

Report of the auditor-general to the Free State Legislature and 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 2016, the statement of financial performance, statement of changes in net assets, cash flow statement, the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the 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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Mohokare Local Municipality as at 30 June 2016 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

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

Restatement of corresponding figures

8. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

9. As disclosed in note 11 to the financial statements, material losses to the amount of R9 568 711 (2015: R18 048 068) were incurred as a result of a write-off of irrecoverable trade debts.
10. As disclosed in note 51 to the financial statements, electricity distribution losses of R6 255 536 (2015: R5 364 000) and water distribution losses of R4 024 892 (2015: R6 492 980) were incurred as a result of leakages, tampering with meters, faulty meters, illegal connections and the drought.

Material impairments

11. As disclosed in note 11 to the financial statements, receivables from exchange transactions were impaired by R99 120 609 (2015: R76 199 137) and, as disclosed in note 12 to the financial statements, receivables from non-exchange transactions were impaired by R22 929 543 (2015: R15 604 627).

Irregular expenditure

12. As disclosed in note 50 to the financial statements, the municipality incurred irregular expenditure of R13 513 256 (2015: R15 985 572) during the year mainly due to non-compliance with supply chain management regulations. In addition, the full extent of irregular expenditure incurred during the year is still in the process of being determined.

Unauthorised expenditure

13. As disclosed in note 48 to the financial statements, non-budgeted expenditure of R32 633 469 (2015: R3 585 484) was incurred during the current and previous financial year, which is regarded as unauthorised expenditure.

Going concern

14. The financial statements indicate that the municipality's current liabilities significantly exceeded its current assets by R54 825 142 (2015: R49 953 043). In addition, as disclosed in note 41 to the financial statements, notices of motion were issued against the municipality as a result of long-outstanding members and council contributions to the pension and provident funds. The municipality has been deducting pension and provident fund contributions from employee's salaries, but has been unable to pay over R27 244 731 (2015: R19 923 190) of the contributions to the relevant third parties. These conditions, along with other matters as set forth in note 46, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to meet its financial obligations as they fall due and to achieve service delivery as outlined in the annual performance plan.

Additional matters

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

Unaudited disclosure notes

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

Unaudited supplementary information

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 this schedule and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to raise reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on them.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2016:
 - KPA 1: Basic service delivery and infrastructure development on pages x to x
20. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance area. 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 (FMPPPI).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. I did not raise any material findings on the usefulness and reliability of the reported performance information for the following key performance area:
 - KPA 1: Basic service delivery and infrastructure development on pages x to x.

Additional matters

23. I draw attention to the following matters:

Adjustment of material misstatements

24. I 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 delivery and infrastructure development. As management subsequently corrected the misstatements, I did not identify any material findings on the usefulness and reliability of the reported performance information.

Unaudited supplementary schedules

25. 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 on them.

Compliance with legislation

26. 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

27. The KPIs set by the municipality did not include indicators on percentage of households with access to a basic level of water, sanitation and electricity, as required by section 43(2) of the Municipal Systems Act and the municipal planning and performance management regulation 10(a).

Annual financial statements, performance and annual report

28. 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, non-current liabilities, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Procurement and contract management

29. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).

Expenditure management

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

Revenue management

34. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of the MFMA.
35. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
36. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Consequence management

37. 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.

Internal control

38. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

39. Although the leadership established a formal code of conduct that addresses appropriate ethical and moral behaviour, continuous monitoring of adherence to such policies needs to be improved as several instances of non-compliance with legislation and municipal policies and procedures were noted.
40. 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 comply with legislation and did not implement municipal policies and procedures.

Financial and performance management

41. Management overly relied on work performed by service providers in the preparation and administration of information for consumer billing purposes. Information prepared by consultants was also not thoroughly reviewed by management to assess the accuracy and completeness thereof for financial reporting purposes.
42. Review functions performed by heads of user departments were not adequate to ensure that information provided to the finance directorate and the performance management directorate was credible. Different departments worked in silos, resulting in a breakdown in communication between the different units.
43. Independent reviews performed on the financial statements and the annual performance report was not adequate to detect material errors made in the preparation thereof and to correct misstatements before submission thereof for audit purposes.

Governance

44. Due to a lack of capacity, the risk management unit did not conclude on the yearly risk assessment process in good time for internal audit to prepare a risk-based internal audit plan before the start of the 2015-16 financial year. This contributed to the internal audit division not being in a position to complete all audits as per the annual plan.

45. The risk management unit also did not closely monitor management's responses to the municipality's strategic and operational risks. The risk management committee was also not fully functional during the 2015-16 financial year.
46. Management did not timeously and adequately address concerns raised by the internal audit unit and the audit committee. This impacted on the effectiveness of the internal audit unit and the audit committee, with the result that they were unable to influence an improvement in the control environment of the municipality. Furthermore, steps taken by management to address internal control deficiencies and emerging audit risks identified in the previous audit were not adequately monitored.

Other reports

47. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

Investigations

48. Three investigations were 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 2016



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence