total liabilities exceeded total assets)	No	No
	• Amount of the net asset / (liability) position	(R220 813 191)	R945 189 126
CASH MANAGEMENT			
4.1	The year-end bank balance was in overdraft	No	No
	• Amount of year-end bank balance	R3 529 470	R1 187 207



FINANCIAL VIABILITY ASSESSMENT			
		AS AT 30 JUNE 2018	AS AT 30 JUNE 2017
4.2	Net cash flows for the year from operating activities were negative	No	No
	<ul style="list-style-type: none"> Amount of net cash in / (out)flows for the year from operating activities 	R44 825 293	R25 421 534
4.3	Creditors as a percentage of cash and cash equivalents	6072.1 %	13663.4%
	<ul style="list-style-type: none"> Amount of creditors (accounts payable) 	(R214 311 235)	(R162 213 272)
	<ul style="list-style-type: none"> Amount of cash and cash equivalents at year-end 	R3 529 470	R1 187 207
4.4	Current liabilities as a percentage of next year's budgeted resources	71%	61%
	<ul style="list-style-type: none"> Amount of current liabilities 	(R220 813 191)	(R167 724 179)
	<ul style="list-style-type: none"> Amount of next year's budgeted income 	R311 807 000	R277 714 000
OVERALL ASSESSMENT			
Overall the financial viability is assessed as:		Red (unfavourable – intervention required)	Red (unfavourable – intervention required)

High-level comments

91. The municipality's net current assets/liability position is concerning as the current liabilities are greater than the current assets, therefore the municipality is unable to settle its immediate payables/current liabilities from its current assets.
92. The main source of this issue is that the municipality takes longer to collect its receivables in order to settle its liability and finance its operations. This is evidenced by the unfavourable debtor's collection days and creditors payment period ratios depicted in the table above.

PROCUREMENT AND CONTRACT MANAGEMENT

Irregular expenditure

93. R1 894 934 (100%) of the irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. Further irregular expenditure incurred in previous years, amounting to R9 191 670.96, was also identified in the current year. 75% of this irregular expenditure was identified during the audit process and not detected by the municipality's monitoring processes. The root causes of the lack of effective prevention and detection are lack of oversight by management to ensure compliance with SCM process. Of the irregular expenditure incurred, goods and/or services were not received for expenditure amounting to R0.

Awards to persons in the service of the state

94. Regulation 44 prohibits awards to persons in the service of the auditee (i.e. employees and councillors), persons in the service of any other state institution and entities owned/managed



by them. The audit included the identification of such prohibited awards. Further testing was also performed to determine whether the legislated requirements with regard to declarations of interest were adhered to.

95. The findings were as follows:

Finding	Number and value of awards made	Number and position of official/councillor or identified	Number of suppliers identified	Further non-compliance or irregularities regarding the awards			
				Supplier did not submit declarations of interest	Supplier did not declare interest (false declaration)	Official/councillor did not declare interest	Official/councillor was involved in awarding the contract/quotation
Awards made to officials and/or councillors of the municipality	3 R46 513	3 3	3	0	3	3	
Awards to persons in the service of other state institutions	3 R488 513	3	3	0	3		

Procurement processes

96. The table below is a summary of findings identified on procurement processes:

	Total		Quotations		Contracts	
	Number	Value R	Number	Value R	Number	Value R
Awards selected for testing	116	41 014 492	97	2 040 389	19	38 974 103
Expenditure incurred on selected awards – current year		12 981 517		2 328 439		10 653 078
Awards on which non-compliance was identified	39	29 150 412	21	1 091 734	18	28 058 677
Irregular expenditure identified	19	1 441 630	18	1 043 360	1	398 270

Procurement processes – general

- (15) awards with a value of R1 026 865.70 were procured without inviting at least the minimum prescribed number of written price quotations from prospective suppliers, and the deviation was approved even though it was possible to obtain the quotations.
- (1) contract with a value of R398 270 was 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.
- (1) contract was awarded to bidder who did not score the highest points in the bid evaluations, and there was no justification for the deviation.
- (1) contract was awarded to a bidder who did not submit a declaration of whether they were employed by the state or connected to any person employed by the state.

Contract management

- The performance of (2) contractors or providers was not monitored monthly. The total value of related contracts was R7 277 172.
- The contract performance and monitoring measures and methods applied in monitoring (9) contracts with a total value of R22 746 346 were insufficient to ensure effective contract management.

Internal control deficiencies

97. Findings on procurement are attributed to non-compliance with SCM processes which resulted in irregular expenditure of R1 894 934 in the current financial year. Most of this irregular expenditure was identified during the audit process and not detected by the municipality's monitoring processes. The root causes for lack of effective prevention and detection were inadequate oversight by management and lack of consequence management for non-compliance with SCM process.

FRAUD AND CONSEQUENCE MANAGEMENT

98. The primary responsibility for preventing and detecting fraud rests with management and those charged with governance. We are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and to issue an auditor's report that includes our opinion. Due to the inherent limitations of an audit, there is a risk that some material misstatements, including fraud, may not be detected.
99. Below is a summary of fraud risk factors identified during the audit that should be addressed to ensure that sufficient measures/controls are in place to prevent material misstatement/ non-compliance due to fraud.
- None were identified during the audit.
100. The MFMA and its regulations clearly stipulate that matters such as incurring unauthorised, irregular and fruitless and wasteful expenditure; the possible abuse of the SCM system (including fraud and improper conduct); and allegations of financial misconduct should be investigated. Disciplinary steps should be taken based on the results of the investigations. Our audits included an assessment of the municipality's management of consequences. The significant findings are provided below:

Measures to manage consequences

101. The following measures were not implemented to ensure that the environment is conducive to effective consequence management:

- The municipality did not adopt systems (policies) to investigate allegations of misconduct; and disciplinary procedures.

Failure to properly deal with allegations reported in the prior year

102. The table below provides a summary of transgressions from the previous year that were either not investigated or proper disciplinary steps were not taken after investigation.

Unauthorised, irregular, fruitless and wasteful expenditure

Findings	Value R
Unauthorised expenditure	
Unauthorised expenditure identified in the previous year was not investigated to determine whether any person was liable for the expenditure	98 576 284
Effective and appropriate disciplinary steps were not taken against officials who made and/or permitted unauthorised expenditure	98 576 284
Unauthorised expenditure was not authorised through an adjustment budget	15 565 864
Irregular expenditure	
Irregular expenditure identified in the previous year was not investigated to determine if any person was liable for the expenditure	6 907 126
Irregular expenditure was not properly investigated	6 907 126
Effective and appropriate disciplinary steps were not taken against officials who made and/or permitted irregular expenditure	6 907 126
Fruitless and wasteful expenditure	
Fruitless and wasteful expenditure identified in the previous year was not investigated to determine whether any person was liable for the expenditure	4 624 980
Fruitless and wasteful expenditure was not properly investigated	4 624 980
Effective and appropriate disciplinary steps were not taken against officials who made and/or permitted fruitless and wasteful expenditure	4 624 980

Transgressions reported to management for investigation

103. During the previous year's audit, we reported findings relating to transgressions by officials or other role players, for management to investigate. During the current year audit, we performed follow-up tests to determine whether the matters reported were dealt with by management.

104. The table below provides a summary of the transgressions reported in the previous year and the year under review that must be investigated and disciplinary steps taken based on the results of the investigations.

Finding	Findings raised in the previous year			Findings reported in current year	
	Number of instances	Number of instances investigated	Number of instances resolved from those investigated	Number of instances	Value (R)
A: Improper conduct in SCM by suppliers					
Supplier submitted false declaration of interest	20	20	0	3	534 667

105. Unauthorised, irregular, fruitless and wasteful expenditure disclosed in note 45, 47, 46 to the financial statements must be investigated to determine whether any official is liable for losses incurred as a result of this expenditure. Disciplinary steps must be taken against officials who caused or permitted the unauthorised, irregular, fruitless and wasteful expenditure and losses incurred must be recovered from the person liable.

106. In terms of section 225 of the IESBA code, we have a responsibility to consider reporting identified and suspected non-compliance with laws and regulations to an appropriate authority. The following matters have been escalated to the council for them to ensure that appropriate steps are taken to address the non-compliance:

- The municipality did not comply with NERSA approved tariffs and this is not in compliance with the Electricity Regulation Act 4 of 2006.
- The municipality did not pay over to SARS employees tax withheld from staff members within the prescribed period as required by Income Tax Act 52 of 1962 (Income Tax Act). Furthermore, the municipality did not put controls in place to ensure that fringe benefits to staff members are identified and that the relevant tax is withheld accordingly per the Income Tax Act.

USE OF CONDITIONAL GRANTS

107. For the financial year under review, the audit included an assessment of the effectiveness of the municipality's use of the following conditional grants received:

- Local Government Financial management Grant: R2 145 000
- Municipal Infrastructure Grant: R20 252 000
- Expanded public works programme integrated grants for municipalities: R1 000 000
- Regional Bulk Infrastructure Grant(DWAF): R15 000 000

FREE BASIC SERVICES

108. The municipality received an equitable share allocation of R68 271 619. Part of the equitable share is used to fund free basic services that are meant for the poor.



USE OF CONSULTANTS

109. The audit included an assessment of the effective use of consultants. In the local government environment, the partnership between the private and public sectors has become important in driving strategic goals.
110. The total expenditure on consultants was R4 792 174.

WATER AND SANITATION

111. The audit included an assessment of the water and sanitation service delivery objective of the municipality. Procedures were performed in relation to the following:
- Performance planning and reporting on the provision of water and sanitation services
 - Planning and budgeting for routine maintenance of water and sanitation infrastructure
 - Planning and budgeting for new water and sanitation infrastructure projects
 - Reporting on water losses
112. The audit included obtaining an understanding of key water and sanitation infrastructure projects undertaken at the municipality. In the context of these key projects, we evaluated whether the municipality executed its mandate in accordance with the predetermined objectives, whether the procurement processes were complied with, whether the transactions were recorded appropriately in the financial statements, and whether quality goods and services were delivered which agreed with the initial requirements.
113. The table below summarises the audit findings on the key projects.

Summary of selected key projects and results of testing	
	Sanitation infrastructure
Key project name	Manyatseng : Construction of 383 Toilet Top Structures
Brief description of key project	Construction of 383 Toilet Top Structures
Project commenced as planned	No, project commenced on 3 May 2018 and it was scheduled for 1 April 2018
Project completed within defined duration (applicable if completed)	N/A- Project was not completed at year end
Status of completion (applicable if WIP)	7%
Available budget for the year	R4 900 000
Actual amount spent in current year	R 2 870 792,27

Summary of selected key projects and results of testing	
	Sanitation infrastructure
Key project name	<i>Manyatseng : Construction of 383 Toilet Top Structures</i>
Total project budget (multi-year)	R4 900 000
Actual amount spent from initiation to date	R2 870 792,27
Source of funding	Municipal Infrastructure Grant
Key performance indicator and target as per annual or strategic planning document	Percentage progress made on construction of Toilet top structures at Manyatseng Ext 9

ROADS INFRASTRUCTURE

114. The audit included an assessment of the roads infrastructure service delivery objective. Procedures were performed in relation to the following:

- Planning for renewal and routine roads maintenance projects
- Planning for new or refurbished roads infrastructure projects
- Follow-up on the previous year's findings

115. A summary of the significant findings from the audit are as follows:

Planning for renewal and routine roads maintenance projects

- Roads maintenance plan for routine maintenance and renewal for the roads infrastructure was not approved.

116. The audit included obtaining an understanding of key roads infrastructure projects undertaken at the municipality. In the context of these key projects, we evaluated whether the municipality executed its mandate in accordance with the predetermined objectives, whether the procurement processes were complied with, whether the transactions were recorded appropriately in the financial statements, and whether quality goods and services were delivered which agreed with the initial requirements.

117. The table below summarises the audit findings on the key projects

Summary of selected key projects and results of testing	
Key project name	Dipelaneng : Construction of 2km paved ring road and storm water in Maclaasen and Graveyard
Brief description of key project	Dipelaneng : Construction of 2km paved ring road and storm water in Maclaasen and Graveyard

Summary of selected key projects and results of testing	
Key project name	Dipelaneng : Construction of 2km paved ring road and storm water in Maclaasen and Graveyard
Project commenced as planned	Yes project commenced on 18/04/2017
Project completed within defined duration	The project was completed on 29 June 2018
Status of completion	99.78%
Available budget for the year	2016/17 = R 5 030 176 2017/18 = R 6 804 209
Actual amount spent in current year	R6 804 209
Total project budget (multi-year)	R11 834 385
Actual amount spent from initiation to date	R11 796 803
Source of funding	Municipal Infrastructure Grant
Key performance indicator and target as per annual or strategic planning document (if applicable)	Percentage of progress made on the 2 km pave road and storm water drainage in Maclaasen, Hobhouse

Follow-up on the previous year's findings

118. Corrective actions to address all findings raised in the prior year were not implemented. The audit included obtaining an understanding of key infrastructure projects undertaken at the municipality. In the context of these key projects, we evaluated whether the municipality executed its mandate in accordance with the predetermined objectives, whether the procurement processes were complied with, whether the transactions were recorded appropriately in the financial statements, and whether quality goods and services were delivered which agreed with the initial requirements.

SECTION 5: Using the work of internal auditors

119. The auditing standards allow external auditors the optional use of the work of internal audit for external audit purposes and for direct assistance. We have used internal audit as follows:
- All quarterly reports were used for risk assessment.
 - The internal audit function was used for external audit purposes or for direct assistance as follows:
 - The physical verification of employees.

SECTION 6: Emerging risks

Accounting, performance management/reporting and compliance matters

New pronouncements

Standards of GRAP

The ASB has issued the following GRAP pronouncements, with effective dates as indicated:

GRAP pronouncement	Effective date
GRAP 18 - <i>Segment reporting</i>	1 April 2020
GRAP 20 - <i>Related-party disclosures</i>	1 April 2019
GRAP 32 - <i>Service concession arrangements: grantor</i>	1 April 2019
GRAP 34 - <i>Separate financial statements</i>	To be determined
GRAP 35 - <i>Consolidated financial statements</i>	To be determined
GRAP 36 - <i>Investments in associates and joint ventures</i>	To be determined
GRAP 37 - <i>Joint arrangements</i>	To be determined
GRAP 38 - <i>Disclosure of interests in other entities</i>	To be determined
GRAP 108 - <i>Statutory receivables</i>	1 April 2019
GRAP 109 - <i>Accounting by principals and agents</i>	1 April 2019
GRAP 110 - <i>Living and non-living resources</i>	1 April 2020
IGRAP 17 - <i>Service concession arrangements where a grantor controls a significant residual interest in an asset</i>	To be determined
IGRAP 18 - <i>Recognition and derecognition of land</i>	1 April 2019
IGRAP 19 - <i>Liabilities to pay levies</i>	1 April 2019

Subsequent events

- None were identified

Audit findings on the annual performance report that may have an impact on the audit opinion in future

120. The planned and reported performance information of selected key performance area was audited against the following additional criteria as developed from the Performance Management Reporting Framework:

- **Presentation and disclosure – Overall presentation:**
 - Overall presentation of the performance information in the annual performance report is comparable and understandable.
- **Relevance – Completeness of relevant indicators:**
 - Completeness of relevant indicators in terms of the mandate of the auditee, including:



- relevant core functions are prioritised in the period under review.
- relevant performance indicators are included for the core functions prioritised in the period under review.

121. Material audit findings arising from the audit against the additional criteria do not have an impact on the audit opinion of the selected key performance area in this report. However, it may impact on the audit opinion in future.

122. No material findings were identified in respect of the additional criteria.

SECTION 7: Ratings of detailed audit findings

123. For the purposes of this report, the detailed audit findings included in annexures A to C have been classified as follows:

- Matters to be included in the auditor's report: these matters should be addressed as a matter of urgency.
- Other important matters: these matters should be addressed to prevent them from leading to material misstatements of the financial statements or material findings on the performance report and compliance with legislation in future.
- Administrative matters: these matters are unlikely to result in material misstatements of the financial statements or material findings on the performance report and compliance with legislation.

SECTION 8: Conclusion

124. The matters communicated throughout this report relate to the three fundamentals of internal control that should be addressed to achieve sustained clean administration. Our staff remains committed to assisting in identifying and communicating good practices to improve governance and accountability and to build public confidence in government's ability to account for public resources in a transparent manner.

Yours faithfully



Disebo Ceba CA(SA)
Senior Manager: Free State

30 November 2018

Enquiries: Malusi Chamane CA(SA)
Telephone: 031 409 0100
Email: malusicha@agsa.co.za

Distribution:
Audit committee
Head of internal audit unit
Executive authority