

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE MOHOKARE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Mohokare Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and budget statement 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 Africa 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, 2013 (Act No. 2 of 2013) (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 the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and 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 entity'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 entity'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

Receivables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence in respect of other receivables stated at R17 797 303 (2013: R18 308 584) and the value of the impairment for other receivables stated at R17 632 076 (2013: R17 962 593) in note 3 to the financial statements. In addition, I was unable to confirm service debtors with a value of R1 814 890 as disclosed in note 3 to the financial statements. This was because the records of the municipality were not sufficient to support these disclosures. I was unable to confirm these balances by alternative means. Consequently, I was unable to determine whether any adjustment was necessary in respect of other receivables.

7. In addition to the matter reported in paragraph 6, due to the misclassification of debtors per customer classification, as disclosed in note 3.2 to the financial statements, national and provincial government receivables were overstated and household receivables understated by R18 097 330. Additionally, there was a resultant impact on the deficit for the period and the accumulated surplus as well as a consequential impact on the cash flow statement.

Service charges

8. I was unable to obtain sufficient appropriate audit evidence in respect of revenue from the sale of water, as meter readings taken during the year were inaccurate and incomplete. I was unable to confirm revenue from water sales by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to revenue from water sales stated at R9 877 534 (2013: R7 496 769) in note 20 to the financial statements.

Irregular expenditure

9. I was unable to obtain sufficient appropriate audit evidence that management had identified, investigated and recorded all instances of irregular expenditure for the current and prior year, as controls over the system were ineffective. I was unable to confirm irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to irregular expenditure stated at R130 196 434 (2013: R129 258 580) in note 40.3 to the financial statements.

Fruitless and wasteful expenditure

10. I was unable to obtain sufficient appropriate audit evidence that management had identified, investigated and recorded all instances of fruitless and wasteful expenditure for the current and prior year, as the controls over the system were ineffective. I was unable to confirm fruitless and wasteful expenditure by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to fruitless and wasteful expenditure stated at R6 829 242 (2013: R4 947 535) in note 40.2 to the financial statements.

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 Mohokare Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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 34 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

Material losses

14. As disclosed in note 32.1 to the financial statements, material losses of R7 287 849 (2013: R9 223 183) were incurred as a result of electricity and water distribution losses, and R15 691 377 (2013: R12 333 732) as a result of the write-off of irrecoverable debtors.

Material impairments

15. As disclosed in note 3 to the financial statements, receivables from exchange transactions were impaired by R79 167 080 (2013: R70 845 752); and as disclosed in note 4 to the financial statements, receivables from non-exchange transactions were impaired by R6 980 116 (2013: R6 275 779).

Unauthorised expenditure

16. As disclosed in note 40.1 to the financial statements, the municipality incurred unauthorised expenditure of R27 617 260 (2013: R41 481 969) during the year under review, due to the overspending of the municipal budget.

Going concern

17. As disclosed in note 52 to the financial statements, the municipality's cash management was under pressure due to an amount of R7 000 000 of unspent municipal infrastructure grants that had been withheld from the equitable share of the municipality as well as the poor collection rate of receivables.

Additional matter

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

Unaudited disclosure notes

19. 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

20. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for the selected development priority presented in the annual performance report, non-compliance with legislation as well as 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

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2014:
 - KPA 1: Basic service delivery and infrastructure development on pages x to x
22. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
23. 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 development priorities. 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 development priority are as follows:

KPA 1: Basic service delivery and infrastructure development

Usefulness of reported performance information

26. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 24% of the reported objectives and indicators and 40% of the targets were not consistent with those in the approved IDP. This was due to the municipality not having sufficiently developed policies and processes to guide the process of performance reporting as well as capacity constraints brought about by a lack of skilled and experienced persons in its performance management department.
27. Section 41(c) of the MSA requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 34% of all planned objectives, indicators and targets specified in the IDP for the year under review. This was due to a lack of information systems to record and document actual achievements against targets. Management, the audit committee and the internal audit unit also provided limited review of the completeness of the reported information.
28. The FMPPI requires the following:
- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 57% of the targets were not specific.
 - Performance targets must be measurable. I could not measure the required performance for 57% of the targets.
 - The period or deadline for delivery of targets must be specified. A total of 84% of the targets were not time bound.
 - Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 52% of the indicators were not well defined.
 - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 91% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI, due to a lack of proper systems and processes, technical indicator descriptions as well as sufficient skills and experience in its performance management department.

Reliability of reported performance information

29. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information. The auditee's records did not permit the application of alternative audit procedures.

Additional matter

30. I draw attention to the following matter:

Achievement of planned targets

31. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraphs 26 to 29 of this report.

Compliance with legislation

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-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

33. The municipality did not conduct its affairs in a manner consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and municipal planning and performance management regulation 6.
34. Although reviewed annually, the IDP was not reviewed based on an assessment of the municipality's performance measurements, as required by section 34 of the MSA and municipal planning and performance management regulations 3 and 11.
35. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
36. Performance targets for the financial year with regard to each of the development priorities and key performance indicators set in the IDP were not measurable, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1) and 12(2)(e).
37. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

Budgets

38. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance report and annual report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Some material misstatements of non-current assets, current assets, current liabilities and expenditure 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.

Audit committee

40. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA. One member of the audit committee resigned during the year and another member's contract was not renewed. This resulted in the audit committee not having the required minimum of three members. The latest audit committee member position became vacant in March 2014.
41. The audit committee did not advise the council on matters relating to internal financial control, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.

42. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness, and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
43. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
44. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
45. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
46. The audit committee did not respond to the council on the issues raised in the audit reports of the auditor-general, as required by section 166(2)(c) of the MFMA.

Internal audit

47. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Human resource management and compensation

48. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by minimum competency levels regulation 14(2)(a).
49. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by minimum competency levels regulation 14(2)(b).

Procurement and contract management

50. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value above R200 000 had been procured by means of inviting competitive bids, as required by supply chain management (SCM) regulation 19(a).
51. Sufficient appropriate audit evidence could not be obtained that bid specifications had been drafted by bid specification committees composed of one or more officials of the municipality, as required by SCM regulation 27(3).
52. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding had been advertised for the required minimum period, as required by SCM regulation 22(1) and 22(2).
53. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulation 18.

Expenditure management

54. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
55. 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.

Conditional grants

56. The municipality did not evaluate its performance in respect of programmes or functions funded by allocations of the municipal systems improvement grant and the local government financial management grant, as required by section 12(5) of DoRA.

Revenue management

57. The credit-control and debt-collection policy of the council was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
58. An adequate management, accounting and information system was not in place to account for revenue, debtors and the receipt of revenue, as required by section 64(2)(e) of the MFMA.
59. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Liability management

60. Short-term debt was not repaid within the financial year, as required by section 45(4) of the MFMA.

Consequence management

61. Unauthorised, irregular as well as 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)(a)(ii) of the MFMA.

Internal control

62. I considered internal control relevant to my audit of the financial statements, performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the performance report and the findings on non-compliance with legislation included in this report.

Leadership

63. The leadership did not adequately respond to the matters reported by the external auditors in the previous financial year, and did not implement consequential performance management for managers and officials that did not implement municipal policies and procedures.
64. In addition, organisational party politics attempted to destabilise the municipality and to deliberately undermine the leadership.

Financial and performance management

65. The work ethic of certain municipal officials, including senior and middle management, was not at the required level. This resulted in officials not performing their job function, which placed undue pressure on the leadership of the municipality.
66. Management did not adequately respond to the audit matters reported in the previous financial year, and did not establish a performance management system and technical indicator descriptions. Within the performance management and SCM departments there was a lack of sufficient skills and experience, resulting in ineffective monitoring and review.
67. Management did not adequately respond to the recommendations of the external auditors to implement processes to monitor and report on compliance with laws and regulations. This resulted in a situation where compliance was still not actively managed.

Governance

68. The governance structures of the municipality were not sufficiently capacitated and as a result did not deliver on their mandates. Consequently, the governance structures did not take into account all the risks that affected the municipal environment and did not monitor the implementation of the recommendations of the risk management division. Furthermore, the internal audit division did not achieve its annual audit plan; and the audit committee did not deliver on its legislated responsibilities.

OTHER REPORTS

Investigation

69. Three investigations are being conducted by an independent consulting firm on request of the municipality and the Office of the Premier. The investigations were initiated based on allegations of irregularities in procurement and payments. The investigations are currently in the reporting phase.

Auditor - General

Bloemfontein

30 November 2014



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence