

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 have audited the financial statements of the Phumelela Local Municipality set out on pages xx to xx, 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 and 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 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 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 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.

Material impairments

8. As disclosed in note 34 to the financial statements, the municipality provided for debt impairment of R23 299 751 (2015: R23 987 195). The provision was as a result of debtors not paying their accounts.

Restatement of corresponding figures

9. As disclosed in note 45 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Going concern

10. As disclosed in note 48 to the financial statements, the municipality has unfavourable indicators in respect of current assets and current liabilities. These conditions indicate the existence of an uncertainty that may cast doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

Unauthorised expenditure

11. As disclosed in note 50 to the financial statements, unauthorised expenditure amounting to R95 720 909 (2015: R162 326 274) was incurred by the municipality. The unauthorised expenditure was due to the budgeted amount being exceeded.

Fruitless and wasteful expenditure

12. As disclosed in note 51 to the financial statements, the municipality incurred irregular expenditure of R6 016 113 (2015: R3 696 825) during the year under review mainly due to penalties and interest on long-outstanding accounts and late payments.

Irregular expenditure

13. As disclosed in note 52 to the financial statements, the municipality incurred irregular expenditure of R9 939 595 (2015: R5 876 567) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements.

Material losses

14. As disclosed in note 53 to the financial statements, the municipality incurred material losses to the value of R8 735 352 (2015: R7 532 912) and R3 147 562 (2015: R1 242 970) as a result of electricity and water distribution losses respectively.

Additional matters

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

Unaudited supplementary information

16. The appropriation statement 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 statement and, accordingly, I do not express an opinion on it.

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, 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 the selected key performance areas 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 for the following selected key performance areas (KPA) presented in the annual performance report of the municipality for the year ended 30 June 2016:

- KPA 2: Basic services and infrastructure investment on pages xx to xx.

20. 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 KPAs. 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. The material findings in respect of the selected objectives are as follows:

KPA 2 – basic services and infrastructure investment

Usefulness of reported performance information

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

23. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council

approves an adjustments budget. Changes to the service delivery and budget implementation plan during the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to important objectives and indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council.

Performance targets not measurable and indicators were not well defined and verifiable

24. The FMPPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance and measurable and specify the period or deadline for delivery. Important targets were not specific and measurable and time bound.
25. The FMPPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. Important indicators were not well defined.
26. The processes and systems that produced the indicator should be verifiable, as required by the FMPPPI. Important indicators were not verifiable.

Relevance of performance indicators

27. The FMPPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. The relevance of important indicators could not be assessed due to a lack of corroborative supporting evidence to verify management's explanation why the indicators were considered important and relevant to the realisation of strategic goals and objectives.

Reliability of reported performance information

28. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. Important indicators for the reported achievements against planned targets were not reliable because I was unable to obtain sufficient appropriate audit evidence for these targets. In addition, the reported achievements against planned targets for important indicators were not reliable when compared to the source information or evidence provided.

Additional matter

29. I draw attention to the following matters:

Achievement of planned targets

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

Unaudited supplementary schedules

31. 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

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 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:

Annual report and annual financial statements

33. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2014-15 annual report was tabled, as required by section 129(1) of the MFMA.
34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
35. The annual 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.

Expenditure management

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

Conditional grants received

40. The integrated national electrification grant was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.

Procurement and contract management

41. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).
42. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

Consequence management

43. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
44. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).
45. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Strategic and annual planning process

46. The adopted integrated development plan (IDP) did not reflect and identify the municipal council's vision for the long-term development of the municipality, and the development priorities or objectives and the KPIs and targets and a financial plan, as required by sections 26 and 41 of the Municipal Systems Act 2000 (Act No. 32 of 2000) (MSA), as well as municipal planning and performance management regulation 2(1)(c) / (e) / 3(a-c) / 10(a).
47. KPIs in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and municipal planning and performance management regulations 1 and 9(1)(a).
48. The IDP was not annually reviewed and amended by the council based on the assessment of its performance measurements and changing circumstances, as required by section 34 of the MSA and municipal planning and performance management regulations 3 and 11.
49. Changes were made to the IDP based on a comparison with the IDP for 2015-16 and the amendment(s) to the IDP was/were adopted by the council without all council members having received reasonable notice thereof and the proposed amendment having been published for public comment, as required by municipal planning and performance management regulation 3(4)/(5) or (6).
50. KPIs in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and municipal planning and performance management regulations 1 and 9(1)(a).
51. The KPIs set by the municipality did not include indicators for the percentage of households with access to basic levels of water and sanitation and electricity, as required by section 43(2) of the MSA and the municipal planning and performance management regulation 10(a).
52. Performance targets were not set for each of the KPIs for the financial year, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulations 12(1) and 12(2)(e).
53. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget did not indicate projections for each month of the revenue to be collected, by source, and/or the operational and capital expenditure, by vote, and service delivery targets and performance indicators for each quarter, as required by section 1 and 53(1)(c) of the MFMA.
54. Revisions to the service delivery and budget implementation plan were not approved by the council, as required by section 54(1)(c) of the MFMA.
55. The annual performance report for the year under review did not include the performance of the municipality and external service providers; a comparison of such performance with set targets and a comparison with the previous financial year; and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.

Internal control

56. 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

57. Leadership did not effectively monitor and enforce corrective action plans to address weaknesses in the processes of financial and performance reporting that were reported in the previous financial year. As a result, the significant compliance findings recurred and are included in the report
58. Consequence management was not effective, because the council did not investigate instances of unauthorised, irregular and fruitless and wasteful expenditure to determine whether any person was liable for the expenditure as the council had neglected to appoint a committee to investigate the expenditure.

Financial and performance management

59. The municipality lacks internal procedures as well as personnel with relevant skills and experience pertaining to the management and reporting on performance information within certain directorates. This resulted in daily and monthly controls pertaining to information management being compromised and insufficient review being performed to ensure the reliability of the information used in reporting.

Governance

60. The internal audit unit did not exist for the full financial period, which has placed a limitation on the audit committee to fulfil its oversight duties. Management also did not conduct regular risk assessments to identify risks relating to compliance and predetermined objectives.

Auditor-general

Bloemfontein

10 February 2017



AUDITOR-GENERAL
SOUTH AFRICA

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