

# Report of the Auditor-General to Limpopo Provincial Legislature and the council on Aganang local municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Aganang local municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, the cash flow statement and the statement of comparison of budget information with actual information 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 Standard of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No 56 of 2003) (MFMA), Division of Revenue Act (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 these financial statements based on my audit. I conducted my 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. 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

### Accumulated surplus

6. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for accumulated surplus. As disclosed in the statement of financial position, the restatement was made to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the accumulated surplus corresponding figure stated at R104 783 701 in the financial statements was necessary

### Property, plant and equipment

7. I was unable to obtain sufficient appropriate audit evidence for an impairment loss in the accounting records and financial statements of the municipality as the impairment loss calculations could not be provided. I could not confirm the correctness of the impairment loss by alternative means. Consequently, I was unable to determine whether any adjustment to impairment loss stated at R753 905 in the note 5 to the financial statements was necessary.
8. The municipality did not review the residual values and useful lives of its assets in accordance with SA Standards of GRAP 17, *Property, Plant and Equipment* which resulted in the incorrect calculation of depreciation and impairment on the assets. Consequently I was not able to determine the correct net carrying amount of assets amounting to R43 068 463, disclosed in the note 5 to the financial statements, as it was impracticable to do so. Furthermore, I could not determine the impact of the above on the stated depreciation on the property plant and equipment in note 5 to the financial statements.
9. The municipality incorrectly included work in progress amounting to R4 704 237 in property, plant and equipment. This balance was also incorrectly taken into account when calculating the impairment loss on property, plant and equipment. As a result of the matters reported in the preceding paragraph, I could not determine the net impact on the balance property, plant and equipment in the financial statements.
10. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for property, plant and equipment and depreciation. As disclosed in note 5 to the financial statements, the restatement was made to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the property, plant and equipment and depreciation's corresponding figures stated at R39 096 910 and R3 753 133 respectively in the financial statements was necessary.

### Trade and other payables

11. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for trade and other payables. As disclosed in note 6 to the financial statements, the restatement was made to rectify a prior year misstatement. I was unable to confirm the restatement by alternative means. Consequently, I was unable to determine whether any adjustment to the trade and other payable's corresponding figure stated at R8 921 409 in the note 6 to financial statements was necessary.

## **Receivables**

12. The municipality did not provide for any impairment on its long outstanding receivables. The municipality estimated that an amount of R54 919 552 will be irrecoverable in the current year. However, no provision for such debt impairment was made. Consequently the municipality has overstated its receivables by R54 919 552 and understated the provision for debt impairment by the same amount.

## **Revenue**

13. I was unable to obtain sufficient appropriate audit evidence about revenue received, as the municipality did not recognise traffic fines revenue in line with SA Standards of GRAP 23, *Revenue from non-exchange transactions* and GRAP 1, *Applying the probability test on initial recognition of revenue*. The municipality's records did not permit the application of alternative procedures. Consequently, I am unable to determine whether any adjustments to the traffic fine revenue stated at R751 756 in the financial statements was necessary.

## **General expenses**

14. I identified a number of transactions, included in general expenses, where the VAT portion of expenditure in the financial statements and accounting records was incorrectly applied. This resulted in the overstatement of general expenses by R2 033 323 and understatement of VAT receivable by the same amount.

15. I identified invoices for expenditure incurred during the year, not accounted for in the financial statements. I was unable to determine the full extent of the expenditure not recorded in the accounting records. Consequently, I was unable to determine whether any adjustments to general expenses amounting R51 517 502 and trade and other payables amounting R9 020 950, stated in notes 21 and 6 respectively, to the financial statements was necessary.

## **Irregular expenditure**

16. I identified procurement of Goods and services amounting to R876 362 was procured in contravention of the supply chain management requirements. As per note 26.3 to the financial statements, this amount did not form part of irregular expenditure. Consequently, I was unable to determine the full extent of the understatement in irregular expenditure stated as R8 344 431 as it was impracticable to do so. Furthermore, the municipality did not include particulars of irregular expenditure in note 26.3 to the financial statements as required by section 125(ii)(d) of the MFMA.

## **Cash flow statement**

17. SA Standards of GRAP 2 *Cash flow statements*, requires that the municipality summarises its operating, investing and financing activities. The municipality did not prepare and present its cash flow statement in accordance with GRAP 2, *Cash flow*

statements. Consequently, the cash flow statement was not properly prepared and presented as a result of an overstatement of cash flow from operating activities by R24 310 017!

### **Qualified opinion**

18. 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 the Aganang local municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

19. I draw attention to the matters below. My opinion is not modified in respect of these matters.
20. As disclosed in the note 26.1 to the financial statements, the municipality incurred unauthorised expenditure amounting R 1 440 040 as municipality overspent the budgeted expenditure.

### **Restatement of corresponding figures**

21. As disclosed in note 25 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

### **Material underspending of the conditional grant**

22. As disclosed in the note 16.1 to the financial statements, the municipality has materially underspent the conditional grant received for basic services delivery and infrastructure development programme to the amount of R8 135 454.

### **Additional matters**

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

### **Unaudited supplementary schedules**

24. The supplementary information set out on pages xx to xx 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.

### **Unaudited disclosure notes**

25. 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.

**Based on other legal and regulatory requirements**

26. 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 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**

27. 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 municipality for the year ended 30 June 2014:

- Basic service delivery and infrastructure development on pages x to x
- Local economic development on pages x to x
- Financial viability and management on pages x to x
- Good governance and public participation on pages x to x

28. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

29. 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 programmes. 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).

30. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

31. The material findings in respect of the selected development objectives are as follows:

**Basic service delivery and infrastructure development**

**Usefulness of reported performance information**

**Measurability**

32. The FMPPI requires that performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 23% of the indicators were not well defined. This was because management did not adhere to the requirements of the FMPPI as the technical indicator

descriptions were not well defined. There was also a lack of standard operating procedures and documented system descriptions for the accurate recording of actual achievements and technical indicator descriptions for the accurate measurement, recording and monitoring of performance.

### **Additional matters**

33. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development priorities, I draw attention to the following matters:

### **Achievement of planned targets**

34. Refer to the annual performance report on pages 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 development priorities reporting in this report.

### **Adjustment of material misstatements**

35. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information of basic services and infrastructure, local economic development and planning, financial viability and good governance participation priorities.

### **Compliance with laws and regulations**

36. 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:

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

37. 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 disclosure items identified by the auditors were subsequently corrected, resulting in the financial statements receiving a qualified audit opinion.

38. Financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1) (a) of the MFMA.

### **Budget**

39. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget in contravention of section 15 of the MFMA.

## **Procurement and contract management**

40. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
41. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 22(1)(a) and the *Preferential Procurement Regulations*.
42. 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).
43. 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.
44. 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.

## **Expenditure management**

45. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred or accounted for creditors, as required by section 65(2)(b) of the MFMA.
46. Reasonable steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
47. Money owed by the municipality was not always paid within 30 days, as required by section 65(2) (e) of the MFMA.

## **Liability management**

48. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2) (a) of the MFMA.

## **Assets management**

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

## **Internal control**

50. 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 non-compliance with legislation included in this report.

## **Leadership**

51. The accounting officer did not develop and implement adequate policies, procedures and process to guide the operations of the municipality.
52. The accounting officer did not implement adequate measures to ensure that the annual financial statements were adequately reviewed before it was submitted for audit.
53. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting, compliance and related internal controls.
54. The leadership did not implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place.
55. The accounting officer did not implement all the recommendations made by the internal audit unit to improve the internal control environment and thereby accurate financial and performance reporting.

## **Financial and performance management**

56. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored.
57. Management did not implement the daily and monthly controls designed for the municipality's business processes.

Polokwane

10 February 2015



*Auditing to build public confidence*