



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 OF THE MAQUASSI HILLS LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

1.1. AUDITOR GENERAL REPORT

Introduction

1. I was engaged to audit the financial statements of the Maquassi Hills Local Municipality set out on pages 1 to 66, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information, 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), 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 for unit rates used in the calculation of the deemed cost of land and buildings, infrastructure and community

assets to the amount of R589 128 258 (2013: R612 437 289) or to confirm the value of infrastructure assets valued at cost of R53 298 460. I was unable to confirm the infrastructure assets by alternative means. Consequently, I was unable to determine whether any further adjustments relating to property, plant and equipment of R653 894 206 (2013: R660 601 069) disclosed in note 3 to the financial statements was necessary.

Trade and other payables

5. I was unable to obtain sufficient appropriate audit evidence regarding trade and other payables from exchange transaction, as the municipality did not have an adequate document management system for trade and other payables. I was unable to confirm the trade and other payables by alternative means. Consequently, I was unable to determine whether any adjustments relating to trade and other payables from exchange transactions of R105 952 872 (2013: R81 033 815) disclosed in note 14 to the financial statements was necessary.

Investment property

6. I was unable to obtain sufficient appropriate audit evidence for investment property as the information and explanations considered necessary for the valuation of these properties was not available. I was unable to confirm the valuation by alternative means. Consequently, I was unable to determine whether any adjustment to investment property of R32 587 374 (2013: R32 587 374) disclosed in note 4 to the financial statements was necessary.

Trade and other receivables

7. I was unable to obtain sufficient appropriate audit evidence for other debtors of R2 518 286 included in trade and other receivables from non-exchange transactions of R14 978 355 as the municipality did not have an adequate document management system for other debtor transactions and journal entries. I was unable to confirm the other debtors included in receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables from non-exchange transactions of R14 978 355 included in the financial statements was necessary.
8. In the prior year, I was unable to obtain sufficient appropriate audit evidence for trade and other receivables as the municipality did not have an adequate document management system for debtor transactions and journal entries. In addition, trade and other receivables from exchange transactions and non-exchange transactions were overstated by R3 240 715 and debt impairment expense is understated with the same amount as the municipality did not calculate its impairment of trade and other receivables in accordance with the requirements of SA Standards of GRAP, GRAP 104, *Financial instruments*. Consequently, I was unable to determine whether any further adjustments relating to the corresponding figure for trade and other receivables from exchange transactions and non-exchange transactions of R92 270 078 and R276 893 180 disclosed in note 9 and 11 to the financial statements respectively were necessary. Consequently my audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. As management did not take adequate corrective steps, I was unable to determine whether any adjustment to this amount was necessary. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Fruitless and wasteful expenditure

9. I was unable to obtain sufficient appropriate audit evidence for the opening balance of fruitless and wasteful expenditure of R15 276 434 disclosed in note 42 to the financial

statements. As the municipality did not quantify the full extent of the fruitless and wasteful expenditure in the prior years, it was impracticable to determine the resultant understatement of fruitless and wasteful expenditure as per note 42 to the financial statements.

Irregular expenditure

10. I was unable to obtain sufficient appropriate audit evidence for the opening balance of irregular expenditure of R5 667 124 disclosed in note 43 to the financial statements. As the municipality did not quantify the full extent of the irregular expenditure in the prior years, it was impracticable to determine the resultant understatement of irregular expenditure as per note 43 to the financial statements.

Inventories

11. I was unable to obtain sufficient appropriate audit evidence regarding inventories, as the municipality did not have an adequate document management system to ensure that all land stock and water inventory was recorded. I was unable to confirm the inventories by alternative means. Consequently, I was unable to determine whether any adjustment to inventories of R710 520 (2013: R660 463) disclosed in note 6 to the financial statements was necessary.

Revenue

12. In the prior year, I was unable to obtain sufficient appropriate audit evidence regarding revenue, as the municipality did not have an adequate document management system for revenue transactions and journal entries. I was unable to confirm revenue by alternative means. Consequently, I was unable to determine whether any adjustment relating to revenue of R302 342 579 disclosed in the statement of financial performance and note 18 to the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Expenditure

13. In the prior year, I was unable to obtain sufficient appropriate audit evidence for journals included in expenditure. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently I was unable to determine whether any adjustment relating to repairs and maintenance, bulk purchases, contracted services and general expenses of R137 811 354 as disclosed in the statement of financial performance and note 32, 31 and 25 respectively, to the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Capital commitments

14. In the prior year, the municipality did not have an adequate contract management system in place for the identification and recognition of commitments. Consequently, I was unable to determine whether any adjustment to the corresponding figure disclosed as R6 016 193 in note 34 to the financial statements was necessary. My audit opinion on

the financial statements for the period ended 30 June 2013 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Accumulated surplus

15. I was unable to obtain sufficient appropriate audit evidence that the limitations placed on my audit in the prior year relating to expenditure have been resolved. I was unable to confirm these limitations by alternative means. Consequently I was unable to determine whether any adjustments relating to accumulated surplus of R500 892 382 (2013: R501 429 766) disclosed in the statement of changes in net assets was necessary.

Cash flow statement

16. Taking into account the misstatements identified in the financial statements and set out in this report, I was unable to practicably quantify the misstatements in the cash flow statement and notes thereto for both the current and prior year. Consequently, I was unable to determine the accuracy, completeness and presentation and disclosure of the cash flow statement and notes thereto.

Disclaimer of opinion

17. 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

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

Unauthorised expenditure

19. As disclosed in note 41 to the financial statements, unauthorised expenditure of R14 358 018 was incurred in the current year and the unauthorised expenditure from prior years of R295 751 818 had not yet been dealt with in accordance with section 32 of the MFMA.

Impairments and material losses

20. As disclosed in note 28 and 46 to the financial statements, impairments of R77 682 859 (2013: R89 561 798) and material losses of R17 562 557 (2013: R9 303 757) respectively were incurred as a result of significant impairment of debtors and electricity and water losses.

Additional matters

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

Unaudited disclosure notes

22. 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.

Unaudited supplementary schedules

23. The supplementary information set out on pages 67 to 68 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 REGULARITY REQUIREMENTS

24. 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 the selected development priorities presented in the annual performance report, non-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

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the Maquassi Hills Local Municipality for the year ended 30 June 2014:
- Development priority 1: Technical services on pages 186 to 187
 - Development priority 2: Municipal manager on pages 150 to 165
 - Development priority 3: Basic services on pages 188 to 193
26. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
27. 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 development. 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).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected development priorities are as follows:

Development priority 1: Technical services

Usefulness of reported performance information

30. I did not raise any material findings on the usefulness of the reported performance information for technical services.

Reliability of reported performance information

31. 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. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of documented system descriptions for the accurate recording of actual achievements, monitoring of the completeness of source documentation in support of actual achievements and the frequent review of the validity of reported achievements against source documentation.

Development priority 2: Municipal manager

Usefulness of reported performance information

32. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan (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 100% of the reported objectives, 50% reported indicators and 100% reported targets were not consistent with the objectives, indicators and targets as per the approved IDP. This is due to the lack of proper planning and communication between the performance manager and the different departments during the drafting of the IDP and service delivery budget implementation plan (SDBIP).
33. The FMPPI requires that targets must be specific in clearly identifying the nature and required level of performance. A total of 25% of the targets were not specific. This was because management did not adhere to the requirements of the FMPPI.

Reliability of reported performance information

34. 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. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves 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.

Development priority 3: Basic services

Usefulness of reported performance information

35. 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 60% of the reported indicators and 48% of targets were not consistent with those in the IDP.
36. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measurable and time bound:
- A total of 40% of the targets were not specific.
 - A total of 20% of the indicators were not well defined.

This was due to a lack of proper technical indicator descriptions.

Reliability of reported performance information

37. 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. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of monitoring of the completeness of source documentation in support of actual achievements.

Additional matters

38. I draw attention to the following matters:

Achievement of planned targets

39. Refer to the annual performance report on pages 150 to 193 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 development priorities reported in paragraphs 30 to 37 of this report.

Compliance with legislation

40. 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 and performance management

41. An integrated development plan (IDP) was not adopted after the start of the council's elected term, as required by section 25 of the MSA.
42. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner which was consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
43. The municipality did not establish a performance management system, as required by section 38(a) of the Municipal Systems Act.
44. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
45. Key performance indicators, 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 the Municipal planning and performance management regulation 1 and 9(1)(a).
46. 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 the Municipal planning and performance management regulations 12(1) and 12(2)(e).
47. The performance management system and related controls were not maintained as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised

and managed, including determining the roles of the different role-players, as required by sections 38 of the MSA and regulation 7 of the MPPMR.

48. The annual performance report for the year under review did not include the performance of external service providers and a comparison of the 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.

Budgets

49. Expenditure was not incurred in accordance with the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

50. 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 current and non-current assets and liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently 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 opinion.
51. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2012/13 annual report was tabled, as required by section 129(1) of the MFMA.

Audit committee

52. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
53. The audit committee did not advise the council 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.
54. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
55. 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.

Internal audit

56. 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.
57. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
- it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.
 - it did not report to the audit committee on the implementation of the internal audit plan.

- it did not advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, loss control.

Human resource management and compensation

58. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the MSA.
59. 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.
60. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
61. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by regulation 14(2)(a) of the Municipal Regulations on Minimum Competency Levels.
62. An approved staff establishment was not in place as required by section 66(1)(a) of the MSA.

Expenditure management

63. 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.
64. 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

65. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as bidding documentation was not available to test compliance, as require by Supply Chain Management (SCM) regulations 17(a) and (c), 19(a) and 36(1).
66. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
67. 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).
68. Bid specifications for procurement of goods and services through competitive bids were drafted in a biased manner that did not allow all potential suppliers to offer their goods or services, in contravention of SCM regulation 27(2)(a).
69. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) & 22(2).

70. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
71. 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).
72. 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).
73. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) or did not qualify for the contract, in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
74. 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.
75. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
76. 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 122(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).
77. 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.
78. The municipality did not implement an SCM policy as required by section 111 of the MFMA.

Revenue management

79. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.

Consequence management

80. 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 Grants

81. The Municipal Systems Improvement Grant (MSIG) and Local Government Financial Management Grant (LGFM) allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of the DoRA.

82. The municipality did not evaluate its performance in respect of programmes or functions funded by the MSIG and LGFM allocation, as required by section 12(5) of the DoRA.

Waste management

83. The municipality operated its wastewater treatment facilities 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).

84. The municipality's operational activities at its waste disposal sites and wastewater treatment facilities contravened or failed to comply with the requirements of a waste management license, section 67(1)(f) and (h) of the NEMWA and section 151(1)(c) and (i) of the NWA.

85. 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.

86. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

Internal control

87. 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 basis for the qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

88. Council has failed to adopt any oversight reports to address the audit outcomes of prior year audits, especially those pertaining to fruitless, irregular and unauthorised expenditure. An overall culture of honesty, ethical business practices and good governance, protecting and enhancing the interests of the entity does not exist. Management does not exercise their oversight responsibility regarding financial and performance reporting and compliance and related internal controls. Due to the lack of proper HR management, skilled resources are not in place and performance is not monitored. There are no consequences for poor performance and transgressions and management did not establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities.

Financial and performance management

89. Management did not implement proper record keeping ensuring that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Internal control over daily and monthly processing and reconciling of transactions is properly implemented and regular, accurate and complete performance reports that are supported and evidenced by reliable information is not prepared. Furthermore the municipality did not review and monitor compliance with applicable laws and regulations and they did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

Governance

90. Management failed to implement appropriate risk management activities to ensure that regular risk assessments are conducted and that a risk strategy is developed and monitored to address the risks relating to financial and performance reporting and compliance with laws and regulations. The internal audit and audit committee did not adequately fulfill all its functions, due to the municipality being under administration for 6 months. This resulted in the oversight of the internal control environment over financial and performance information and compliance with laws and regulations being ineffective.

Auditor General

Potchefstroom

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence