

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

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Matjhabeng Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2017, the statement of financial performance, 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 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 Matjhabeng 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 this 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 relating to going concern

6. I draw attention to the matter below. My opinion is not modified in respect of this matter:
7. Note 47 to the financial statements, indicates that the municipality incurred a net loss of R550 278 707 during the year ended 30 June 2017 and, as of that date, the municipality's current liabilities exceeded its current assets by R2 576 323 820. In addition, the municipality owed Eskom R1 464 169 380 (2016: R 957 081 689) and the water board R1 886 576 057 (2016: R 1 552 021 591) as at 30 June 2017. This debt is long overdue. These conditions, along with commitments and contingent liabilities as set forth in note 41 and 42 of the annual financial statements respectively, 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.

Irregular expenditure

9. As disclosed in note 51 to the financial statements, irregular expenditure of R323 171 276 (2016: R305 669 955) was incurred, due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

10. As disclosed in note 50 to the financial statements, fruitless and wasteful expenditure of R186 771 314 (2016: R149 978 569) was incurred, mainly due to interest and penalties charged for late payments by suppliers.

Restatement of corresponding figures

11. As disclosed in note 44 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2017.

Material losses

12. As disclosed in note 52 to the financial statements, material electricity losses of R74 080 387 (2016: R75 434 684) was incurred, which represents 13,25% (2016:18,70%) of total electricity purchased, mainly due to tampering and theft.
13. As disclosed in note 52 to the financial statements, material water losses of R299 865 808 (2016: R205 292 597) was incurred, which represents 51,30% (2015: 50,45%) of total water purchased, mainly due to leakages, burst water pipes, line losses, tampering and theft.

Material impairments

14. As disclosed in note 12 to the financial statements, receivables from non-exchange transactions was impaired by R187 612 632 (2016: R173 681 854).
15. As disclosed in note 14 to the financial statements, receivables from exchange transactions was impaired by R1 532 476 770 (2016: R1 187 481 412).

Other matters

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

Unaudited disclosure notes

17. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement, as contained in note 52 to the financial statements, did not form part of the audit of the financial statements and, accordingly, I do not express opinion on it.

Service delivery matters

18. The construction of Thabong T16 waterborne sanitation of 1 300 stands project started in 2014 at a project value of R61 899 139. During the project site visit, it was identified that the lower lying areas of T16 sewer outfall were to gravitate to the pump station and from pump station to treatment plant because the area is sloping down and there is a need for a booster pump for the outfall to be able to divert to the waste water treatment plant. However, the municipality prioritised the construction of the toilet structures, plumbing, internal sewer ahead of the bulk network at the pump station due to poor planning; the sewer pipeline was not connected to the pump station. This resulted in sewer overflow around the area of construction at pump station and also within few meters of the residential area, which caused pollution of the environment and compromised the safety and health of the residents of Thabong.
19. The municipality entered into an agreement for the upgrading of Nyakallong waste water treatment works in 2012 for the amount of R52 299 552. A contractor was appointed in 2012 and paid an amount of R8 800 776 until 2013. In 2016, a new contractor was appointed, which is the contractor currently on site and is been paid to date an amount of R10 849 612. The accumulative amount, including amounts paid to the consultants, expensed on this contract to date is R29 689 653. The significant delays on the project have resulted in unbearable odour to the residential dwelling due to sewerage outflows running across the street.

Responsibilities of the accounting officer for the financial statements

20. 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.
21. In preparing the financial statements, the accounting officer is responsible for assessing the Matjhabeng 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 the intention is to liquidate the municipality or cease operations, or there is no realistic alternative but to do so.

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

22. 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 aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

23. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

24. 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 (KPAs) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
25. 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.
26. 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 KPAs presented in the annual performance report of the municipality for the year ended 30 June 2017:

KPA	Pages in the annual performance report
KPA 1 – basic service delivery and infrastructure investment	x – x

27. I performed procedures to determine whether the reported performance information 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.
28. The material findings in respect of the reliability of the selected KPA are as follows:

KPA 1 – basic service delivery and infrastructure

Various indicators

29. The reported achievements for the indicators listed below were misstated, as the evidence provided did not agree with the reported achievements:

Indicator	Reported achievement	Audited value
Number of informal settlements formalised in identified wards	21	8
Number of pump stations refurbished to comply with Green Drop Standards	12	10
Number of sumps cleaned in the next financial year	4	6
Number of dysfunctional water meters replaced	2 800	1 700

Length (km) of undersigned gravel roads constructed

30. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of length of undersigned gravel roads constructed. This was due to limitations placed on the scope of my work, as a result of non-submission 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 achievement of 10km.

Other matters

31. I draw attention to the matters below.

Achievement of planned targets

32. Refer to the annual performance report on pages 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 reliability of the reported performance information in paragraphs 29 to 30 of this report.

Report on the audit of compliance with legislation

Introduction and scope

33. 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.

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

Annual financial statements, performance and annual reports

35. 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, liabilities and expenditure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

36. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (Municipal Systems Act).

Procurement and contract management

37. Due to poor record keeping, sufficient appropriate audit evidence could not be obtained that all contracts were awarded in accordance with the legislative requirements as reported in paragraph 38, 39 and 43 below. Similar limitation was also reported in the previous year.

38. Sufficient appropriate audit evidence could not be obtained that quotations were awarded only to bidders who submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

39. Sufficient appropriate audit evidence could not be obtained that quotations were only accepted from, and contracts awarded to, bidders whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43. Similar non-compliance was also reported in the previous year.

40. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the previous year.

41. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).

42. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).

43. Sufficient appropriate audit evidence could not be obtained that contracts were awarded only to bidders who submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

44. The performance of some of the contractors or service providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

45. Awards were made to service providers who were in the service of the municipality and whose directors were in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, the service provider failed to declare that s/he was in the service of the municipality, as required by SCM regulation 13(c).
46. Awards were made to service providers who were in the service of other state institutions and whose directors were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44.

Expenditure management

47. Effective steps were not taken to prevent irregular expenditure of R323 171 276 as disclosed in note 51 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 SCM processes.
48. Effective steps were not taken to prevent fruitless and wasteful expenditure of R220 861 454 as disclosed in note 50 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was caused by interest levied by Eskom on late payments.
49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Assets management

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

Liabilities management

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

Human resource management

52. 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 Municipal Systems Act.

Budgets

53. Reasonable steps were not taken to prevent unauthorised expenditure of R1 031 091 788 as disclosed in note 49 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by failure to budget for impairment of financial assets, and under-budgeting of bulk purchases and depreciation.

Other information

54. The Matjhabeng 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 and those selected KPAs presented in the annual performance report that have been specifically reported in the auditor's report.
55. 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.
56. 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.
57. 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

58. 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.
59. The leadership did not always take adequate corrective actions in time to address weaknesses in the finance and performance reporting directorate. This resulted in non-compliance with applicable legislation and gave rise to unauthorised, irregular and fruitless and wasteful expenditure.
60. The leadership did not ensure that an organisational structure that is aligned to the municipality's needs was approved on time. As a result, personnel that needed to address the municipality's needs were not appointed during the financial year. The municipality tried to address the capacity constraints in the finance section by appointing the consultants; however, this may result in overreliance on the consultants if capacity constraints are not addressed.
61. Management did not, in all instances, prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information. This resulted in material differences that gave rise to material adjustments in the annual financial statements submitted for auditing. Additionally, controls over revenue management were not effective, resulting in significant consumer accounts being billed using estimates without actual meter readings being taken.

62. The municipality did not implement effective human resource management to ensure that performance is monitored for all employees. As a result, material weaknesses in the internal controls environment reported in the previous year were not addressed.
63. The audit committee was not effective during the financial year as they only met twice. The contracts of all the audit committee members expired at the end of June 2017 and, as a result, they were not available to review the financial statements before they were submitted for auditing.
64. The internal audit division was not adequately resourced to plan and execute risk-based audits. As a result, a significant number of audits planned for 2016-17 were not done and they could not adequately advise the accounting officer and report to the audit committee on implementing the internal audit plan and matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, performance management, loss control and compliance with the legislation.

Other reports

65. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
66. At the time of this report, there was an ongoing investigation being conducted by the South African Police Services into allegations of unauthorised amendments to the supplier banking details on the municipality's accounting system. The investigation covers the specific incident that occurred on 13 May 2016.
67. There was an ongoing investigation into allegations of forgery of the a signature of a municipal official that resulted in a payment being made without a service being rendered to the municipality. This investigation is being conducted by the South African Police Services and covers a specific incident that occurred on 11 November 2015. At the time of this report, this investigation had not yet been finalised.

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 Matjhabeng 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.