

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

Report on the financial statements

Introduction

1. I have audited the financial statements of the Nala Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and appropriation statement 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 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 Nala 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 DoRA.

Emphasis of matters

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

Going concern

8. Note 38 to the financial statements indicates that the municipality had a deficit for the year ended 30 June 2015 and, as of that date, the municipality's current liabilities exceeded its current assets. These and the other conditions disclosed indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to meet its financial obligations as they fall due and to achieve service delivery objectives as outlined in the Service Delivery and Budget Implementation Plan (SDBIP).

Material losses

9. As disclosed in note 49 to the financial statements, material electricity and water losses of R10 627 694 (2014: R13 725 205) and R12 403 814 (2014: R1 701 280), respectively, were incurred as a result of line losses, tampering and theft.

Irregular expenditure

10. As disclosed in note 42 to the financial statements, the municipality incurred irregular expenditure of R11 751 465 (2014: R67 810 775) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements. In addition, the full extent of irregular expenditure is still being determined.

Additional matter

11. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

12. 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

13. 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 key performance areas (KPA) 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

14. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - KPA1: Basic service delivery on pages x to x
15. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
16. 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 KPA. 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)*.
17. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
18. The material findings in respect of the selected KPA are as follows:

Key performance area 1: Basic service delivery

Usefulness of reported performance information

19. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 60% of the reported objectives were not consistent with those in the approved integrated development plan. This was due to inadequate reviews conducted on the annual performance report.
20. Performance targets should be measurable as required by the FMPPPI. I could not measure the required performance for 20% of the targets.
21. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPPI. A total of 45% of the indicators were not well defined.

22. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 100% of the indicators were not verifiable.

The above were due to a lack of proper systems and processes for predetermined objectives.

Reliability of reported performance information

23. 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. Adequate and reliable corroborating evidence could not be provided for all of the targets to assess the reliability of the reported performance information. This was due to limitations placed on the scope of my work as the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matter

24. I draw attention to the following matter:

Achievement of planned targets

25. Refer to the annual performance report on pages x to x and x to x 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 KPA reported in paragraphs 19 to 23 of this report.

Compliance with legislation

26. 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:

Strategic planning and performance management

27. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
28. The SDBIP for implementing the municipality's delivery of municipal services and annual budget did not indicate projections for each month of the capital expenditure, by vote, as required by section 1 of the MFMA.
29. The annual performance report for the year under review did not include a comparison of the performance with the previous financial year and measures taken to improve performance as required by section 46(1)(b) and (c) of the MSA.

30. The annual performance agreements for the senior manager of technical services could not be obtained and it could therefore not be established whether the agreement is linked to the measurable performance objectives approved with the budget and to the SDBIP as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.
31. A performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement as well as how it is conducted, organised and managed, including determining the roles of the different role-players, as required by section 38 of the MSA and municipal planning and performance management (MPPM) regulation 7.

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. An effective system of expenditure control, including procedures for the withdrawal or payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.
34. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, as required by section 65(2)(b) of the MFMA.
35. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

36. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
37. 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).
38. 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.

Human resource management

39. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff in contravention of section 67(1)(d) of the MSA.
40. The competencies of the chief financial officer, financial and SCM officials were not assessed in a timely manner to identify and address gaps in competency levels as required by municipal regulation on minimum competency levels 13.

41. The municipality did not submit a report on compliance with the prescribed competency levels to the National Treasury and relevant provincial treasury as required by municipal regulations on minimum competency levels 14(2)(a).

Audit committee

42. 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.
43. 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.
44. 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.
45. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by MPPM regulation 14(4)(a)(ii).
46. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by MPPM regulation 14(4)(a)(i).
47. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPM regulation 14(4)(a)(iii).
48. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

49. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not report to the audit committee on the implementation of the internal audit plan.
 - it did not advise the accounting officer and report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management as well as loss control.
50. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

Asset management

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

52. The municipality did not establish an investment policy that had been adopted by the council, as required by section 13(2) of the MFMA and municipal investment regulation 3(1)(a).

Revenue management

53. A credit-control and debt-collection policy was not maintained and implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
54. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Annual report and annual financial statements

55. 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.
56. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2013-14 annual report had been tabled, as required by section 129(1) of the MFMA.
57. 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 non-current assets, current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Grant management

58. Municipal infrastructure grant funds were retained or rolled over to the next financial year without seeking the approval of the National Treasury, as required by section 22(1) of DoRA.

Internal control

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

Leadership

60. Leadership's implementation of recommendations in prior year management reports was slow, especially relating to oversight functions such as the audit committee and internal audit unit which did not improve from the prior year.
61. Management had not implemented consequence management for the past number of years to set the tone at the top that compliance with legal and ethical standards is a prerequisite. This resulted in various non-compliance matters.

62. Human resource management was not effective in ensuring that competent and sufficiently skilled officials were appointed and that performance was monitored.
63. The action plan process was not effective, as it did not timeously address financial and performance reporting matters and non-compliance occurring during the financial year.

Financial and performance management

64. During the year under review, management was slow to implement policies and procedures to regularly review and monitor compliance with laws and regulations as well as performance information.
65. Management did not timeously ensure that all prior year audit recommendations were implemented, resulting in errors that had to be corrected as well as non-compliance.

Governance

66. Neither the internal audit unit nor management timeously took action to ensure that the internal audit unit functioned properly giving rise to various internal control weaknesses in financial and performance reporting not being detected. This also hampered the functioning of the audit committee which could not execute its prescribed mandate.

Other reports

Investigations

67. An investigation is being conducted by the National Prosecuting Authority into findings relating to procurement as contained in the report of the Public Protector of South Africa issued during September 2010. The investigation was still ongoing at the reporting date.

Auditor-General

Bloemfontein

30 November 2015



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence