

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

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Dihlabeng Local Municipality set out on pages XX to XX, 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 Dihlabeng Local Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with South African Standards of General 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 my 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 related to going concern

6. I draw attention to the matter below. My opinion is not modified in respect of this matter:
7. Note 48 in the financial statements, indicates that the municipality incurred a net loss of R74 121 500 (2016: R54 204 702) during the year ended 30 June 2017 and the municipality's current liabilities exceeded its current assets by R254 651 169 (2016: R172 235 928). In addition, the municipality owed Eskom R172 364 929 (2016: R108 217 546) as at 30 June 2017 which is long overdue. These conditions, along with other matters as set forth in note 48, 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.

Unauthorised expenditure

9. As disclosed in note 50 to the financial statements, unauthorised expenditure of R83 107 226 (2016: R76 123 483) was incurred, due to expenditure that exceeded the limits provided for in the main divisions of the approved budget.

Fruitless and wasteful expenditure

10. As disclosed in note 51 to the financial statements, fruitless and wasteful expenditure of R22 589 654 (2016: R11 887 300) was incurred, mainly due to interest and penalties charges on the late payment of suppliers and SARS.

Irregular expenditure

11. As disclosed in note 52 to the financial statements, irregular expenditure of R11 176 819 (2016: R37 079 173) was incurred, due to non-compliance with supply chain management (SCM) requirements.

Restatement of corresponding figures

12. As disclosed in note 45 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

13. As disclosed in note 23 to the financial statements, water distribution losses of 37.65% (2016: 32.78%) and electricity distribution losses of 14.44% (2015: 7.83%) were incurred by the municipality mainly due to the ageing infrastructure of the networks, leakages in the water network and the illegal connections in the electricity network.

Other matters

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

Unaudited disclosure notes

15. 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.

Supplementary explanations of budget variances

16. The supplementary explanations of budget variances contained in the accounting officer's report, as referred to in note 54, do not form part of the financial statements. I have not audited these explanations and accordingly do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

17. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with 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.
18. In preparing the financial statements, the accounting officer is responsible for assessing the Dhlabeng 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

19. 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 the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
20. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

21. 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.
22. 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/measures 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.
23. 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 – Accelerated service delivery and infrastructure development	x – x

24. 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.

25. The material finding in respect of the usefulness and reliability of the selected KPA is as follows:

KPA 1 – Accelerated service delivery and infrastructure development

225.4Km of Municipal paved/tarred Roads and 203.1km of gravel roads maintained as per the approved Maintenance Plan. Development, approval and implementation of Roads Master Plan by 2017.

The following target was reported in the annual performance report while it was not approved in the IDP. This is not in line with the requirements of section 41(c) of the MSA. Additionally, the target was not specific and measurable in clearly identifying the nature and required level of performance as required by the FMPPPI:

- Implementation of infrastructure asset maintenance program

To comply with Disaster Risk Management Act.

The following targets were reported in the annual performance report while they were not approved in the IDP. This is not in line with the requirements of section 41(c) of the MSA:

- Extend fire services to Fouriesburg

The following target did not specify the period or deadline for delivery, as required by the FMPPPI:

- Review disaster risk plan

Various indicators

The following indicators and targets were not reported in the annual performance report while they were approved in the integrated development plan (IDP). This is not in line with the requirements of section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA):

- Fouriesburg 6ML reservoir, 4,6km pipeline and Appurtenant works constructed and functional by 2017
- Existing recycling projects
- An adopted IWMP

The following targets as determined during planning were not specific and measurable in clearly identifying the nature and required level of performance as required by the FMPPPI:

- Implementation of WSDP
- Implementation of sanitation master plan

The following targets did not specify the period or deadline for delivery, as required by the FMPPi:

- Implementation of maintenance program for all public lighting, high mast light, traffic signals with DLM
- Draft contingency plans for approval

Other matters

26. I draw attention to the matters below.

Achievement of planned targets

27. Refer to the annual performance report on pages x to x; 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 finding on the usefulness and reliability of the reported performance information in paragraphs xx to xx of this report.

Adjustment of material misstatements

28. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1 - accelerated service delivery and infrastructure development. As management did not correct all the misstatements I raised a material finding on the usefulness of the reported performance information.

Report on the audit of compliance with legislation

Introduction and scope

29. 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.

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

Annual financial statements

31. 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, current liabilities and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided, resulting in the financial statements receiving an unqualified audit opinion.

Human resource management and compensation

32. Job descriptions were not established for all posts in which appointments were made, as required by section 66(1)(b) of the MSA.

Expenditure management

33. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
34. Effective steps were not taken to prevent irregular expenditure amounting to R11 176 819 (2016: R37 079 073) as disclosed in note 52 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 supply chain management (SCM) regulations.
35. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R22 589 654 (2016: R11 887 300), as disclosed in note 51 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless & wasteful expenditure was caused by interest and penalties paid on Eskom, SARS and other creditors due to cash flow constraints during the year as well as payments made to fictitious suppliers.

Procurement and contract management

36. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Similar non-compliance was also reported in the prior year.

Asset management

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

Consequence management

38. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
39. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
40. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Government grants and subsidies

41. The municipality did not evaluate its performance in respect of programmes or functions funded by the Regional Bulk Infrastructure Grant, as required by section 12(5) of the DoRA.

Budget

42. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R83 107 226, as disclosed in note 50 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of unauthorised expenditure was caused by the increase in the provision for bad debts and bulk purchases of electricity above the budgeted amounts.

Other information

43. The Dhlabeng 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 thereon and the selected KPA presented in the annual performance report that have been specifically reported on in the auditor's report.
44. 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.
45. 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.
46. 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

47. 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.
48. Leadership did not always take timely and adequate action to address weaknesses in the reporting on financial and performance management, due to lack of monitoring and supervision, which resulted in material adjustments in the financial statements and the annual performance report.
49. Leadership did not always take timely and adequate action to address weaknesses in the supply chain management section due to lack of skilled staff, which resulted in non-compliance with applicable legislation and gave rise to irregular expenditure.
50. Consequence management was not effective as the council did not investigate instances of unauthorised, irregular and fruitless and wasteful expenditure to determine whether any person was liable for the expenditure.

Other reports

51. Fraudulent changes were made to the banking details on the municipality's suppliers' list, resulting in payments made to fictitious bank accounts. The matter was reported to the South African Police Service (SAPS) and the case was ongoing at the time of this report.
52. Subsequent to an internal investigation that was instituted by the municipality into possible irregularities with the cash count process at certain units in the municipal area, certain employees were suspended and dismissed and the case was reported to the SAPS. The investigation is currently in progress and a final report has not been submitted.

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 development area 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 Dhlabeng 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 here applicable, related safeguards.