

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

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Phumelela Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2017, 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 to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Phumelela Local Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended 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, 2016 (Act No. 3 of 2016) (Dora).

Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Material uncertainty related to going concern

6. I draw attention to the matter below. My opinion is not modified in respect of this matter:
7. Note 38 in the financial statements indicates that the municipality incurred a net loss of R23 032 506 during the year ended 30 June 2017 and, as of that date, the municipality's current liabilities exceeded its current assets by R182 376 117. In addition, the municipality owed Eskom R78 505 078 (2016: R89 893 861) and the water board R52 816 049 (2016: R36 228 534) as at 30 June 2017, which is long overdue. 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 operate as a going concern and to meet its service delivery objectives.

Emphasis of matters

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

Material impairments

9. As disclosed in note 33 to the financial statements, the municipality provided for debt impairment of R35 451 633 (2016: R23 299 751). The provision was as a result of debtors not paying their accounts.

Unauthorised expenditure

10. As disclosed in note 48 to the financial statements, unauthorised expenditure amounting to R93 565 456 (2016: R95 720 909) was incurred by the municipality. The unauthorised expenditure was due to the budgeted amount being exceeded.

Irregular expenditure

11. As disclosed in note 52 to the financial statements, the municipality incurred irregular expenditure of R11 964 432 (2016: R9 939 595) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements.

Material losses

12. As disclosed in note 50 to the financial statements, the municipality incurred material losses to the value of R13 976 193 (2016: R8 735 352) and R4 550 768 (2016: R3 147 562) as a result of electricity and water distribution losses, respectively.

Other matters

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

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFM. This disclosure requirement, as contained in the note xx to the financial statements, did not form part of the audit the financial statements and, accordingly, I do not express opinion on it.

Rental received from the Department of Agriculture

15. The municipality entered into a one-year lease agreement with the Free State Department of Agriculture in 2013 for the municipal land on farm number 275, which includes areas which might be necessary for municipal development. According to the agreement, the department had the right to exercise the option to vacate the land or extend the lease. In 2013, the land was expropriated and it is now in the name of the free State Provincial Government. Although the rental agreement was not extended, the municipality is still receiving an annual rental income amounting to R958 880 from the department although the ownership has been transferred to the Free State Department of Public Works.

Responsibilities of the accounting officer for the financial statements

16. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and 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.
17. In preparing the financial statements, the accounting officer is responsible for assessing the Phumelela Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

18. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
19. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

20. 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 material findings on the reported performance information against predetermined objectives for selected key performance areas (KPA's) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
21. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
22. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA's presented in the annual performance report of the municipality for the year ended 30 June 2017:

KPAs	Pages in the annual performance report
KPA 2 – Basic services and infrastructure investment	x – x

23. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

24. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA 2 – basic service delivery and infrastructure Investment

Various indicators

25. The reported achievements of the indicators listed below and narrative information on performance feedback were contradictory:

Performance indicator	Target	Reported achievement	Performance feedback
Number of formal residential properties connected to the municipal waste water sanitation/sewerage network for sewerage service, irrespective of the number of water closets (toilets) and billed for the service as at 30 June 2017	10923	7 964	Achieved
Number of formal residential properties that receive piped water (credit and prepaid water) that is connected to the municipal water infrastructure network and billed for the service as at 30 June 2017	10923	8 613	Achieved
Number of residential properties for which refuse is removed once per week and billed for the service as at 30 June 2017	10923	9 057	Achieved

26. The reported achievements of the indicators listed below were misstated, as the evidence provided did not agree with the reported achievements as follows:

Performance indicator	Reported achievement	Audited value
90% of the MIG funding for sport projects spent by 30 June 2017	71%	185%

27. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the indicators listed below. This was due to the unavailability of supporting documentation. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements.

Indicator	Reported achievement
Compliance to general standards with regard to waste water outflow by 30 June 2017	90%
Water quality level obtained as per SANS 241 physical and micro-parameters by 30 June 2017	95%
Limit water network losses to less than 20% by 30 June 2017	20%
100% of the electricity capital budget spent by 30 June 2017	100%

Other matters

28. I draw attention to the matters below.

Achievement of planned targets

29. Refer to the annual performance report on pages x to x; x to x for information on the achievement of planned targets for the year and explanations provided for the underachievement of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs xx to xx of this report.

Report on audit of compliance with legislation

Introduction and scope

30. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

31. The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

Expenditure management

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

33. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R610 446 as disclosed in note 49 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties on long outstanding accounts.

34. Effective steps were not taken to prevent irregular expenditure amounting to R11 964 432 as disclosed in note 50 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the supply chain management regulations.

Consequence management

35. 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.

36. 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).

37. 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).

Annual financial statements, performance and annual reports

38. 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 revenue identified by the auditors in the submitted financial statement were subsequently corrected and/or the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.

39. 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.

40. The 2015-16 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

41. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.

Budgets

42. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R93 565 456, as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending of the budget.

Human resource management

43. Appropriate systems and procedures to monitor, measure and evaluate performance of staff were not developed and adopted as required by section 67(1)(d) of the MSA.

Procurement and contract management

44. A contract was awarded to a bidder that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and Preferential Procurement Regulations.

Other information

45. The Phumelela Local Municipality's accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected KPAs presented in the annual performance report that have been specifically reported on in the auditor's report.
46. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
47. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPAs presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed on the other information obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact.
48. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

Internal control deficiencies

49. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective

was not to express any form of assurance thereon. 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.

50. The leadership did not always take timely and adequate action to address weaknesses in the reporting on financial and performance management and predetermined objectives due to a lack of monitoring and supervision, which resulted in material adjustments and audit report matters.
51. Consequence management was not effectively applied as the council did not investigate instances of irregular and fruitless and wasteful expenditure to determine whether any person was to be held liable for the expenditure. This was because the council did not appoint a committee to investigate the expenditure before it was written off.
52. Senior management did not ensure that supporting documentation for some indicators and targets were kept and that the reported information is consistent, accurate and complete. As a result, issues were reported in the audit report that could have been prevented.
53. Inadequate monitoring of the financial statements compilation process as well as a lack of skills and review by municipal officials resulted in material adjustments to the financial statements that could have been prevented.
54. Management did not regularly review and monitor compliance with laws and regulations and municipality's policies and procedures. As a result, significant non-compliance issues were noted that could have been prevented.
55. The internal audit did not adequately review and verify the information reported in the annual financial statements and performance report submitted for auditing. This resulted in various matters to be adjusted and corrected in the audit process that could have been prevented.
56. The audit committee did not adequately review the financial statements submitted for audit, as a result, there were material adjustments that could have been prevented.

Auditor-General

Bloemfontein

30 November 2017



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected key performance areas and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit 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.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Phumelela Local Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other

matters that may reasonably be thought to have a bearing on my independence and where applicable, related safeguards.