



AUDITOR-GENERAL  
SOUTH AFRICA

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# FINAL MANAGEMENT REPORT

## KAROO HOOGLAND LOCAL MUNICIPALITY

30 JUNE 2016

**Communicated to management on: 10 November 2016**





## MANAGEMENT REPORT

KAROO HOOGLAND LOCAL MUNICIPALITY

30 June 2016

Discussed with management on: 17 November 2016

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## **MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE KAROO HOOGLAND LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2016**

### **INTRODUCTION**

**1. Our responsibility is to:**

- express an opinion on the financial statements
- express a conclusion in the management report on the usefulness and reliability of the reported performance information for selected development priorities, and report the material findings in the auditor's report
- report on material findings relating to compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

Our engagement letter sets out our responsibilities and those of the accounting officer in detail.

- 2.** This management report includes audit findings arising from the audit of the financial statements, reporting on predetermined objectives and compliance with legislation for the year ended 30 June 2016. These findings were communicated to management and the report details management's response to these findings. The report includes information on the internal control deficiencies that we identified as the root causes of the matters reported. Addressing these deficiencies will help to improve the audit outcome.
- 3.** This management report consists of an executive summary and annexures containing the detailed audit findings.
- 4.** The purpose of the management report is to communicate audit findings to the accounting officer and does not constitute public information. The auditor's report is finalised only after the management report has been communicated. All matters included in this report that relate to the auditor's report remains in draft form until the final auditor's report is signed. In adherence to section 50 of the PAA, we do not disclose any information obtained during the audit and contained in this management report.

## EXECUTIVE SUMMARY

### SECTION 1: Interactions with stakeholders responsible for oversight and governance

5. During the audit cycle, we met with the following key stakeholders responsible for oversight and governance to communicate matters relating to the audit outcome of the municipality:

| Stakeholder                         | Number of interactions |
|-------------------------------------|------------------------|
| Municipal council                   | 0                      |
| Municipal public accounts committee | 0                      |
| Mayor of the municipality           | 2                      |
| Municipal manager                   | 4                      |
| Audit committee                     | 1                      |

6. At these interactions, we discussed the audit approach, audit progress, suspected or alleged fraud, deficiencies in internal control and misstatements identified during the audit process. All stakeholders made commitments to implement initiatives that can maintain/improve the audit outcome. The commitments given and the progress of previous commitments are included in section 2.6, which deals with the assessment of assurance providers.

**SECTION 2: Matters relating to the auditor's report**

**2.1 MISSTATEMENTS IN THE FINANCIAL STATEMENTS**

7. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the municipality's system of internal control. These material misstatements also constitute non-compliance with section 122 of the Municipal Finance Management Act (MFMA).
8. The misstatements that were not corrected form the basis for the qualified opinion on the financial statements.

| Financial statement item                    | Material misstatement Finding   |                        | Impact R current year | Impact R prior year |
|---|---|------------------------|-----------------------|---------------------|
|   | Material misstatement   | Occurred in prior year |                       |                     |
| <b>Material misstatements not corrected</b> |   |                        |                       |                     |
| Non-current assets                          |   |                        |                       |                     |
| Property plant and equipment                | PPE: Property plant and equipment not physically verified. (Ex 33)                                      | Yes                    | 55 410 584            | -                   |
| Property plant and equipment                | PPE: No sufficient evidence to confirm if asset were properly assessed for impairment. (Ex 41)          | Yes                    | 3 877 712             | -                   |
| Property plant and equipment                | PPE: Land and buildings not in the name of the municipality were recorded in the asset register.(Ex 49) | Yes                    | 36 147 994            | -                   |
| Property plant and equipment                | PPE: Incomplete land and buildings. (Ex 48)   | Yes                    | 46 064 463            | -                   |
| Property plant and equipment                | PPE: Prior period error adjustments.(Ex 64)   | Yes                    | 86 960 470            | -                   |
| Investment property                         | Investment property: Incomplete investment register.(Ex 50)   | Yes                    | 24 901 710            | -                   |
| <b>Material misstatements corrected</b>     |   |                        |                       |                     |
| <b>Revenue</b>                              |   |                        |                       |                     |
| Grants                                      | Grant revenue not correctly classified into conditional and unconditional grants received               | No                     | 4 366 852             |                     |



| Material misstatement Finding |  | Occurred in prior year | Impact R current year | Impact R prior year |
|-------------------------------|--|------------------------|-----------------------|---------------------|
| Financial statement item      |  |                        |                       |                     |
| <b>Expenditure</b>            |  |                        |                       |                     |
| General expenses              | Expenditure: Classification of Grant Expenditure.                                    | No                     | 3 109 282             |                     |
| <b>Disclosures</b>            |  |                        |                       |                     |
| Remuneration of councillors   | Remuneration per each councillor not disclosed in notes to the financial statements. | No                     | 2 139 474             |                     |

## 2.2 MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS

### Emphasis of matter paragraphs

9. The following emphasis of matter paragraphs will be included in our auditor's report to draw the users' attention to matters presented or disclosed in the financial statements:

### Restatement of corresponding figures

10. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

### Material losses and impairments

11. As disclosed in note 45 to the financial statements, 16.76 % material losses of electricity (2015: 10.45%) were incurred as a result of technical losses, faulty meters and illegal connections.
12. As disclosed in note 5 to the financial statements, material impairment to the amount of R3 829 038 (2015: 3 493 874) were incurred as a result of the impairment of receivables from non-exchange transactions.
13. As disclosed in note 7 to the financial statements, material impairment to the amount of R15 772 657 (2015: 13 459 440) were incurred as a result of the impairment of receivables from exchange transactions.

### Irregular expenditure

14. As disclosed in note 44 to the financial statements, the municipality incurred irregular expenditure of R3 722 458 (2015: R11 925 044) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements. The total amount of irregular expenditure recorded in the annual financial statements at 30 June 2016 amount to R27 105 403 (2015: R23 382 945).

### Additional matter paragraphs

15. The following additional matter paragraphs will be included in our auditor's report to draw the users' attention to matters regarding the audit, the auditor's responsibilities and the auditor's report:

### Unaudited supplementary information

16. The supplementary information set out in appendix A-D does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

### 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 did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## 2.3 REPORT ON PREDETERMINED OBJECTIVES

18. I am unable to report on the usefulness and reliability of the performance information, as the annual performance report of the municipality as required by section 46 of the MSA and section 121(3)(c) of the MFMA was provided without complete and accurate underlying records, integrated development plan and service delivery budget implementation plan for the year under review as required by section 25 of the MSA and section 1, 21 and 53 of the MFMA.

## 2.4 FINDINGS ON COMPLIANCE WITH LEGISLATION

19. Included below are material findings on compliance with selected specific requirements of applicable legislation, as set out in the general notice issued in terms of the PAA.

### **Strategic planning and performance management**

20. The adopted integrated development plan (IDP) did not reflect the key performance indicators and targets as required by sections 26 and 41 of the MSA, as well as Municipal planning and performance management regulation 2(1)(c).
21. The municipality did not establish a performance management system as required by section 38(a) of the MSA.
22. Key performance 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).
23. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation, electricity and solid waste removal as required by section 43(2) of the MSA and the Municipal planning and performance management regulation 10(a).

### **Financial statements, performance and annual reports**

24. 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 identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving a qualified audit opinion.

### **Procurement and contract management**

25. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
26. The preference point system was not 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).
27. Contracts 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).
28. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.





29. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

#### **Human resource management and compensation**

30. 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 Municipal Systems Act.
31. The senior manager directly accountable to the municipal manager did not sign a performance agreement, as required by section 57(2)(a) of the Municipal Systems Act.
32. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

#### **Expenditure management**

33. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

#### **Consequence management**

34. 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 Municipal Finance Management Act.
35. Irregular and 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 Municipal Finance Management Act.




#### **Asset management**

36. 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.




## 2.5 INTERNAL CONTROL
















37. Below is our assessment of implementing the drivers of internal control based on significant deficiencies identified during our audit of the financial statements, the annual performance report and compliance with legislation. Significant deficiencies occur when internal controls do not exist, are not appropriately designed to address the risk, or are not implemented. These either had caused, or could cause, the financial statements or the [annual performance report to be materially misstated, and material instances of non-compliance with legislation to occur.

38. The internal controls were assessed as follows:

|   |   |
|---|---|
|  | The required preventative or detective controls were in place.  |
|  | Progress was made on implementing preventative or detective controls, but improvement is still required, or actions taken were not or have not been sustainable.  |
|  | Internal controls were either not in place, were not properly designed, were not implemented or were not operating effectively. Intervention is required to design and/or implement appropriate controls. |

39. The movement in the status of the drivers from the previous year-end to the current year-end is indicated collectively for each of the three audit dimensions under the three fundamentals of internal control. The movement is assessed as follows:

|   |           |
|---|-----------|
|  | Improved  |
|  | Unchanged |
|  | Regressed |

|   | Financial statements  |   | Performance reporting   |   | Compliance with legislation   |   |
|---|---|---|---|---|---|---|
|   | Current year  | Prior year  | Current year  | Prior year  | Current year  | Prior year  |
| <b>Leadership</b>   |   |   |   |   |   |   |
| <b>Overall movement from previous assessment</b>  |  |   |  |   |  |   |
| • Provide effective leadership based on a culture of honesty, ethical business practices and good governance, and protecting and enhancing the best interests of the entity |  |  |   |  |  |  |
| • Exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls                                       |  |  |   |  |  |  |

|  | Financial statements |            | Performance reporting |            | Compliance with legislation |            |
|--|----------------------|------------|-----------------------|------------|-----------------------------|------------|
|  | Current year         | Prior year | Current year          | Prior year | Current year                | Prior year |
| <ul style="list-style-type: none"> <li>Implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored</li> </ul>                                  |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities</li> </ul>                   |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Develop and monitor the implementation of action plans to address internal control deficiencies</li> </ul>  |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Establish an information technology governance framework that supports and enables the business, delivers value and improves performance</li> </ul>   |                      |            |                       |            |                             |            |
| <b>Financial and performance management</b>  |                      |            |                       |            |                             |            |
| <b>Overall movement from previous assessment</b>   | ↑                    |            | ↔                     |            | ↔                           |            |
| <ul style="list-style-type: none"> <li>Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting</li> </ul> |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Implement controls over daily and monthly processing and reconciling transactions</li> </ul>  |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information</li> </ul>  |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Review and monitor compliance with applicable legislation</li> </ul>  |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Design and implement formal controls over information technology systems to ensure the reliability of the systems and the availability, accuracy and protection of information</li> </ul>           |                      |            | N/A                   | N/A        | NA                          | N/A        |
| <b>Governance</b>  |                      |            |                       |            |                             |            |
| <b>Overall movement from previous assessment</b>   | ↑                    |            | ↔                     |            | ↑                           |            |

|   | Financial statements |            | Performance reporting |            | Compliance with legislation |            |
|---|----------------------|------------|-----------------------|------------|-----------------------------|------------|
|   | Current year         | Prior year | Current year          | Prior year | Current year                | Prior year |
| <ul style="list-style-type: none"> <li>Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored</li> </ul>                    |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively</li> </ul>   |                      |            |                       |            |                             |            |
| <ul style="list-style-type: none"> <li>Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation</li> </ul> |                      |            |                       |            |                             |            |

## Leadership

### Effective leadership culture

40. Management established a formal code of conduct that addressed appropriate ethical and moral behaviour, but the code was not communicated to all staff and staff was not trained to properly understand and implement the code. Instances of management override and numerous cases of fraud and theft are being investigated.

### Oversight responsibility

41. The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting.

### Human resource management

42. We identified the following shortcomings in human resource management relating to predetermined objectives:

- The municipality did not have sufficient capacity to plan, manage and report on its performance.

43. An assessment of human resource management has identified the follow

#### Performance management

- No performance management system in place for employees other than senior managers.
- Senior managers did not sign performance agreements
- Performance agreements not linked to the measurable performance objectives.



### **Policies and procedures**

44. The municipality did not have documented and approved internal policies and procedures to address planning, implementation, monitoring and reporting processes and events pertaining to financial, and performance management and reporting.
45. The municipality did not have documented and approved internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting of performance information.
46. The municipality did not develop and implement proper performance planning and management practices to provide for the development of performance indicators and targets.

### **Action plans to address internal control deficiencies**

47. The municipality developed a plan to address internal and external audit findings, but the appropriate level of management did not monitor adherence to the plan in a timely manner.

### **Information technology governance framework**

48. The municipality did not have an IT security policy in place during the period under review.
49. There is no IT manager or IT personnel to oversee IT matters and implementation of IT controls.
50. There is a lack of IT policies and procedures such as user access, disaster recovery.
51. The review of user access did not take place regularly.

### **Financial and performance management**

#### **Proper record keeping**

52. The municipality did not have a proper record management system to maintain information that supported the reported performance in the annual performance report. This included information that related to the collection, collation, verification, storing and reporting of actual performance information.

#### **Daily and monthly processing and reconciling of transactions**

53. Management did not implement the following monthly control designed for the municipality's business processes:
  - Monthly fixed asset register reconciliations were not prepared.

#### **Regular, accurate and complete financial and performance reports**

54. As indicated in section 2.1 of this report, the financial statements contained material misstatements that were not corrected. This was mainly due to a lack of adequate review and risk assessment as well as weaknesses in the design and implementation of internal control in respect of financial management and financial reporting.

#### **Compliance monitoring**

55. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored.

## Information technology systems

56. The weaknesses surrounding security management, IT service continuity and user account management were due to the following:

- Inappropriately skilled IT resource, to design and implementation appropriate controls, which was further compounded by budgetary constraints.
- Lack of management commitment to develop and monitor action plans to address internal control deficiencies previously raised.
- Karoo Hoogland Local Municipality did not have sufficient budgetary means to employ an IT unit and relies on the services of a contracted IT service provider. Due to this reason, the municipality did not have staff that was aware of the formal processes that should be implemented for an effective management of IT controls.

## Governance

### Risk management activities and risk strategy

57. The municipality did not conduct a risk assessment, as required by the MFMA.

### Internal audit

58. We are concerned about the following matters regarding the effectiveness of the internal audit unit, which require attention:

- The internal audit unit did not conduct internal audits or reviews of performance information systems and management that focused on compliance aspects as well as the usefulness and reliability of the reported performance information.
- The internal audit unit did not review financial and performance reports to confirm the reliability of the reports before their submission to the audit committee or external auditors.
- The internal audit unit did not review supply chain management.
- The internal audit unit did not review compliance with legislation.
- The internal audit unit did not follow up the implementation of internal and external audit recommendations to address audit findings.

### Audit committee

59. A performance audit committee was not in place to fulfil to performance audit committee function.

## Summary

60. The matters above, as they relate to the basis for the qualified opinion, findings on the annual performance report and findings on compliance with legislation, will be summarised in the auditor's report as follows:

### Leadership

61. The accounting officer did not exercise adequate oversight responsibility over the preparation of the financial statements, the report on predetermined objectives, compliance with laws and

regulations, and internal control. The leadership did not implement adequate processes to ensure that reviews took place before information was submitted. This was evidenced by the material misstatements in the financial statements, non-compliance with laws and regulations and internal control deficiencies noted throughout the audit process.

62. Senior management did not adhere to internal controls, which resulted in various instances of irregular and unauthorised expenditure being incurred and other material misstatements in the financial statements, not detected by management.
63. Management is in process to establish, update and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes, and responsibilities within the municipality.

#### **Financial and performance management**

64. Material misstatements were made in the financial statements as these were not accurate and complete, because senior management did not detect misstatements during the review process. This indicates that there were weaknesses in internal control with regard to the review process of the financial statements. Furthermore, the financial statements were not sufficiently reviewed for completeness and accuracy prior to submission for auditing.
65. There were deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.
66. The supply chain management unit of the municipality did not always function effectively. The necessary procedures were not always followed.

#### **Governance**

67. An appropriate risk management activity was not implemented to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored.

## 2.6 ASSURANCE PROVIDERS AND STATUS OF IMPLEMENTATION OF COMMITMENTS AND RECOMMENDATIONS

68. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance. One of the important oversight functions of the legislature and council is to consider auditees' annual reports. To perform this oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report includes our auditor's report, which provides assurance on the credibility of the financial statements and the annual performance report, as well as on the auditee's compliance with legislation.
69. Our reporting and the oversight processes reflect on past events, as it takes place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.
70. We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in section 2.5) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

### Senior management—Provides some assurance

71. A lot of progress was made during the year under review in resolving prior year findings; the municipality continues to improve as the number of components that contain material misstatements have reduced. Therefore senior management is making progress, and comfort could be obtained from management. Compliance and performance information are still areas of concern.

### Municipal manager— Provides some assurance

72. A lot of progress was made during the year under review. The municipal manager holds his staff accountable. The municipal manager initiated improvement in addressing prior year findings, therefore the municipal manager contributed to the progress made, and comfort could be obtained from the municipal manager. The only area of concern is performance information and compliance with supply chain regulations and policies.

### Mayor of municipality— Provides some assurance

73. The public perception of the mayor is good. The mayor interacted with the audit team during the audit process. There were however material amendments on the annual report and the financial statements that should have been addressed.

### Internal audit— Provides limited assurance

74. Legislation in South Africa requires the establishment and roles and responsibilities of internal audit units. Internal audit units form part of the internal control and governance structures of the municipality and play an important role in its monitoring activities. Internal audit provides an independent assessment of the municipality's governance, risk management and internal control processes.
75. The internal audit unit of a municipality must prepare a risk-based audit plan and internal audit programme for each financial year. It must 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 MFMA. The internal audit unit must also perform such other duties as may be assigned by the accounting officer.





76. The internal audit provided limited assurance as they did not review the performance information, procurement and contract management and effectiveness of internal controls.

#### Audit committee– Provides some assurance

77. The audit committee is an independent advisory body to the council, accounting officer and the management and staff of the municipality on matters relating to internal financial control and internal audits; risk management; accounting policies; the adequacy, reliability and accuracy of financial reporting and information; performance management; effective governance; the DoRA, MFMA, Treasury Regulations and any other applicable legislation; performance evaluation; and any other issues.

78. The audit committee is also expected to review the annual financial statements to provide an authoritative and credible view of the municipality, its efficiency and effectiveness and its overall level of compliance with the applicable legislation.

79. The audit committee reviewed the financial statements prior to submission for audit. The audit committee also provided feedback on fraud pertaining to the municipality during the audit process. However, the audit committee did not review performance information for the period under review.

#### Municipal council– Provides some assurance

80. The municipal council did not ensure that the municipality has approved policies and procedures subsequent to the same finding being raised in prior year. This resulted in a weak control environment and consequently misstatements in the financial statements.

#### MPAC– Provides some assurance

81. The extent to which the council adopted the MPAC guides has been considered in the assessment of MPAC as an assurance provider.

82. We noted that the MPAC adopted the prior year annual report without any amendments.

83. MPAC is politically stable and keeps the Mayor accountable. MPAC was however not able to influence the municipality in such a way that all unauthorised, irregular and fruitless expenditure could be prevented.

#### Status of implementing commitments and recommendations

84. Below is our assessment of the progress in implementing the commitments made by the municipality to address the prior and current year's audit findings.

| No. | Commitment   | Made by                      | Date         | Status      |
|-----|--|------------------------------|--------------|-------------|
| 1   | Ensure that the Internal Audit submit regular report to Municipal Manager                | G von Mollendorf             | 30 June 2016 | Implemented |
| 2   | Ensure that the Audit Committee meets at least four times per annum                      | G von Mollendorf             | 30 June 2016 | Implemented |
| 3   | Ensure the recovery of these expenses are done in accordance with Section 32 of the MFMA | G von Mollendorf / S Myburgh | 30 June 2016 | In progress |
| 4   | Implement controls to ensure electricity losses are within the norm of 7-10%             | F Lotter                     | 30 June 2016 | In progress |
| 5   | Ensure that a calculation of the PPPFA 80/20 and 90/10 is done                           | D Vermeulen                  | 30 June 2016 | In progress |

| No. | Commitment  | Made by                          | Date              | Status      |
|-----|---|----------------------------------|-------------------|-------------|
|     | and documented for all tenders above R 30 000. If above R 30 000 and below R 1 Mil the 80/20 calculation must be used if more than R 1 Mil the 90/10 calculation must be used. Work through the entire population to ensure compliance. |                                  |                   |             |
| 6   | Ensure Asset Register reconcile to G/L and updated for 2015/2016 Financial year   | F Lotter<br>A Haas               | 31 July 2016      | Implemented |
| 7   | Develop PM template and populate on FMS to maintain the PMS on the FMS  | G von<br>Mollendorf<br>C Viljoen | 31 August<br>2016 | In progress |
| 8   | Establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities.   | G von<br>Mollendorf              | 30 June 2016      | In progress |
| 9   | Implement proper internal controls regarding the monitor and review of the procurement process.   | D Vermeulen                      | 30 June 2016      | In progress |
| 10  | Ensure that a fraud prevention plan is in place   | C Viljoen                        | 31 March<br>2016  | Implemented |
| 11  | Outsourced activity ensure that Asset register is complete and updated  | A Haas                           | 15 August<br>2016 | In progress |
| 12  | Ensure landfill sites have licences   | F Lotter                         | 30 June 2016      | In progress |

85. 37 audit recommendations accepted by management in the prior year on matters included in the auditor's report and other important matters were implemented, or alternative actions were taken to resolve the finding.
86. 26 recommendations are still being implemented and 2 have not been addressed, or very limited progress has been made.
87. Details on the status of implementing the previous year's recommendations are provided in section 8, which summarises the detailed audit findings.

## 2.7 OTHER REPORTS

88. I draw attention to the following engagements conducted by various parties that have or could potentially have an impact on the matters reported on the municipality's financial-, performance- and compliance. The reports noted do not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

### Investigations

89. Fraud allegations against senior officials are still under investigation. The matter has been reported to the South African Police Service. The investigation was still ongoing at the reporting date.

## SECTION 3: Specific focus areas

### 3.1 FINANCIAL VIABILITY

90. Our audit included a high-level overview of the municipality's financial viability as at year-end. The financial viability assessment provides useful information for accountability and decision-making purposes and complements the financial statements by providing insights and perspectives thereon. The financial viability assessment is expected to enhance timely remedial decision-making and policy reforms where financial viability may be at risk. It will also highlight to management those issues that may require corrective action and the urgency and magnitude of the reforms and decisions necessary to maintain operations. The information should be used to complement, rather than substitute, management's own financial assessment.

| FINANCIAL VIABILITY ASSESSMENT   |   |                       |                       |
|--|---|-----------------------|-----------------------|
| (Limitation = unable to obtain sufficient appropriate information to assess the indicator) |   | AS AT 30 JUNE<br>2016 | AS AT 30 JUNE<br>2017 |
| <b>EXPENDITURE MANAGEMENT</b>  |   |                       |                       |
| 1.1  | Creditor-payment period   | 203 Days              | 172 Days              |
| <b>REVENUE MANAGEMENT</b>  |   |                       |                       |
| 2.1  | Debtor-collection period (after impairment)   | 57 Days               | 62 Days               |
| 2.2  | Debtors impairment provision as a percentage of accounts receivable                                     | 83%                   | 82%                   |
|  | • Amount of debtors impairment provision  | R19 601 695           | R16,953,314           |
|  | • Amount of accounts receivable   | R23 575 089           | R20,646,966           |
| <b>ASSET AND LIABILITY MANAGEMENT</b>  |   |                       |                       |
| 3.1  | A deficit for the year was realised (total expenditure exceeded total revenue)                          | No                    | No                    |
|  | • Amount of the surplus / (deficit) for the year  | R1 994 032            | R1 037 963            |
| 3.2  | A net current liability position was realised (total current liabilities exceeded total current assets) | Yes                   | Yes                   |
|  | • Amount of the net current assets / (liability) position   | (R30 594 084)         | (R32 882 585)         |
| 3.3  | A net liability position was realised (total liabilities exceeded total assets)                         | No                    | No                    |
|  | • Amount of the net asset / (liability) position  | R204 182 310          | R173 049 011          |
| 3.4  | Liquid assets as a percentage of total current liabilities (acid test percentage)                       | 26%                   | 17%                   |
|  | • Amount of liquid assets (total current assets less inventory less prepayments)                        | R10 951 841           | R6 943 034            |
|  | • Amount of total current liabilities   | (R41 560 480)         | (R39 833 519)         |
| <b>CASH MANAGEMENT</b>   |   |                       |                       |
| 4.1  | The year-end bank balance was in overdraft  | No                    | No                    |
|  | • Amount of year-end bank balance (cash and cash equivalents) / (bank overdraft)                        | R6 503 433            | R2 913 329            |
| 4.2  | Net cash flows for the year from operating activities were negative                                     | No                    | No                    |
|  | • Amount of net cash in / (out)flows for the year from operating activities                             | R10 826 029           | R11 058 638           |
| 4.3  | Creditors as a percentage of cash and cash equivalents  | 167%                  | 333%                  |

| FINANCIAL VIABILITY ASSESSMENT   |  |  |
|--|--|--|
| (Limitation = unable to obtain sufficient appropriate information to assess the indicator)   | AS AT 30 JUNE<br>2016                      | AS AT 30 JUNE<br>2017                      |
| <ul style="list-style-type: none"> <li>Amount of creditors (accounts payable)</li> <li>Amount of cash and cash equivalents / (bank overdraft) at year-end</li> </ul>   | <b>R10 885 955</b><br><b>R6 503 433</b>    | <b>R9 707 161</b><br><b>R2 913 329</b>     |
| OVERALL ASSESSMENT   |  |  |
| Overall the financial viability is assessed as:  | <b>Yellow<br/>(Unfavorable indicators)</b> | <b>Yellow<br/>(Unfavorable indicators)</b> |
| * <i>This (these) amount(s) has (have) been adjusted for uncorrected misstatements that resulted in the modification of the audit opinion and will therefore not agree to the financial statement amounts.</i> |  |  |

91. A creditor payment period that is significantly above the norm of 30 days has been noted for the current and prior year, this leads to an incurrence of fruitless and wasteful expenditure.
92. A slightly higher debtor's collection period noted for the current and prior year, this leads to an impairment provision of more than 50% of accounts receivables.

### 3.2 PROCUREMENT AND CONTRACT MANAGEMENT

93. The audit included an assessment of procurement processes, contract management and the related controls in place. To ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system, the processes and controls need to comply with legislation and minimise the likelihood of fraud, corruption, favouritism and unfair and irregular practices.

94. A summary of the findings from the audit are as follows:

#### Irregular expenditure

95. R3 288 414 (100%) of irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. The root causes of the lack of effective prevention and detection are inadequate training of supply chain management officials and a lack review and monitoring of compliance with applicable legislation.

#### Procurement processes

96. The table below is a summary of findings identified on procurement processes:

|   | Total  |            | Quotations |           | Contracts |            |
|---|--------|------------|------------|-----------|-----------|------------|
|   | Number | Value      | Number     | Value     | Number    | Value      |
| <b>Awards selected for testing</b>                            | 41     | 11 421 538 | 33         | 1 100 178 | 8         | 10 321 360 |
| <b>Expenditure incurred on selected awards - current year</b> |        | 9 421 538  |            | 1 100 178 |           | 8 321 360  |
| <b>Awards on which non-compliance was identified</b>          | 37     | 4 459 071  | 33         | 1 100 178 | 3         | 2 924 849  |
| <b>Irregular expenditure identified</b>                       | 11     | 3 167 321  | 8          | 242 472   | 3         | 2 924 849  |

#### Procurement processes – general

97. 3 quotations to the value of R113 252 were procured from suppliers without valid tax clearance from the South African Revenue Services.

98. 3 contracts with a value of R2 924 849 were procured without inviting competitive bids, and the deviations were not approved.

99. 9 contracts and quotations with a value of R467 733 were awarded without applying the preference points system.

100. 27 quotations were awarded to bidders who did not submit a declaration of whether they were employed by the state or connected to any person employed by the state.

#### Contract management

101. The performance of 5 contractors or providers was not monitored monthly. The total value of related contracts was R13 354 279.

### Internal control deficiencies

- The accounting officer did not exercise adequate oversight responsibility over financial and performance reporting, compliance with laws and regulations as well as internal control which resulted in:
- Inadequate control to ensure that interests is declared
- SCM officials are not aware of the policies and procedures under all circumstances
- There is not an effective internal monitoring system to determine, on the basis of a retrospective analysis, whether the authorised SCM processes are being followed and whether the desired objectives are being achieved.
- SCM officials are not trained on the implementation of the SCM policy



### 3.3 FRAUD AND CONSEQUENCE MANAGEMENT

102. The primary responsibility for preventing and detecting fraud rests with management and those charged with governance. We are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and to issue an auditor's report that includes our opinion. Due to the inherent limitations of an audit, there is a risk that some material misstatements, including fraud, may not be detected.
103. No findings have been identified.
104. The MFMA and its regulations clearly stipulate that matters such as incurring unauthorised, irregular as well as fruitless and wasteful expenditure; the possible abuse of the SCM system (including fraud and improper conduct); and allegations of financial misconduct should be investigated. Disciplinary steps should be taken based on the results of the investigations. Our audits included an assessment of the municipality's management of consequences. The significant findings are provided below:

#### Failure to implement consequences

105. The table below provides a summary of transgressions from the previous year that were either not investigated or proper disciplinary steps were not taken after investigation.

#### Unauthorised, irregular and fruitless and wasteful expenditure

| Finding  | Value      |
|--|------------|
| Unauthorised expenditure identified in the previous year was not investigated to determine whether a person was liable for the expenditure           | 10 599 769 |
| Irregular expenditure identified in the previous year was not investigated to determine if a person was liable for the expenditure.                  | 11 925 044 |
| Fruitless and wasteful expenditure identified in the previous year was not investigated to determine whether a person was liable for the expenditure | 350 937    |

#### Transgressions identified in the current year

106. Unauthorised, irregular and fruitless and wasteful expenditure disclosed in note 42, 43 and 47 to the financial statements must be investigated to determine whether any official is liable for losses incurred as a result of the unauthorised, irregular and fruitless and wasteful expenditure. Disciplinary steps must be taken against officials who caused or permitted the unauthorised, irregular and fruitless and wasteful expenditure and losses incurred as a result must be recovered from the person liable.



### 3.4 UTILISATION OF CONDITIONAL GRANTS

#### Utilisation of conditional grants received

107. For the financial year under review, the audit included an assessment of the effectiveness of the utilisation of the following conditional grant received:

- Municipal Infrastructure Grant (MIG)

108. The following compliance findings were identified in the utilisation of selected grant:

| Finding  | National MIG Grant | N/A | N/A |
|--|--------------------|-----|-----|
| Quarterly non-financial performance reports were not submitted to the transferring national officer and the relevant provincial treasury within 30 days after the end of each quarter. | ✓                  |     |     |

109. No audit findings were noted on the effectiveness of the utilisation of conditional grant received.

110. For each of the grants tested as per the table above, we selected key projects funded by the grant and audited the utilisation of grants on the project. Listed below are the audit findings identified for each project.

| Summary of selected key project and result of testing                            | Details                                 |
|--|---|
| Name of grant  | <b>MIG</b>                              |
| Project/initiative funded by the grant   | <i>MIG 1358 : Sutherland Bulk Water</i> |
| Results of testing procurement of goods and services for the project             | Findings identified                     |
| Misstatements were identified on the accounting for the assets/ work-in-progress | Yes- misstatement identified            |
| Results of testing the receipt of goods/ services for the project                | No misstatement identified              |

### 3.5 PUBLIC PARTICIPATION

111. Sub-outcome 2 as per MTSF chapter 9 aims at addressing poor communication with communities and weak and ineffective platforms for public participation. The anticipated impact through this sub-outcome is to strengthen the capacity of municipalities, especially at ward level, for deliberate public participation through improved consultation, communication and feedback mechanisms to citizens to participate in decision-making and be kept informed of key issues and developments.
112. As part of the audit of predetermined objectives we audit compliance with the provisions of the Municipal Systems Act (MSA) relevant to community participation. The following findings were identified:
- Ward level improvement plans have not been developed.
  - The municipality is not using MISA's Municipal Infrastructure Performance Management Information System (MIPMIS) or a similar system.

### 3.6 USE OF CONSULTANTS

113. The audit included an assessment of the effective use of consultants. In the local government environment, the partnership between the private and public sector has become important in driving strategic goals.
114. The total expenditure on consultants is R 1 384 347
115. A summary of the significant findings from the audit are as follows:

#### Performance management and monitoring

116. The consultant's contract did not stipulate deliverables or deliverables stipulated in consultants' contract were not linked to timelines.
117. Measures to monitor contract performance and delivery were not defined and/or implemented.
118. A comparison of the consultant's services rendered and the deliverable to the initial project objectives and needs was not evaluated.

### 3.7 WATER AND SANITATION

119. The audit included an assessment of the water and sanitation service delivery objective of the municipality. We focused on the following:

- Management of grant funding for water and sanitation infrastructure
- Management processes for water and sanitation infrastructure projects
- Maintenance of water infrastructure
- Water losses

120. A summary of the significant findings from the audit are as follows:

#### Management processes for water and sanitation infrastructure projects

121. 2 of 2 water infrastructure projects have exceeded their planned completion date.

122. 2 of 2 water projects selected for audit have significant supply chain findings.

#### Maintenance of water infrastructure

123. The municipality does not have an approved policy in place that addresses routine maintenance of water infrastructure.

124. The municipality did not plan for the maintenance of water infrastructure by setting specific timeframes and targets in this regard.

#### Water losses

125. The municipality disclosed water losses to the extent of 8.23%.

### 3.8 ROADS INFRASTRUCTURE

126. The audit included an assessment of the roads infrastructure service delivery objective. We focused on the following:

- The existence of a policy, plan and strategy for the upgrade of roads infrastructure
- Availability of budgeted funds to maintain and upgrade ageing road networks

127. A summary of the significant findings from the audit are as follows:

#### The existence of a policy, plan and strategy for the upgrade of roads infrastructure

128. The municipality does not have an approved policy in place for the planning, management and reporting of roads infrastructure.

129. The municipality does not have an approved roads maintenance plan/priority list in place for the renewal and routine maintenance of roads infrastructure.

130. 60% of the municipality's 2015-16 roads infrastructure repair and maintenance budget was allocated to reactive maintenance while 40% was allocated towards routine/schedule maintenance.



## SECTION 4: Emerging risks

### Accounting, performance management/reporting and compliance matters

#### New pronouncements

#### Standards of GRAP

131. The ASB has approved the following Standards of GRAP and Interpretations of Standards of GRAP for which the Minister of Finance has not yet determined an effective date:

- GRAP 20 – Related party disclosures
- GRAP 32 – Service concession arrangements: grantor
- GRAP 108 – Statutory receivables
- GRAP 109 – Accounting by principals and agents
- IGRAP 17 – Service concession arrangements where a grantor controls a significant residual interest in an asset

132. In addition the ASB approved Directive 12 – Selection of an appropriate reporting framework by public entities, which will become effective for financial periods commencing on or after 1 April 2018, but early application is permitted.

#### Municipal SCOA

133. Karoo Hoogland Local Municipality is aware of the mSCOA requirements and has made good progress in ensuring that the municipality would be in a better position to implement mSCOA by the due date of 1 July 2017.

#### New legislation

#### National Treasury's SCM reforms:

134. The National Treasury, through the Office of the Chief Procurement Officer is accelerating measures that will make it easy for business and government to transact; and ensure that government purchase what it needs at the right time, the right price, in the correct quantities and delivered to right location. The measures implemented by the national treasury include:

- a) Establish the Central Supplier Database (CSD) of government to be used by all organs of state: The CSD is a single database that will serve as the source of all supplier information for organs of state.
- b) Establish the eTender Portal: This portal provides a single point of access to information on all tenders made by all public sector organisations at all spheres of government.

These measures were communicated by the national treasury through MFMA circulars 81 and 83 and they are already effective from 01 July 2016.

135. The audit included a basic assessment of whether the municipality has implemented the measures. The following weaknesses were identified with regard to the municipality's implementation of these reforms:-

Central suppliers' database:

- The SCM policy was not updated to provide for inviting quotations from suppliers registered in the CSD.
- The municipality is still utilising its own database of prospective suppliers that is not synchronised with the CSD.
- SCM officials have not been trained on the use the CSD

eTender Portal

- The SCM policy was not updated to provide for invitation of competitive bids through the eTender portal.
- As at the date of this report, the municipality has not started inviting bids through the eTender Portal.
- SCM officials do not have access to the eTender portal



## SECTION 5: Ratings of detailed audit findings

136. For the purposes of this report, the detailed audit findings included in annexures A to C have been classified as follows:

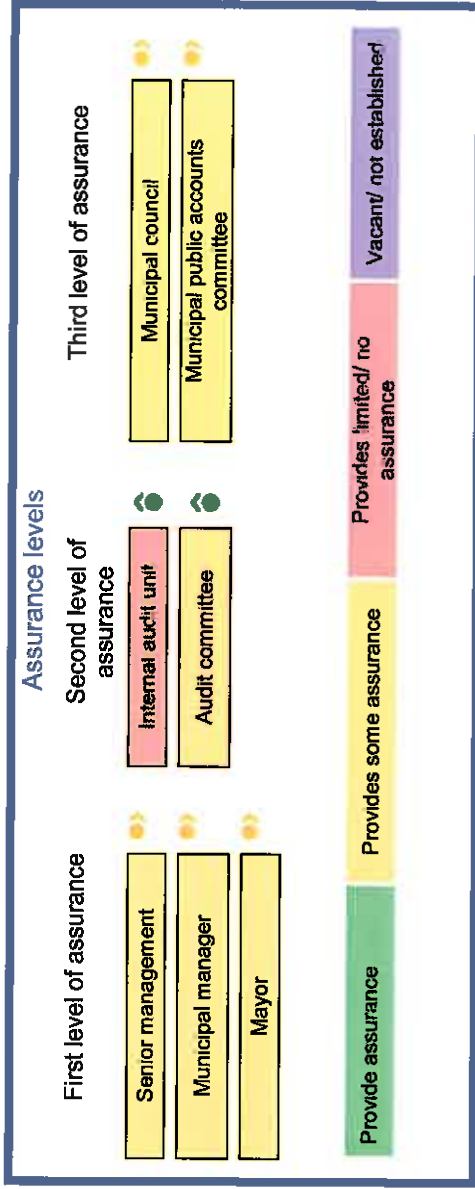
- **Matters to be included in the auditor's report:** These matters should be addressed as a matter of urgency.
- **Other important matters:** These matters should be addressed to prevent them from leading to material misstatements of the financial statements or material findings on the performance report and compliance with legislation in future.
- **Administrative matters:** These matters are unlikely to result in material misstatements of the financial statements or material findings on the performance report and compliance with legislation.

## SECTION 6: Conclusion

137. The following figure summarises our message.



1 To improve/maintain the audit outcomes ...

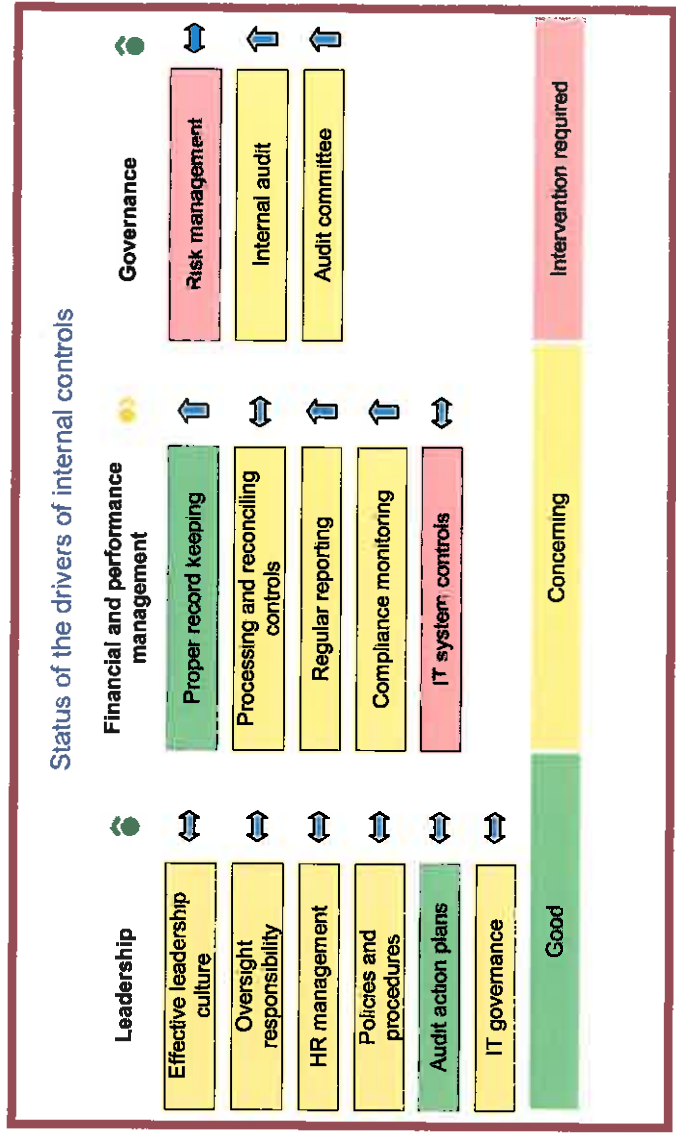
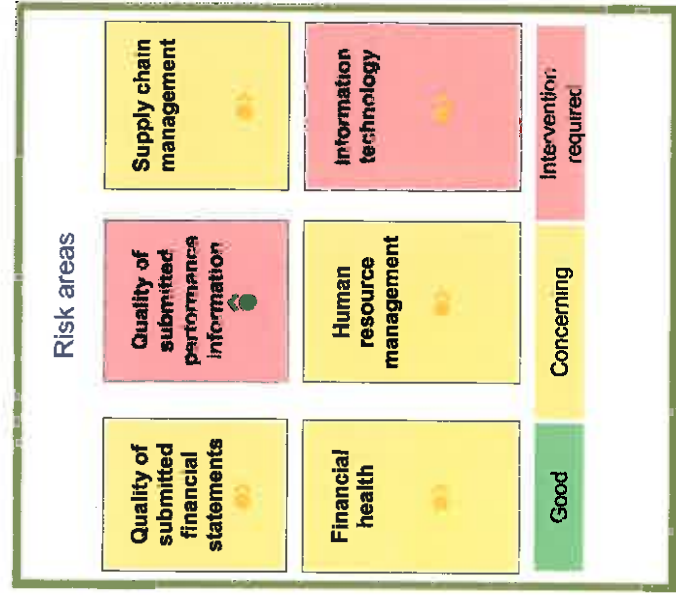
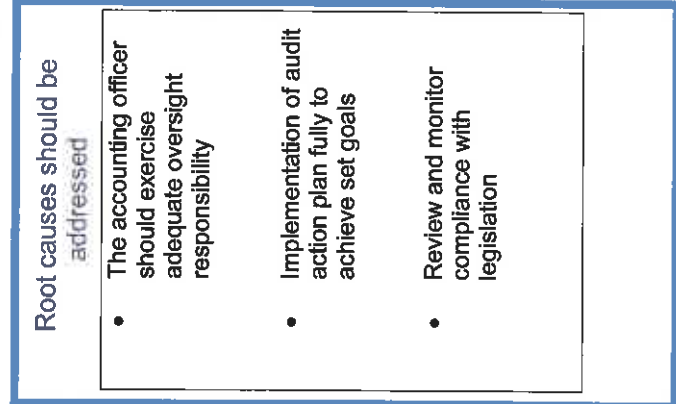


2 ...the key role players need to assure that...

5 ... the root causes are addressed...  
... the best practices are maintained.

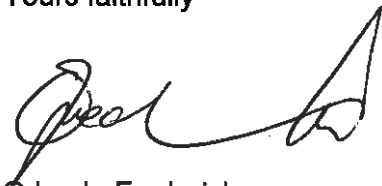
4 ...the risk areas, and ...

3 ...attention is given to the key controls, and ...



138. Our staff remains committed to assisting in identifying and communicating good practices to improve governance and accountability and to build public confidence in government's ability to account for public resources in a transparent manner.

Yours faithfully



Orlando Fredericks

Senior Manager: Northern Cape

30 November 2016

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**Distribution:**

Municipal Manager  
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