



## Report of the auditor-general to the North West Provincial Legislature and the council on the Naledi Local Municipality

### Report on the audit of the financial statements

#### Disclaimer of opinion

1. I was engaged to audit the financial statements of the Naledi Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2021, the statement of financial performance, statement of changes in net assets, and 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. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of this auditor's report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

#### Basis for disclaimer of opinion

##### VAT receivables and VAT payables

3. I was unable to obtain sufficient appropriate audit evidence for the VAT receivables in the current year and the VAT payables in the previous year as the municipality did not maintain adequate accounting records. I was unable to confirm the VAT receivables and VAT payables by alternative means. Consequently, I was unable to determine whether any further adjustment relating to the VAT receivables of R32 879 501 (2020: VAT payables of R31 789 911) as disclosed in note 12 to the financial statements was necessary.

##### Receivables from exchange and non-exchange transactions

4. The municipality did not calculate the provision for impairment of receivables in accordance with GRAP 104, *Financial instruments* as the municipality did not do an assessment of the credit risk for groups or sub-groups of receivables. I am unable to quantify the full extent of the misstatement in receivables from non-exchange transactions of R34 397 196 (2020: R23 726 333), receivables from exchange transactions of R88 556 797 (2020: R64 308 069) and the debt impairment of R42 408 318 (2020: R40 214 492) as disclosed in notes 4, 5 and 32 to the financial statements.

##### Property, plant and equipment

5. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment as the municipality did not have an adequate system of internal control and did not keep proper accounting records. I was unable to confirm the property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustments relating to property, plant and equipment of R542 831 045 (2020: R556 994 485) as disclosed in note

9 and the depreciation and amortisation expense of R39 607 579 (2020: R35 676 315) as disclosed in note 30 to the financial statements were necessary.

### Consumer deposits

6. During 2020, I was unable to obtain sufficient appropriate audit evidence for consumer deposits due to the status of accounting records. I was unable to determine whether any adjustment to consumer deposits of R5 104 789 as disclosed in note 17 to the financial statements was necessary. My audit opinion on the financial statements for the period ended 30 June 2020 was modified accordingly. I was still unable to confirm these consumer deposits by alternative means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

### Payables from exchange transactions

7. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions as the municipality did not have an adequate system of internal control and did not keep proper accounting records. I was unable to confirm these payables from exchange transactions by alternative means. In addition, the municipality incorrectly included loans in trade payables resulting in an overstatement of payables from exchange transactions and understatement of other financial liabilities of R10 370 231. Consequently, I was unable to determine whether any further adjustment relating to payables from exchange transactions of R737 743 312 (2020: R820 926 716) as disclosed in note 13 to the financial statements was necessary.

### Service charges

8. I was unable to obtain sufficient appropriate audit evidence that revenue, expenditure and the receivables relating to the provision of retail water services have been correctly accounted for by the municipality as the service delivery agreement entered into between the Dr Ruth Segomotsi Mompati District Municipality as water service authority and the municipality as water service provider expired on 30 June 2018. In terms of section 22 of the Water Services Act 108 of 1997, no person may operate as a water service provider without the approval of the water service authority. I was unable to confirm, by alternative means, that the local municipality was authorised to operate as the water service provider. Consequently, I was unable to determine whether any adjustments relating to revenue from the sale of water of R30 926 457 (2020: R32 198 296) included in the service charges as disclosed in note 19 to the financial statements or any other receivables and expenditure relating to the provision of retail services by the municipality were necessary.
9. I was unable to obtain sufficient appropriate audit evidence for service charges relating to water and electricity as the municipality did not have an adequate system of internal control and did not keep proper accounting records. I was unable to confirm these services charges by alternative means. In addition, the municipality did not bill all consumers for waste management service charges resulting in an understatement of service charges and receivables from exchange transactions of R14 108 002 and revenue from the sale of pre-paid electricity have been recorded inclusive of the VAT resulting in an overstatement of service charges and VAT receivable of R10 443 140. Consequently, I was unable to determine whether any further adjustments relating to service charges of R229 459 575 (2020: R212 314 849) and receivables from exchange transactions of R88 556 797 (2020: R64 308 069) as disclosed in notes 19 and 5 to the financial statements were necessary.

### Interest income

10. The municipality did not correctly calculate and charge interest on consumer debtors due to the incorrect interest rate that was used to charge interest. I was unable to determine the full extent of the misstatement on interest income from outstanding receivables of R29 966 015 (2020: R21 103 503) as disclosed in note 21 and interest income from outstanding receivables



of R6 126 856 as disclosed in note 25 to the financial statements or the related receivables balances as it was impracticable to do so.

### Property rates

11. The municipality did not correctly record all property rates revenue as not all properties were levied property rates for every month in the financial year. Consequently, revenue from property rates and receivables from non-exchange transactions was understated by R139 163 333.
12. During 2020, I was unable to obtain sufficient appropriate audit evidence for property rates as the municipality did not have an adequate system of internal control and did not keep adequate accounting records. I was unable to determine whether any adjustment to property rates of R42 785 471 was necessary. Furthermore, the municipality did not correctly recognise revenue from property rates in accordance with GRAP 23, *Revenue from non-exchange transactions*, as property rates relating to the 2018-19 period was recognised as revenue in the 2019-20 period. I was unable to quantify the full extent of the misstatement as it was impracticable to do so. My audit opinion on the financial statements for the period ended 30 June 2020 was modified accordingly. I was still unable to confirm these property rates by alternative means. Consequently my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

### Commitments

13. I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality did not have an adequate system of internal control and did not keep proper accounting records. I was unable to confirm these commitments by alternative means. Consequently, I was unable to determine whether any further adjustment relating to commitments of R29 919 196 (2020: R21 943 819) as disclosed in note 38 to the financial statements was necessary.

### Fruitless and wasteful expenditure

14. I was unable to obtain sufficient appropriate audit evidence for fruitless and wasteful expenditure due to the status of accounting records. I was unable to confirm this fruitless and wasteful expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to fruitless and wasteful expenditure of R190 250 423 (2020: R 172 260 118) as disclosed in note 43 to the financial statements was necessary.

### Irregular expenditure

15. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for irregular expenditure. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to the irregular expenditure of R239 454 664 (2020: R231 950 353) as disclosed in note 44 of the financial statements was necessary.

### Material uncertainty relating to going concern

16. I draw attention to the matter below. My opinion is not modified in respect of this matter.
17. As disclosed in note 42 to the financial statements the municipality had a deficit for the year and its current liabilities exceeds its current assets resulting in not paying its creditors within 30 days. These events or conditions, along with the other matters as set forth in note 42, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.



## Responsibilities of the accounting officer for the financial statements

18. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 4 of 2020 (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.
19. In preparing the financial statements, the accounting officer is responsible for assessing the Naledi 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 appropriate governance structure either intends to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

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

20. My responsibility is to conduct an audit of the financial statements in accordance with International Standards on Auditing (ISAs) and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.
21. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code), as well as the other ethical requirements that relevant to my audit of the financial statements in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

## Report on the audit of the annual performance report

### Introduction and scope

22. In accordance with the Public Audit Act 25 of 2004 (PAA) and the general notice issued in terms thereof, I have a responsibility to report on the usefulness and reliability of the reported performance information against predetermined objectives for selected key performance area presented in the annual performance report. I was engaged to perform procedures to raise findings but not to gather evidence to express assurance.
23. I was engaged to evaluate 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 key performance area presented in the municipality's annual performance report of the for the year ended 30 June 2021:

Key performance area	Pages in the annual performance report
KPA 4: Basic services delivery and infrastructure investment	23 – 35

24. I performed procedures to determine whether the reported performance information [was properly presented and whether performance] 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 findings in respect of the usefulness and reliability of the selected key performance area are as follows:

#### KPA 4: Basic services delivery and infrastructure investment

##### Various indicators

26. I was unable to obtain sufficient appropriate audit evidence that systems and processes were established to enable consistent measurement and reliable reporting of performance against the predetermined indicator definitions for the indicators and that the predetermined source information and evidence to be used when measuring the actual achievement for the indicators were clearly defined. As a result, I was also unable to test the reliability of the reported achievements and the disclosed measures taken to improve performance. I was unable to validate the existence of the systems, test whether the indicators were well-defined or to confirm reported achievements and measures taken to improve performance by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and measures taken to improve performance:

Indicator description	Reported achievement	Measures taken to improve performance
Number of households with access to basic level of water by 30 June 2020	Target not achieved	No
Number of households with access to basic level of sanitation by 30 June 2020	Target not achieved	No
Number of households with access to basic level of electricity by 30 June 2020	Target not achieved	No

##### Various indicators

27. The achievements below were reported in the annual performance report for the listed indicators. However, some supporting evidence provided materially differed from the reported achievement, while in other instances I was unable to obtain sufficient appropriate audit evidence. In addition, the measures taken to improved performance disclosed for indicators with variances between the planned target and the reported achievement did not agree with the supporting evidence provided. Based on the supporting evidence provided, the reason for the variance was not collaborated with supporting documentation and could not be verified against the information on the annual performance report. This was due to the lack of accurate and complete records. I was unable to confirm the reported achievements or measures taken to improve performance by alternative means. Consequently, I was unable to determine whether any further adjustments were required to these reported achievements or measures taken to improve performance.

Indicator description	Reported achievement	Measures taken to improved performance
Number of households with access to solid waste removal on weekly basis	Target not achieved	No
Number of formalised households earning less than R2300 per month with access to free basic services on a monthly basis	Target not achieved	No
Reports on the 100% expenditure on total amount allocated (gazetted) MIG funding commensurate to the 100% completion of construction on capital projects by 30 June 2021	Not 100% of the allocated MIG Funding was spent	No

## Other matter

28. I draw attention to the matter below.

### Achievement of planned targets

29. Refer to the annual performance report on pages 23 to 35 for information on the achievement of 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 in paragraphs 24 to 26 of this report.

## Report on audit of compliance with legislation

### Introduction and scope

30. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

31. The material findings on compliance with specific matters in key legislation are as follows:

### Financial statements

32. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.

33. The annual financial statements were not submitted to the auditor-general for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

### Strategic planning and performance management

34. The performance management system and related controls were inadequate as they did not describe how the performance measurement and review processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

### Expenditure management

35. Reasonable steps were not taken to prevent irregular expenditure amounting to R7 504 311 as disclosed in note 44 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by management's non-compliance with supply chain management regulations.

36. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the fruitless and wasteful expenditure could not be quantified as indicated in the basis for disclaimer paragraph. The majority of the disclosed fruitless and wasteful expenditure was caused by late payment to suppliers due to the cash flow constraints of the municipality.

37. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R10 129 849, as disclosed in note 50 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed unauthorised expenditure was caused by spending in excess of the budgets for individual votes.

### Consequence management

38. Unauthorised, irregular as well as 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)(a) and (b) of the MFMA.

### Asset management

39. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
40. 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.

### Revenue management

41. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
42. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

### Procurement and contract management

43. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(1)(a) and (c). Similar non-compliance was also reported in the prior year.
44. Quotations were accepted from 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). Similar non-compliance was also reported in the prior year.
45. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the prior year.
46. Some of the contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
47. The contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

### Internal control deficiencies

48. 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 basis for disclaimer opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

- The municipality's leadership did not exercise adequate oversight over financial and performance reporting, compliance monitoring and related internal controls. Policies and procedures did not adequately guide financial, performance and compliance activities and consequence management measures were not fully implemented.
- Management's internal controls and processes over the preparation and presentation of financial statements, performance reports and compliance monitoring were not able to ensure that the reports were free from material misstatements and material deviations



from legislation. Various financial registers and schedules submitted by management did not agree to amounts as per the financial statements, were not completed for all items recorded and management did not adequately ensure the collection, collation, verification, storing and reporting of actual performance information.

- The audit committee and internal audit fulfilled their functions, however management did not adequately respond to the concerns raised by the audit committee and did not implement all the recommendations made by internal audit resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective. These matters together with the ineffective implementation and monitoring of the audit action plans resulted in the audit committee and internal audit not having a positive impact on the audit outcome.

## Material irregularities

49. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit and on the status of the material irregularities reported in the previous year's auditor's report.

### Material irregularities identified during the audit

50. The material irregularities identified are as follows:

#### Full and proper records not kept (2019-20) – infrastructure assets, provision of retail water services and material uncertainty relating to going concern

51. Reasonable steps were not taken in the 2019-20 financial year to ensure that full and proper records were kept of infrastructure assets, provision of retail water and material uncertainty relating to going concern, as required by section 62(1)(b) of the MFMA. The non-compliance contributed to a disclaimed audit opinion as I could not obtain sufficient appropriate audit evidence to support the amounts and disclosures in the financial statements.
52. The lack of full and proper records is likely to result in substantial harm to the municipality as it contributed to the material uncertainty regarding its ability to continue operations. This, in turn, is likely to have a negative impact on the municipality's ability to discharge its service delivery mandate.
53. The accounting officer was notified of the material irregularity on 22 September 2021 and invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer provided inadequate actions to resolve the material irregularity. I recommend that the accounting officer should take the following actions to address the material irregularity, which should be implemented by 16 May 2022:
- The non-compliance with section 62(1)(b) of the MFMA should be investigated to determine the reasons and circumstances that led to the non-compliance for the purpose of taking appropriate corrective actions and to address control weaknesses.
  - Based on the reasons and circumstance, appropriate action should be taken to develop and commence with the implementation of an action plan to address poor record keeping so that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards, as required by 62(1)(b) of the MFMA. The plan should include anticipated timeframes and address the following key areas as a minimum:
    - a. Complete asset register of all of the municipality's infrastructure assets, property, plant and equipment, including work-in-progress, as well as information for assets that have been fully depreciated but still in use;
    - b. Billing information and reconciliations to support revenue from service charges;



- a. Reconciliation of property rates income to the valuation roll;
  - b. Payment vouchers, creditor statements and creditor reconciliations for purchases. The expenditure incurred should be supported by sufficient evidence that goods and services paid for were received, including payments made from conditional grant funding; and
  - c. Reconciliations of all bank accounts in the name of the municipality.
54. I further recommend that the accounting officer should take appropriate action to develop and commence with the implementation of an action plan to address the financial problems of the municipality, as required by section 135(1) and 135(3)(a) of the MFMA, by 15 August 2022. The plan should describe the anticipated timeframe and milestones to be achieved and include as a minimum strategies to:
- d. Increase the collection of revenue;
  - e. Efficiently manage the available resources of the municipality; and
  - f. Enter into payment arrangements with major suppliers.
55. The above timeframes for the implementation of the recommendations will run concurrently. I will follow up on the implementation of these recommendations by the due date.

Auditor General  
Klerksdorp

27 February 2022



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*



