



A U D I T O R - G E N E R A L  
S O U T H A F R I C A

*Auditing to build public confidence*

# Report of the auditor-general to the North West provincial legislature and the council on the Maquassi Hills Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Maquassi Hills Local Municipality set out on pages 270 to 369, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, the statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

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

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with 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 International Standard on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are

appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## **Basis for qualified opinion**

### **Trade and other payables from exchange transactions**

6. I was unable to obtain sufficient appropriate audit evidence for retentions due the status of the accounts records. I could not confirm the retentions by alternative means. In addition, the municipality did not record all payables as required by GRAP 104 *Financial instruments*, due to an inadequate creditor management system. Trade and other payables from exchange transactions as disclosed in the statement of financial position and expenditure as disclosed in the statement of financial performance are therefore understated by R5 935 335. Consequently, I was unable to determine whether any adjustment to trade and other payables from exchange transactions of R121 030 873 as disclosed in note 13 to the financial statements was necessary.

### **Service charges**

7. The municipality did not recognise service charges as required by GRAP 9 *Revenue from exchange transactions* and GRAP 1 *Presentation of financial statement*, as the municipality did not maintain adequate records of services rendered. I was unable to determine the full extent of the understatement of service charges and trade and other receivables from exchange transactions as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments relating to revenue from service charges of R121 578 293 as disclosed in note 19 of the financial statements and trade and other receivables from exchange transactions of R21 021 603 as disclosed in note 10 to the financial statement were necessary.

### **Fruitless and wasteful expenditure**

8. Section 125 of the MFMA requires the disclosure of fruitless and wasteful expenditure incurred. I was unable to obtain sufficient appropriate audit evidence for fruitless and wasteful expenditure of R29 913 273, due to the status of the accounting records. I could not confirm fruitless and wasteful expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to fruitless and wasteful expenditure of R29 913 273 as disclosed in note 42 of the financial statement were necessary.

### **Irregular expenditure**

9. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure. I was unable to confirm irregular expenditure by alternative means. In addition, the municipality made payments of R20 287 495 in contravention with the supply chain management requirements which were not included in irregular expenditure disclosed. As the municipality did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement. Consequently, I was unable to determine whether any further adjustment relating to irregular expenditure of

R98 313 168 (2014: R92 937 753) as disclosed in note 43 to the financial statements were necessary.

## **MFMA disclosure**

10. The municipality did not include particulars of non-compliance with the MFMA in the accounting officer's report and the notes to the financial statements, as required by section 125(2) (e) of the MFMA.

## **Qualified opinion**

11. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Maquassi Hills Local Municipality as at 30 June 2015 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 the DoRA.

## **Emphasis of matters**

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

## **Material losses**

13. As disclosed in note 46 to the financial statements, material electricity and water losses to the amount of R115 112 (2014: R1 620 407) and R40 407 503 (2014: R24 136 714) were incurred.

## **Material impairments**

14. As disclosed in note 7 and 10 to the financial statements, material impairments of R184 203 882 (2014: R129 649 046) and R407 846 445 (2014: R342 711 802) were incurred as a result of the provision for irrecoverable receivables.

## **Unauthorised expenditure**

15. As disclosed in note 41 to the financial statements, unauthorised expenditure of R31 178 343 incurred in the current year and the unauthorised expenditure from prior years of R337 224 850 had not yet been dealt with in accordance with section 32 of the MFMA.

## **Going concern**

16. As disclosed in note 39 to the financial statements, the municipality are experiencing difficulties in settling its current liabilities. These conditions, along with other matters as set forth in note 39, 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**

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

## **Unaudited supplementary schedules**

18. The supplementary information set out on pages 343 to 345 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**

19. 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**

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected strategic objectives presented in the annual performance report of the municipality for the year ended 30 June 2015:

- Objective: Local economic development on page 170
- Objective: Basic service delivery and infrastructure development on page 167

21. I evaluated the performance information as indicated in paragraph 22 against the overall criteria of usefulness and reliability.

22. I evaluated the usefulness of the performance information as indicated above, 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 strategic 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).

23. I 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 selected strategic objectives are as follows:

### **Objective: Local economic development**

#### **Usefulness of reported performance information**

25. The FMPPI requires that indicators be verifiable. A total of 100% of the indicators were not verifiable. This was because management was not trained in the requirements of the FMPPI, due to a lack of proper technical indicator descriptions and effective monitoring

systems.

26. The FMPPI requires performance indicator to relate logically and directly to an aspect of the auditees mandate and the realisation of strategic goals and objectives. 100% of the indicators did not fall within the control of the municipality. The relevance of the performance indicators could not be assessed due to the performance indicator not under the direct control of the municipality.

### **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 and the auditee's records not permitting the application of alternative audit procedures.

### **Objective: Basic service delivery and infrastructure development**

#### **Usefulness of reported performance information**

28. The FMPPI requires that indicators be well defined and verifiable:

- A total of 54% of the indicators were not well defined
- A total of 100% of the indicators were not verifiable.

This was because management was not trained in the requirements of the FMPPI, due to a lack of proper technical indicator descriptions and effective monitoring systems and processes.

29. Section 41(c) of the MSA requires the IDP to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 48% of the reported objectives, 73% reported indicators and 60% reported targets in the annual performance report were not consistent with the objectives, indicators and targets as per the approved IDP. This is due to the lack of proper review and planning between the performance manager and the different departments during the drafting of the IDP and (SDBIP).

### **Additional matter**

30. I draw attention to the following matter:

#### **Achievement of planned targets**

31. Refer to the annual performance report on pages 156 to 176 for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected strategic objectives reported in paragraphs 10 to 20 of this report.

### **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 findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

33. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
34. KPIs, including input, output and outcome indicators, 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 regulations 1 and 9(1)(a) of the MPPMR.
35. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water and sanitation and electricity and solid waste removal as required by section 43(2) of the MSA and regulation 10(a) of the MPPMR.
36. Measurable performance targets for the financial year with regard to each of the development priorities or objectives and key performance indicators were not set in the IDP, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the MPPMR.
37. The adopted IDP did not reflect and identify the key performance indicators (KPIs) and targets as required by sections 26 and 41 of the MSA, as well as regulation 2(1)(e) of the Municipal planning and performance management regulations (MPPMR).
38. The municipality did not give effect to its IDP and conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and regulation 6 of the MPPMR.
39. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

### **Annual financial statements, performance and annual reports**

40. 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 on Trade and other payables from exchange transactions, service charges, fruitless and wasteful expenditure and Irregular expenditure identified by the auditors in the submitted financial statements were not correct and material misstatements on property, plant and equipment, commitments, contingent liabilities, inventory and investment property was subsequently corrected and the supporting records were provided, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
41. The 2013-14 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.
42. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2013-14 annual report in the council, as required by sections 127(3) and 133(1)(a) of the MFMA.
43. An oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013-14 annual report was tabled, as required by section 129(1) of the MFMA.
44. The annual performance report for the year under review did not include the performance of the municipality, a comparison of the performance with set targets and

comparison with the previous financial year as required by section 46(1)(a)(b) of the MSA.

## **Audit committee**

- 45. An audit committee was not in place, as required by section 166(1) of the MFMA.
- 46. A performance audit committee was not in place and the audit committee was not used to fulfil the performance audit committee function, as required by regulation 14(2) (a) of the MPPMR.

## **Internal audit**

- 47. An internal audit unit was not established, as required by section 165(1) of the MFMA.

## **Human resource management and compensation**

- 48. The municipality did not develop and adopt appropriate systems, policies and procedures to monitor measure and evaluate performance of staff in contravention of section 67(d) of the MSA.

## **Expenditure management**

- 49. 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.
- 50. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.

## **Procurement and contract management**

- 51. Sufficient appropriate audit evidence could not be obtained to confirm that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the municipality did not provide all documentation to provide evidence of a competitive bidding process.
- 52. 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) & (c).
- 53. Sufficient appropriate audit evidence could not be obtained to confirm that measures to combat the abuse of the SCM system were implemented as per the requirements of SCM regulation 38(1).
- 54. Contracts and 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).
- 55. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2) (b) of the MFMA.
- 56. 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.
- 57. 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. The municipality did not implement an SCM policy as required by section 111 of the MFMA.

## **Revenue management**

- 58. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2) (f) of the MFMA.
- 59. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2) (b) of the MFMA.

## **Consequences management**

- 60. Unauthorised, irregular and fruitless and wasteful expenditure, incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

## **Conditional grant**

- 61. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Infrastructure Grant (MIG), Municipal Systems Improvement Grant (MSIG) and Local Government Financial Management Grant (LGFMG) allocation, as required by section 12(5) of the DoRA.

## **Liability management**

- 62. An effective system of internal control for liabilities was not in place, as required by section 63(2) (c) of the MFMA.

## **Waste management**

- 63. The municipality did not exercise its legislative and executive authority as required by sections 11(3) (l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.
- 64. The municipality operated its waste disposal sites and wastewater treatment facility without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
- 65. The municipality's operational activities at its waste disposal sites and wastewater treatment facility contravened or failed to comply with the regulatory norms and standards as required by sections 67(1)(f) and (h) of the NEMWA and sections 151(1)(c) and (i) of the NWA.
- 66. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1) (c) and (d) and 26(1) (b) of the NEMWA.

## **Internal control**

- 67. I considered internal control relevant to my audit of the financial statements, performance

report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for adverse opinion, the findings on the performance report and the findings on non-compliance with legislation included in this report

## **Leadership**

68. The establishment of a culture of honestly, ethical business practices and good governance requires urgent intervention. Leadership failed to appoint sufficient appropriately skilled staff in key positions within the finance unit and the training and development initiatives failed to address the underlying deficiencies that caused matters to be reported on repeatedly.

## **Financial and performance management**

69. The accounting officer did not adequately monitor reporting, compliance with laws and regulations and internal controls. The inability to address prior year audit findings pertaining to performance reporting, non-compliance with laws and regulation and staff in the finance unit no understanding the requirement of the reporting framework is concerning. Management's lack of commitment to address repetitive findings relating to supply chain management regulations is indicative of financial misconduct.

## **Governance**

70. The Leadership failed to instil good governance principles within the municipality. These include the development and implementation of a risk management policy, fraud prevention plan, establishment of the internal audit component and the appointment of an audit committee.

## **Other reports**

### **Investigations**

71. The Special Investigations Unit (SIU) is investigating supply chain management irregularities. The investigation report was not yet finalised on date of this report.

72. The Hawks is investigating supply chain management irregularities. The investigation report was not yet finalised on the date of this report.

73. The South African Police Service (SAPS) is investigating supply chain management irregularities. The investigation was not yet finalised on the date of this report.

*Auditor-General*

Auditor General

Rustenburg

30 November 2015



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SOUTH AFRICA

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