

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the financial statements of the Phumelela Local Municipality set out on pages 6 to 73, which comprise the statement of financial position as at 30 June 2014, the statements of financial performance, changes in net assets, cash flows, statement of comparison of budget and actual amounts, and the appropriation 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 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 the financial statements based on conducting the 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. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### Basis for disclaimer of opinion

#### Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment for the current and prior year due to the inadequacies in the accounting records. I was therefore unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment relating to property, plant and equipment stated at R519 670 314 (2013: R536 727 738) in the financial statements was necessary. The municipality did not correctly calculate the depreciation and amortisation charge and did not capitalise all items of property, plant and equipment as required by SA Standards of GRAP, GRAP 17, *Property, plant and equipment* (GRAP 17). Consequently, property, plant and equipment are overstated by R2 373 967, investment property is understated by R242 136, intangible assets are overstated by R17 356, depreciation and amortisation are understated by R3 562 594, accumulated surplus is understated by R714 077, repairs and maintenance are overstated by R811 362 and general expenses are understated by R112 031. Not all the disclosures as required by GRAP 17 were included in the financial statements.

### **Payables from exchange transactions**

5. I was unable to obtain sufficient appropriate audit evidence regarding payables from exchange transactions for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm payables from exchange transaction by alternative means. Consequently, I was unable to determine whether any adjustment relating to payables from exchange transactions stated at R92 988 413 (2013: R58 409 972) in the financial statements was necessary. The municipality did not appropriately reconcile the supplier invoices to the creditors' listing, did not correctly record transactions relating to general expenses (including grant expenditure) and bulk purchases in the correct accounting period and incorrectly recorded a journal between unallocated receipts and deposits and the landfill provision. Consequently, payables from exchange transactions are understated by R31 242 843, bulk purchases are understated by R12 166 530, general expenses are understated by R13 858 249, accumulated surplus is overstated by R3 970 456 and provisions are overstated by R1 247 608.

### **Investment property**

6. I was unable to obtain sufficient appropriate audit evidence regarding investment property for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm investment property by alternative means. Consequently, I was unable to determine whether any adjustment relating to investment property stated at R19 390 444 (2013: R19 974 659) in the financial statements was necessary. The municipality did not capitalise all items of investment property in accordance with SA Standards of GRAP, GRAP 16 *Investment property* (GRAP 16). This occurred due to assets included in the asset register that could not be traced to the valuation roll or title deeds, Consequently, investment property was overstated by R6 742 212 and accumulated surplus overstated by R6 742 212. Not all the disclosures as required by GRAP 16 were included in the financial statements.

### **Employee benefit obligation**

7. I was unable to obtain sufficient appropriate audit evidence regarding employee benefit obligation for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm employee benefit obligation by alternative means. Consequently, I was unable to determine whether any adjustment relating to employee benefit obligation stated at R9 666 000 (2013: R8 197 000) in the financial statements was necessary. Not all the disclosures as required by SA Standards of GRAP, GRAP 25 *Employee benefits* were included in the financial statements.

### **Provisions**

8. I was unable to obtain sufficient appropriate audit evidence regarding provisions for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm provisions by alternative means. Consequently, I was unable to determine whether any adjustment relating to provisions stated at R7 682 456 (2013: R7 115 134) in the financial statements was necessary.

### **Consumer debtors**

9. I was unable to obtain sufficient appropriate audit evidence regarding consumer debtors for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm consumer debtors by alternative means. Consequently, I was unable to determine whether any adjustment relating to consumer debtors stated at R4 678 608 (2013: R1 190 276) in the financial statements was necessary. The municipality did not recognise consumer debtors in accordance with SA Standards of GRAP, GRAP 1 *Presentation of financial statements* (GRAP 1). Consequently, the amount disclosed regarding other business levies is understated by R822 220, allowance for impairment is overstated by R822 220, the disclosure regarding debt impairment written off against allowance is understated by R1 221 221 and consumer debtors are understated by R1 221 221. Additionally, debtors with credit balances do not agree to the debtor's age analysis. Consequently, consumer debtors are understated by R1 416 197 and debt impairment is understated by R1 416 197. Not all the disclosures as required by SA Standards of GRAP, GRAP 104 *Financial instruments* (GRAP 104) regarding consumer debtors were included in the financial statements.

### **Cash and cash equivalents and bank overdraft**

10. I was unable to obtain sufficient appropriate audit evidence regarding cash and cash equivalents and bank overdraft for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm cash and cash equivalents and bank overdraft by alternative means. Consequently, I was unable to determine whether any adjustment relating to cash and cash equivalents and bank overdraft stated at R4 458 957 (2013: R1 245 284) in the financial statements was necessary. In addition, the municipality did not disclose all restrictions regarding cash and cash equivalents in accordance with GRAP 1. Not all the disclosures required by GRAP 1 regarding cash and cash equivalents and bank overdraft were included in the financial statements.

### **Other financial liabilities**

11. I was unable to obtain sufficient appropriate audit evidence regarding other financial liabilities for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm other financial liabilities by alternative means. Consequently, I was unable to determine whether any adjustment relating to other financial liabilities stated at R3 699 611 (2013: R4 506 129) in the financial statements was necessary.

### **VAT receivable**

12. I was unable to obtain sufficient appropriate audit evidence regarding VAT receivable for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustment relating to VAT receivable stated at R3 679 010 (2013: R1 153 217) in the financial statements was necessary. The municipality did not correct a journal that was incorrectly processed in the prior period. Consequently, VAT receivable is overstated by R473 694 and accumulated surplus is overstated by R473 694. The municipality did not disclose an accounting policy regarding VAT receivable in accordance with GRAP 1.

### **Unspent conditional grants and receipts**

13. I was unable to obtain sufficient appropriate audit evidence regarding unspent conditional grants and receipts for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm unspent conditional grants and receipts by alternative means. Consequently, I was unable to determine whether any adjustment relating to unspent conditional grants and receipts stated at R3 556 809 (2013: R906 705) in the financial statements was necessary.

### **Receivables from exchange transactions**

14. I was unable to obtain sufficient appropriate audit evidence regarding receivables from exchange transactions receipts for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm unspent conditional grants and receipts by alternative means. Consequently, I was unable to determine whether any adjustment relating to receivables from exchange transactions stated at R2 011 543 (2013: R2 363 624) in the financial statements was necessary. The municipality applied the incorrect rates in the calculation of property rates in the prior period. Consequently, receivables from exchange transactions are overstated by R1 853 420 and accumulated surplus is overstated by R1 853 420. Not all the disclosures as required by GRAP 104 regarding receivables from exchange transactions were included in the financial statements.

### **Finance lease obligation**

15. I was unable to obtain sufficient appropriate audit evidence regarding finance lease obligation for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm financial lease obligations by alternative means. Consequently, I was unable to determine whether any adjustment relating to finance lease obligation stated at R782 489 (2013: R1 223 487) in the financial statements was necessary.

### **Inventories**

16. I was unable to obtain sufficient appropriate audit evidence regarding inventories for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm inventories by alternative means. Consequently, I was unable to determine whether any adjustment relating to inventories stated at R612 321 (2013: R693 012) in the financial statements was necessary. Not all the disclosures as required by SA Standards of GRAP, GRAP 12 *Inventory* were included in the financial statements.

### **Other financial assets**

17. I was unable to obtain sufficient appropriate audit evidence regarding other financial assets for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm other financial assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to other financial assets stated at R490 901 (2013: R533 984) in the financial statements was necessary. Not all the disclosures as required by GRAP 104 regarding other financial assets were included in the financial statements.

### **Receivables from non-exchange transactions**

18. I was unable to obtain sufficient appropriate audit evidence regarding receivables from non-exchange transactions for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment relating to receivables from non-exchange transactions stated at R335 547 (2013: R3 918 121) in the financial statements was necessary. Not all the disclosures as required by GRAP 104 regarding receivables from non-exchange transactions were included in the financial statements.

### **Consumer deposits**

19. I was unable to obtain sufficient appropriate audit evidence regarding consumer deposits for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm consumer deposits by alternative means. Consequently, I was unable to determine whether any adjustment relating to consumer deposits stated at R231 326 (2013: R232 220) in the financial statements was necessary.

### **Intangible assets**

20. I was unable to obtain sufficient appropriate audit evidence regarding intangible assets for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm intangible assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to intangible assets stated at R47 694 (2013: R47 694) in the financial statements was necessary.

### **Heritage assets**

21. I was unable to obtain sufficient appropriate audit evidence regarding heritage assets for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm heritage assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to heritage assets stated at R2 010 (2013: R2 010) in the financial statements was necessary.

### **Operating lease liability**

22. I was unable to obtain sufficient appropriate audit evidence regarding operating lease liability for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm operating lease liabilities by alternative means. Consequently, I was unable to determine whether any adjustment relating to operating lease liability stated at R0 (2013: R0) in the financial statements was necessary.

### **Government grants and subsidies**

23. I was unable to obtain sufficient appropriate audit evidence regarding government grants and subsidies for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm government grants and subsidies by alternative means. Consequently, I was unable to determine whether any adjustment relating to government grants and subsidies stated at R108 034 694 (2013: R119 923 319) in the financial statements was necessary.

### **Employee-related cost and remuneration of councillors**

24. I was unable to obtain sufficient appropriate audit evidence regarding employee-related cost and remuneration of councillors for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm employee-related cost and remuneration of councillors by alternative means. Consequently, I was unable to determine whether any adjustment relating to employee-related cost and remuneration of councillors stated at R51 585 482 (2013: R48 929 592) in the financial statements was necessary. Not all the disclosures as required by GRAP 1 regarding employee related cost and remuneration of councillors were included in the financial statements.

### **Service charges**

25. I was unable to obtain sufficient appropriate audit evidence regarding service charges for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm service charges by alternative means. Consequently, I was unable to determine whether any adjustment relating to service charges stated at R26 655 865 (2013: R22 592 369) in the financial statements was necessary. The municipality did not account for the estimated unmetered consumption for all debtors at year-end, did not correctly capture meter readings and did not recognise revenue in accordance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions*. Consequently, consumer debtors are understated by R4 454 754 and service charges are understated by R4 454 754.

### **Debt impairment**

26. I was unable to obtain sufficient appropriate audit evidence regarding debt impairment for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm debt impairment by alternative means. Consequently, I was unable to determine whether any adjustment relating to debt impairment stated at R21 783 711 (2013: R16 929 193) in the financial statements was necessary.

### **Depreciation and amortisation**

27. Due to the limitations placed on property, plant and equipment, investment property, heritage assets and intangible assets I was unable to obtain sufficient appropriate audit evidence regarding depreciation and amortisation. I was also unable to obtain sufficient appropriate audit evidence regarding depreciation and amortisation for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm depreciation and amortisation by alternative means. Consequently, I was unable to determine whether any adjustment relating to depreciation and amortisation stated at R20 396 203 (2013: R26 376 769) in the financial statements was necessary.

### **Bulk purchases**

28. I was unable to obtain sufficient appropriate audit evidence regarding bulk purchases for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm bulk purchases by alternative means. Consequently, I was unable to determine whether any adjustment relating to bulk purchases stated at R18 164 469 (2013: R17 601 563) in the financial statements was necessary.

### **General expenses**

29. I was unable to obtain sufficient appropriate audit evidence regarding general expenses for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm general expenses by alternative means. Consequently, I was unable to determine whether any adjustment relating to general expenses stated at R17 584 708 (2013: R17 381 839) in the financial statements was necessary. The municipality did not recognise expenditure in accordance with GRAP 1. This occurred due to expenditure being recorded in the incorrect periods. Consequently, general expenses are overstated by R11 731 341 and accumulated surplus is overstated by R11 731 341.

### **Contracted services**

30. I was unable to obtain sufficient appropriate audit evidence regarding contracted services for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm contracted services by alternative means. Consequently, I was unable to determine whether any adjustment relating to contracted services stated at R9 148 108 (2013: R8 175 531) in the financial statements was necessary.

### **Repairs and maintenance**

31. I was unable to obtain sufficient appropriate audit evidence regarding repairs and maintenance for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm repairs and maintenance by alternative means. Consequently, I was unable to determine whether any adjustment relating to repairs and maintenance stated at R8 048 694 (2013: R12 629 866) in the financial statements was necessary.

### **Property rates**

32. I was unable to obtain sufficient appropriate audit evidence regarding property rates for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm property rates by alternative means. Consequently, I was unable to determine whether any adjustment relating to property rates stated at R7 799 030 (2013: R7 482 667) in the financial statements was necessary. Not all the disclosures as required by SA Standards of GRAP, GRAP 23 *Revenue from non-exchange transactions* were included in the financial statements.

### **Interest received (trading)**

33. I was unable to obtain sufficient appropriate audit evidence regarding interest received (trading) for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm interest received (trading) by alternative means. Consequently, I was unable to determine whether any adjustment relating to interest received (trading) stated at R6 506 525 (2013: R3 539 175) in the financial statements was necessary.

### **Finance cost**

34. I was unable to obtain sufficient appropriate audit evidence regarding finance cost for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm finance cost by alternative means. Consequently, I was unable to determine whether any adjustment relating to finance cost stated at R2 861 584 (2013: R2 027 332) in the financial statements was necessary. Not all the disclosures as required by GRAP 1 regarding finance cost were included in the financial statements.

### **Rental of facilities**

35. I was unable to obtain sufficient appropriate audit evidence regarding rental of facilities for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm rental of facilities by alternative means. Consequently, I was unable to determine whether any adjustment relating to rental of facilities stated at R989 631 (2013: R601 958) in the financial statements was necessary.

### **Interest received – investment**

36. I was unable to obtain sufficient appropriate audit evidence regarding interest received – investment for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm interest received - investment by alternative means. Consequently, I was unable to determine whether any adjustment relating to interest received - investment stated at R545 846 (2013: R672 013) in the financial statements was necessary.

### **Rendering of services**

37. I was unable to obtain sufficient appropriate audit evidence regarding rendering of services for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm rendering of services by alternative means. Consequently, I was unable to determine whether any adjustment relating to rendering of services stated at R481 344 (2013: R379 204) in the financial statements was necessary.

### **Other income**

38. I was unable to obtain sufficient appropriate audit evidence regarding other income for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm other income by alternative means. Consequently, I was unable to determine whether any adjustment relating to other income stated at R239 967 (2013: R110 471) in the financial statements was necessary.

### **Fines**

39. I was unable to obtain sufficient appropriate audit evidence regarding fines for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm fines by alternative means. Consequently, I was unable to determine whether any adjustment relating to fines stated at R64 404 (2013: R107 650) in the financial statements was necessary.

### **Licences and permits**

40. I was unable to obtain sufficient appropriate audit evidence regarding licences and permits for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm licences and permits by alternative means. Consequently, I was unable to determine whether any adjustment relating to licences and permits stated at R16 995 (2013: R16 977) in the financial statements was necessary.

### **Impairment loss/ Reversal of impairments**

41. Due to the limitations placed on property, plant and equipment, investment property, heritage assets and intangible assets I was unable to obtain sufficient appropriate audit evidence regarding impairment loss/ reversal of impairments. I was also unable to obtain sufficient appropriate audit evidence regarding impairment loss/ reversal of impairments for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm impairment loss/ reversal of impairments by alternative means. Consequently, I was unable to determine whether any adjustment relating to impairment loss/ reversal of impairments stated at R0 (2013: R1 347) in the financial statements was necessary.



#### **Public contributions and donations**

42. I was unable to obtain sufficient appropriate audit evidence regarding public contributions and donations for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm public contributions and donations by alternative means. Consequently, I was unable to determine whether any adjustment relating to public contributions and stated at R0 (2013: R0) in the financial statements was necessary.

#### **Accumulated surplus**

43. I was unable to obtain sufficient appropriate audit evidence regarding accumulated surplus and the statement of changes in net assets for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm accumulated surplus and the statement of changes in net assets by alternative means. Consequently, I was unable to determine whether any adjustment relating to accumulated surplus stated at R432 747 159 (2013: R480 041 156) in the financial statements was necessary.

#### **Cash flow statement**

44. I was unable to obtain sufficient appropriate audit evidence that the cash flow statement and the related notes were fairly presented due to the material effect of the limitations set out in this report. I was unable to confirm the cash flows by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement and related notes were necessary. Not all the disclosures as required by SA Standards of GRAP, GRAP 2 *Cash flow statements* were included in the financial statements.

#### **Statement of comparison of budget and actual amounts and appropriation statement**

45. I was unable to obtain sufficient appropriate audit evidence that the statement of budget and actual amounts and related appropriation statement were fairly presented due to the material effect of the limitations set out in this report and inconsistencies between the amounts disclosed. I was unable to confirm the statement of comparison between budget and actual amounts and appropriation statement by alternative means. Consequently, I was unable to determine whether adjustment relating to the statements of comparison of budget and actual amounts and appropriation statement was necessary. Not all the disclosures as required by SA Standards of GRAP, GRAP 24 *Presentation of budget information in financial statements* were included in the financial statements

#### **Financial instruments/ Risk management**

46. I was unable to obtain sufficient appropriate audit evidence regarding financial instruments due to the material limitations set out in this report. I was unable to confirm this disclosure by alternative means. Consequently, I was unable to determine whether an adjustment to the disclosure of financial instruments was necessary. Not all the disclosures as required by GRAP 104 were included in the financial statements.

#### **Commitments**

47. I was unable to obtain sufficient appropriate audit evidence regarding commitments for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm commitments by alternative means. Consequently, I was unable to determine whether any adjustment relating to commitments stated at R5 713 014 (2013: R31 274 248) in the financial statements was necessary.

### **Contingencies**

48. I was unable to obtain sufficient appropriate audit evidence regarding contingencies for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm contingencies by alternative means. Consequently, I was unable to determine whether any adjustment relating to contingencies stated at R13 022 109 (2013: R13 022 109) in the financial statements was necessary. The municipality did not disclose contingencies in accordance with the requirements of SA Standards of GRAP, GRAP 19 *Provisions*. Possible claims and legal fees were not disclosed. Consequently, the disclosure regarding contingencies is understated by R5 287 036.

### **Related parties**

49. I was unable to obtain sufficient appropriate audit evidence regarding related party disclosure for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm related parties by alternative means. Consequently, I was unable to determine whether any adjustment relating to related party disclosure stated at R2 400 (2013: R310 00) in the financial statements was necessary.

### **Prior period errors and comparative figures**

50. Prior period errors and comparative information were not disclosed in accordance of the requirements of SA Standards of GRAP, GRAP 3 *Accounting policies, changes in accounting estimates and errors* and the municipality did not disclose its accounting policy regarding subsequent events in the financial statements, in accordance with GRAP 1. Consequently, the disclosure for prior period errors and comparative information is incomplete. Additionally, I was unable to obtain sufficient appropriate audit evidence that the amounts disclosed regarding property, plant and equipment, investment property and accumulated surplus were fairly presented due to material limitations set out in this report. I was unable to confirm these disclosures by alternative means. Consequently, I was unable to determine whether any adjustment to the disclosure of prior period errors and comparative figures was necessary.

### **Unauthorised expenditure**

51. I was unable to obtain sufficient appropriate regarding unauthorised expenditure as management did not calculate the unauthorised expenditure per vote. Additionally, sufficient supporting documentation to recalculate the unauthorised expenditure was not submitted for audit purposes. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustment relating to unauthorised expenditure stated at R117 406 290 (2013: R68 854 329) in the financial statements was necessary.

### **Fruitless and wasteful expenditure**

52. The municipality did not disclose all fruitless and wasteful expenditure in accordance with the MFMA. Expenditure items, including interest on overdue accounts, were identified that were not recorded in the fruitless and wasteful register. Consequently, the disclosure for fruitless and wasteful expenditure is understated by an amount of R890 482.

### **Irregular expenditure**

53. I was unable to obtain sufficient appropriate audit evidence regarding irregular expenditure for the current and prior years due to the inadequacies in the accounting records. I was unable to confirm irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to irregular expenditure stated at R129 748 421 (2013: R123 971 570) in the financial statements was necessary. The municipality did not recognise irregular expenditure in accordance with the MFMA. This occurred due to SCM requirements not being complied with. Consequently, the irregular expenditure disclosure is understated by R17 209 911.

#### **Additional disclosure in terms of Municipal Finance Management Act**

54. Additional disclosure was not disclosed in accordance with the MFMA. Deviations regarding awards granted were not disclosed. This was because the procurement process for awarding of contracts/tenders was not followed. Consequently, the disclosure for supply chain management regulations is understatement by R2 430 142.

#### **Preparation of the financial statements**

55. I was unable to obtain sufficient appropriate audit evidence that the accounting officer has fulfilled his responsibility for the preparation of the financial statements in accordance with the SA Standards of GRAP, as written representations in this respect were not provided. I was also unable to obtain written representations from the accounting officer that I had been provided with all relevant information and access as agreed in terms of the audit engagement and that all transactions had been recorded and were reflected in the financial statements. I could not determine the effect of the lack of such representations on the financial position of the municipality at 30 June 2014 or the financial performance and cash flows for the year then ended.

#### **Disclaimer of opinion**

56. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

#### **Emphasis of matters**

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

#### **Restatement of corresponding figures**

58. As disclosed in notes 42 and 43, *Prior period errors* and *Comparative information* respectively, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the Phumelela Local Municipality at, and for the year ended, 30 June 2013.

#### **Material losses**

59. As disclosed in note 50, *Additional disclosure in terms of Municipal Finance Management Act*, material losses to the amount of R11 314 081 were incurred as a result of technical losses, theft, vandalism, cable bridging, meter by-passing and unread meters.

#### **Material impairments**

60. As disclosed in note 30, *Debt impairment*, to the financial statements, material contributions to debt impairment provision have been made amounting to R21 783 711(2013: R16 929 193).

#### **Financial sustainability**

61. Note 45, *Going concern* indicates that the municipality's current liabilities exceeded its total assets. These conditions, along with other matters as set forth in note 45, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

#### **Additional matters**

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

### **Unaudited disclosure notes**

63. 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.

### **Material inconsistencies in other information included in the other information and supplementary schedules**

64. Paragraph 5 of the accounting officer's responsibility and approval indicates that the financial records may be relied on for the preparation of the financial statements. This is inconsistent with the material limitations set out in this report.

65. Paragraph 6 of the accounting officer's responsibility and approval indicates that the municipality has access to adequate resources to continue in operational existence for the foreseeable future. This is inconsistent with the uncertainty regarding the going concern assumption set out in this report.

66. Unaudited annexure B, *Analysis of property, plant and equipment as at 30 June 2014 and 30 June 2013, respectively* includes supplementary information that is inconsistent with the balances disclosed in the financial statements.

67. Unaudited annexure D, *Segmental statement of financial performance for the year ended 2013 and 2014, respectively*, includes supplementary information that is inconsistent to the class of transactions and budget information disclosed in the financial statements.

68. Unaudited annexure E(1), *Actual versus budget (revenue and expenditure) for the year ended 30 June 2014* includes supplementary information that is inconsistent to the class of transactions and budget information disclosed in the financial statements.

69. Unaudited annexure E(2), *Budget analysis of capital expenditure as at 30 June 2014* includes supplementary information that is inconsistent to the class of transactions and budget information disclosed in the financial statements.

70. Unaudited annexure G3, *Budgeted financial performance (revenue and expenditure) for the year ended June 30, 2014* includes supplementary information that is inconsistent to the class of transactions and budget information disclosed in the financial statements.

71. Unaudited annexure G4, *Budgeted capital expenditure by vote, standard classification and funding for the year ended 30 June 2014* includes supplementary information that is inconsistent to the class of transactions and budget information disclosed in the financial statements.

72. Unaudited annexure G5, *Budgeted cash flows for the year ended June 30, 2014* includes supplementary information to the classes of transactions and budget information disclosed in the financial statements.

### **Unaudited supplementary schedules**

73. The supplementary information set out on pages 74 to 92 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

74. 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 selected development priorities presented in the annual performance report, 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**

75. I am unable to report on the usefulness and reliability of the performance information, as the annual performance report of the municipality was not prepared as required by section 46 of the MSA and section 121(3)(c) of the MFMA (for municipalities).

### **Compliance with legislation**

76. 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 compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Budgets**

77. Sufficient appropriate evidence could not be obtained that expenditure was incurred in accordance with the approved budget as per section 15 of the MMFMA.

### **Financial statements, performance and annual reports**

78. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.

79. The performance management system:

- was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan; and
- did not link to the integrated development planning processes as required by section 38(a) (iii) of the MSA and regulation 7(2)(g) of the *Municipal planning and performance management regulations*.

80. The performance management system did not provide for steps of improvement where performance targets were not met, as required by section 41(1)(d) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) MSA.

81. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

82. The local community was not consulted by means of a municipal-wide structure for community participation or through a forum that enhances community participation in implementing the integrated development plan (IDP), as required by section 28 of the MSA and regulation 15(1)(a)(i) of the *Municipal planning and performance management regulations*.

83. The annual performance report for the financial year under review was not provided, as

required by section 46 of the MSA and section 121(3)(c) of the MFMA.

84. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant allocation, as required by section 12(5) of DoRA.

#### **Audit committees**

85. Sufficient appropriate evidence could not be obtained whether the audit committee advised council and the accounting officer on matters relating to internal financial control, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.

86. Sufficient appropriate evidence could not be obtained whether the audit committee advised council and the accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

87. Sufficient appropriate evidence could not be obtained whether the audit committee advised council and the accounting officer 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.

88. Sufficient appropriate evidence could not be obtained whether the audit committee responded 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.

89. Sufficient appropriate evidence could not be obtained whether the performance and audit committee reviewed the municipality's performance management system and/or made recommendations to the council, as required by regulation 14(4)(ii) of the *Municipal planning and performance management regulations*.

90. Sufficient appropriate evidence could not be obtained whether the performance and audit committee submitted, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by regulation 14(4)(a)(iii) of the *Municipal planning and performance management regulations*.

#### **Internal audit**

91. The internal audit unit did not function as required by section 165(2) of the MFMA in that:

- the unit did not report to the audit committee on the implementation of the internal audit plan; and
- the unit did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.

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

93. The performance and audit committee did not review the quarterly internal audit reports on performance measurement, as required by regulation 14(4)(a)(i) of the *Municipal planning and performance management regulations*.

## Procurement and contract management

94. Whilst performing procurement testing for the competitive bids process, appropriate audit evidence could not be obtained regarding the following:
95. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
96. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
97. 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).
98. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
99. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by inviting competitive bids and that deviations were only approved by the accounting officer if it was impractical to invite competitive bids, as required by SCM regulations 19(a) and 36(1).
100. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
101. 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, as required by SCM regulation 46(2)(e).
102. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the *Preferential procurement regulations*.
103. Contracts and quotations were awarded to bidders based on preference points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.
104. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
105. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).

106. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
107. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
108. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
109. Sufficient appropriate audit evidence could not be obtained that awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
110. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
111. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

#### **Expenditure management**

112. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
113. Payments were made from the municipality's bank account without the approval of a properly authorised official, as required by section 11(1) of the MFMA.
114. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
115. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
116. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.

#### **Asset and liability management**

117. An adequate management, accounting and information system which accounts for assets and liabilities was not in place, as required by section 63(2)(a) of the MFMA.
118. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.



## **Consequence management**

119. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.
120. The accounting officer did not always report to the South African Police Service cases of alleged irregular expenditure that constituted a criminal offence, as required by section 32(6) and 32(7) of the MFMA.
121. Allegations of fraud, corruption, favouritism, unfair or irregular practice and failure to comply with the SCM system were not investigated by the accounting officer, as required by regulation 38(1)(b) of the *Municipal supply chain management regulations*.

## **Internal control**

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

## **Leadership**

123. Management did not exercise oversight of financial and performance reporting, compliance and related internal controls.
124. Management did not establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities.
125. Management did not develop and monitor the implementation of action plans to address internal control deficiencies.

## **Financial and performance management**

126. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting.
127. Management did not implement controls over daily and monthly processing and reconciling of transactions.
128. Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.
129. Management did not review and monitor compliance with applicable laws and regulations.

## **Governance**

130. Management did not ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively.

131. Management did not ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and by providing oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

*Auditor - General*

Bloemfontein

30 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*