

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

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Phumelela Local Municipality set out on pages ... to ..., excluding the appropriation statement as set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with 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, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with 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 municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Phumelela Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

## Emphasis of matters

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 45 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

## Debt impairment

9. As disclosed in note 34 to the financial statements, the municipality provided for debt impairment of R23 987 195 (2014: R13 466 892). The provision was as a result of debtors not paying their accounts.

## Unauthorised expenditure

10. As disclosed in note 49 to the financial statements, the municipality incurred unauthorised expenditure of R52 427 833 (2014: R48 551 961). The unauthorised expenditure was as a result of the budget not being followed.

## Fruitless and wasteful expenditure

11. As disclosed in note 50 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R3 696 825 (2014: R1 598 444). The fruitless and wasteful expenditure was as a result of the municipality paying interest and fines due to the unavailability of funds to pay the creditors on time.

## Irregular expenditure

12. As disclosed in note 51 to the financial statements, the municipality incurred irregular expenditure of R5 876 576 (2014: R5 776 851). The irregular expenditure was as a result of contravention of the supply chain management regulations.

## Material losses

13. As disclosed in note 51 and 52 to the financial statements, there were material losses to the value of R9 180 454 (2014: 10 120 705) and R2 971 799 (2014: R1 193 376) as a result of electricity and water distribution losses respectively.

## Going concern

14. As disclosed in note 47 to the financial statements, the municipality had a deficit for the year ended 30 June 2015 and the municipality did not pay its suppliers within 30 days as required, furthermore high levels of distribution losses, slow collection and low recoverability of outstanding consumer accounts and unfavourable financial ratios were noted. These and the other conditions disclosed 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 objectives as outlined in the service delivery business implementation plan.

## Additional matters

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

## Unaudited supplementary schedules

16. The supplementary information set out on pages XX to XX and the appropriation statement as set out on pages XX to XX, does not form part of the financial statements and is presented as additional information. I have not audited this information and, accordingly, I do not express an opinion thereon.

## Unaudited disclosure notes

17. 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

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

## Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2015:
  - Key performance area (KPA) – basic services and infrastructure investment, on pages XX to XX

20. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
21. 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 objectives. 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).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected objectives are as follows:

## **KPA – basic services and infrastructure investment**

### Usefulness of reported performance information

#### **Reported objectives, indicators and targets not consistent with planned objectives, indicators and target**

24. Section 41(c) of the Municipal Systems Act 2000 (Act No. 32 of 2000) (MSA), requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 33% of the reported objectives, 49% of the reported indicators and 66% of the reported targets were not consistent with those in the approved service delivery and budget implementation plan. This was due to management not performing proper monitoring and review processes on the planning and reporting documents.

#### **Performance targets not specific**

25. Performance targets should be specific in clearly identifying the nature and required level of performance, as required by the FMPPI. A total of 74% of the targets were not specific.

#### **Performance indicators not well defined**

26. Performance indicators should be clearly defined so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 29% of the indicators were not well defined.

### Reliability of reported performance information

27. 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 the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information due to a lack of monitoring of the completeness of source documentation and the frequent review of the validity and accuracy of reported achievements against source documentation.

## **Additional matter**

28. I draw attention to the following matters:

### **Achievement of planned targets**

29. Refer to the annual performance report on page x to x for information on the achievement of the planned targets for the year.

### **Unaudited supplementary schedules**

30. The supplementary information set out on pages xx to xx 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**

31. 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:

## **Audit committee**

32. The audit committee did not advise the accounting officer on matters relating to accounting policies and effective governance, as required by section 166(2)(a) of the MFMA.

33. The audit committee did not advise the council and 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.

34. 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.

35. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by municipal planning and performance management regulation 14(4)(a)(ii).

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

37. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by municipal planning and performance management regulation 14(4)(a)(iii).

## **Internal audit**

38. The internal audit unit did not function as required by section 165(2) of the MFMA, in that, it did not report to the audit committee on the implementation of the internal audit plan and it did not advise the accounting officer and to the audit committee on

matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.

39. 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.

## **Asset management**

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

## **Expenditure management**

42. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
43. 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.

## **Annual report and annual financial statements**

44. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
45. 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 disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.
46. The annual performance report for the year under review did not include the performance of the external service provider, a comparison of the performance with performance in the previous financial year and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.

## **Human resource management**

47. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury, as required by section 14(2)(a) of the Municipal Regulations on Minimum Competency Levels.

## **Procurement and contract management**

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



49. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
50. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
51. 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.
52. Quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

## **Consequence management**

53. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

## **Strategic planning and performance management**

54. The performance management system and related controls relating to the planning, monitoring, measurement, review and reporting and how it is conducted, organised and managed, were not maintained as required by section 38 of the MSA and regulation 7 of the Municipal Planning and Performance Management Regulations.
55. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
56. The key performance indicators set by the municipality did not include indicators on percentage of households with access to basic level of sanitation and electricity, as required by section 43(2) of the MSA and municipal planning and performance management regulation 10(a).

## **Internal control**

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

## **Leadership**

58. The leadership did not effectively monitor and enforce corrective action plans to address the weaknesses in the processes of financial and performance reporting that were reported in the previous financial year. As a result various findings reported previously on controls and compliance regarding financial and performance information were repeated.

## Financial and performance management

59. The municipality lacks adequate personnel with relevant skills and experience pertaining to the management and reporting of financial and performance information within its directorates. Due to the lack of personnel daily and monthly controls pertaining to information, management is compromised and insufficient reviews are done to ensure the reliability of the information that is used in reporting.
60. Major constraints and weaknesses regarding information technology control environment and the financial system in use, as well as a lack of compensating manual controls to mitigate incorrect recording of transactions, again required material adjustments to be effected to the financial statements.

## Governance

61. Due to a lack of commitment by management to support the functioning of the governance structures consisting of the audit committee an internal audit, the structures did not fulfil their legislative requirements
62. Management did not implement appropriate risk management activities to ensure that regular risk assessments include risks on management of performance information.

*Auditor-General*

Bloemfontein

31 August 2016



AUDITOR - GENERAL  
SOUTH AFRICA

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