

**AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE  
LEGISLATURE AND THE COUNCIL ON MAFUBE LOCAL MUNICIPALITY**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Mafube Local Municipality, which comprise the statement of financial position as at 30 June 2010 and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx.

**Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**Auditor-General's responsibility**

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Cash and cash equivalents**

4. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation of, and rights to, the cash and cash equivalents balance of R11 741 262 (2009: (R10 238 846)), as disclosed in the statement of financial position and note 17 to the financial statements. Due to the lack of proper monthly reconciliations, the municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness and valuation of, and rights to, cash and cash equivalents.
  - (a) The year-end bank reconciliation shows an unreconciled difference of R1 009 043, for which no valid explanation could be obtained. Due to the lack of audit evidence I could not determine the effect on the other account balances or classes of transactions reported in the financial statements.

- (b) My report was modified in the previous year as a difference of R10 822 397, noted between the bank overdraft balance disclosed in the financial statements and the amount included as the cash book balance in the year-end bank reconciliation and general ledger, could not be explained. No evidence could be obtained that the difference was investigated and rectified. Accordingly, I was unable to obtain sufficient appropriate audit evidence that the cash and cash equivalents balance of R11 741 262, and the corresponding disclosure of R187 381 and the bank overdraft balance of R10 238 846, as disclosed in the statement of financial position and note 17 to the financial statements, did not contain significant misstatements.
5. Paragraph 18 of SA Standards of GRAP, GRAP 1, *Presentation of financial statements* (GRAP 1) requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The municipality reported a cash and cash equivalents balance of R11 478 681 in the statement of financial position and note 17 to the financial statements. The bank reconciliation includes stale cheques of R653 284. Consequently, the bank balance is understated by R653 284. Due to the lack of audit evidence I could not determine the effect on the other account balances or classes of transactions reported in the financial statements.
  6. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Unprocessed deposits and receipts of R56 531 998 were identified, which had not been accounted for at year-end. Consequently, revenue is understated and receivables overstated. The municipality's records did not allow me to quantify the understatement relating to revenue and the overstatement of receivables.
  7. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Although the financial statements indicate a favourable bank balance of R11 478 681, the bank statements indicate an overdraft of R252 522, while uncleared cheques amounted to R291 898. This resulted in an overstatement of R12 023 101. Due to the lack of audit evidence I could not determine the effect on the other account balances or classes of transactions reported in the financial statements.
  8. Contrary to the requirements of the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*, the municipality did not disclose the fact that land with a value of R3 000 000 has been provided as security to the bank in respect of the municipality's overdraft facility.
  9. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. My report was modified in the prior year as the 2008-09 year-end bank reconciliation included "debit orders" of R5 152 742 that appeared on the bank statements, but had not been processed in the cash book. Sufficient and appropriate audit evidence could not be obtained that these misstatements had been followed up and resolved. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness, valuation, rights and obligations to cash and cash equivalents of R11 741 262, and the corresponding disclosure of R187 381 and the bank overdraft balance of R10 238 846, as disclosed in the statement of financial position and note 17 to the financial statements.

## Property, plant and equipment

10. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation of, and rights to, property, plant and equipment with a carrying value of R219 312 447 (2009: R208 542 470), as disclosed in the statement of financial position and note 10 to the financial statements. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness and valuation of, and rights to, property, plant and equipment.
- (a) The municipality did not maintain an accurate fixed asset register as required by section 63(2)(c) of the MFMA. The net carrying value of R219 312 447, as disclosed in note 10 to the financial statements, did not agree to the balance of R187 168 299, as per the fixed asset register. No explanations could be obtained for the unreconciled difference of R32 144 147. Consequently, I was unable to confirm the existence, completeness, valuation of, and rights to, property, plant and equipment. I could thus not confirm:
- the accuracy and completeness of additions of R1 676 722 as disclosed in note 10 to the financial statements
  - that all disposals of property, plant and equipment had been accounted for in the accounting and underlying records
  - the existence, accuracy and completeness of the accumulated depreciation of R12 041 621 as disclosed in note 10 to the financial statements.
- (b) For assets with a carrying value of R34 736 041 the descriptions, serial numbers and locations indicated in the fixed asset register were inadequate for identification purposes. Consequently, I was unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, valuation, completeness, presentation and disclosure of and the municipality's rights to property, plant and equipment to this amount.
- (c) Contrary to the requirements of paragraph 5 of the SA Standard of GRAP, GRAP 16 *Investment Property* (GRAP 16), the municipality did not perform an evaluation in terms of GRAP 16 to determine which properties should be disclosed as investment properties.
- (d) My report was modified in the previous year as a fixed asset register was not provided. Accordingly, I was unable to obtain sufficient appropriate audit evidence that property, plant and equipment with a carrying value of R219 312 477 and the corresponding disclosure of R208 542 470, as disclosed in the statement of financial position and note 10 to the financial statements, did not contain significant misstatements.
11. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Due to calculation errors, assets disclosed in the financial statements exceeded the underlying accounting records by R12 082 231. Assets and the accumulated deficit were therefore overstated by R12 082 231.

### **Trade and other receivables**

12. Trade and other receivables from exchange transactions, before any impairment adjustments, amounted to R95 057 999 (2009: R70 928 930) as disclosed in note 12 to the financial statements. Management raised a general provision of R88 543 373 (2009: R49 996 277) for impairment against these consumer debtors. In view of the following, I could not confirm the completeness, existence and accuracy of consumer debtors with a carrying value of R6 514 627 (2009: R20 932 653). The municipality's records did not permit the application of alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the completeness, existence and accuracy of consumer debtors.
- (a) Sufficient appropriate audit evidence could not be obtained to confirm government debts of R1 766 925 disclosed in note 13 to the financial statements. The existence of, and rights to, these receivables could not be confirmed.
  - (b) I was unable to obtain sufficient appropriate audit evidence for debit journals of R16 243 476 and credit journals of R13 939 215. I was unable to test the completeness, accuracy and validity of the journals processed against trade and other receivables.
  - (c) My report was modified in the previous year as the existence, completeness, valuation of, and rights relating to, consumer debtors of R26 136 734 could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that service receivables with a carrying value of R5 079 107 and the corresponding disclosure of R19 345 185, as included in the statement of financial position and note 12 to the financial statements, did not contain significant misstatements.
13. Other receivables of R7 485 242 (2009: R7 850 974) were disclosed in note 12 to the financial statements. Due to the lack of sufficient appropriate evidence and the fact that a journal of R7 850 974 was processed without sufficient appropriate audit evidence, the existence of, and rights to, other receivables could not be confirmed. The municipality's records did not permit the application of alternative audit procedures and I was unable to confirm the existence of, and rights to, other receivables of R7 485 242.

### **Trade and other payables**

14. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of trade payables, of R9 772 013 (2009: R16 274 542), as disclosed in the statement of financial position and note 5 to the financial statements. The municipality's records did not permit the application of alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to confirm the existence, completeness and valuation of trade and other payables.
- (a) Payroll suspense accounts of R2 104 581 as at 30 June 2010 could not be confirmed to sufficient appropriate audit evidence. Accordingly, I was unable to obtain sufficient appropriate audit evidence as to the existence and accuracy of payroll suspense account of R2 104 581.
  - (b) Payroll suspense accounts with debit balances of R13 948 313, included in the disclosure of trade payables in note 6 to the financial statements, had not been cleared at year-end as required by section 65(2)(j) of the MFMA. I was unable to obtain sufficient appropriate evidence to support the transactions and balances included in these suspense accounts. The municipality's records did not permit the application of alternative audit procedures and accordingly I could not confirm the existence, completeness and valuation of payroll receivables of R13 948 313.
  - (c) I was unable to obtain sufficient appropriate audit evidence for debit journals of R40 190 362 and for credit journals of R67 289 542. I was unable to test the completeness, accuracy and validity of the journals processed against payables.

- (d) Debtors with credit balances of R1 559 672 included in trade payables in note 5 to the financial statements could not be confirmed to sufficient appropriate audit evidence. The existence and valuation of these payables could not be confirmed.
  - (e) The leave pay provision of R1 337 169 (2009: R320 021) was included in the current employee benefits disclosed as a current liability in the statement of financial position and note 5 to the financial statements. The municipality could not supply a leave register on which the leave provision calculation was based. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness, valuation of, and obligation to, the leave pay provision.
  - (f) My report was modified in the previous year as the existence, completeness, valuation of, and obligations relating to, creditors of R15 453 873 could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that trade and other payables of R9 772 013 and the corresponding disclosure of R16 274 542, as included in the statement of financial position and note 6 to the financial statements, did not contain significant misstatements.
15. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. In note 7 to the financial statements, trade payables of R9 772 013 were materially understated by R58 640 816, due to all trade creditors not being accounted for in the general ledger. Trade creditors and expenditure were thus understated by R58 640 816.
  16. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Taxes owed to the South African Revenue Service (SARS) in respect of employee taxes of R1 860 860 outstanding at year-end had not been recorded as payables. Payables and employee costs were thus understated by R1 860 860.

#### **Unspent conditional grants and receipts**

17. Included in unspent conditional grants disclosed in note 7 to the financial statements was an amount of R9 092 789 in respect of operation Hlasela, while the separate bank account maintained for this purpose had a closing balance of R85 780, resulting in an unexplained difference of R9 007 008. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness, valuation of, and obligation to, this unspent conditional grant. Due to the lack of sufficient appropriate audit evidence I could not determine if operation Hlasela's expenditure had been understated or if the municipality had used this money to defray other running costs.
18. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Included in unspent conditional grants disclosed in note 7 to the financial statements was an amount of R30 772 906 in respect of the Municipal Infrastructure Grant (MIG). According to note 7, MIG-related expenditure incurred amounted to R3 327 000, while expenses of R19 168 441 were identified from the bank statements and management had disclosed expenditure of R18 674 320 on the MIG-signed certificate of expenditure and revenue. Expenditure in respect of the MIG grant was understated, while unspent conditional grants were overstated by an unknown amount.

19. My report was modified in the previous year as the existence, completeness, valuation of, and obligations relating to, unspent conditional grants of R12 454 161 included in current liabilities could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that unspent conditional government grants and receipts of R39 865 696 and the corresponding disclosure of R20 454 161, as included in the statement of financial position and note 7 to the financial statements, did not contain significant misstatements.

#### **Long-term liabilities**

20. My report was modified in the previous year as the financial statements disclosure for long-term liabilities exceeded the balance according to the general ledger by R1 758 014. No evidence could be found that this difference had been followed up and resolved. Accordingly, I was unable to obtain sufficient appropriate audit evidence that long-term liabilities of R971 072 and the corresponding disclosure of R948 733, as included in the statement of financial position and note 3 to the financial statements, did not contain significant misstatements.

#### **Accruals, provisions and contingent liabilities**

21. The municipality has not disclosed or raised a provision in respect of pending litigation and legal actions instituted against the municipality. In the absence of sufficient appropriate audit evidence that legal actions were evaluated to determine whether they should be disclosed as contingent liabilities or provided for in accordance with SA Standards of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets* (GRAP 19), I was unable to determine if accruals, provisions and contingent liabilities were understated. The municipality's management also did not sign/issue letters agreeing to third-party confirmation letters being sent out to their legal representatives and the application of alternative audit procedures could thus also not be performed. Accordingly, I could not obtain sufficient appropriate audit evidence to ensure the completeness of accruals, provisions and contingent liabilities.

22. Contingent liabilities of R20 916 762 were identified during the 2008-09 audit. This disclosure has not been included in the financial statements, no evidence could be obtained that these cases had been resolved by 30 June 2010 and as a result no assurance could be expressed that contingent liabilities as disclosed in the financial statements were complete.

23. Provision has not been made for the environmental rehabilitation costs of restoring the municipality's landfill sites. A provision should be made for the municipality's present obligation incurred as a consequence of its past use of the landfill sites, in accordance with GRAP 19. In the absence of a valuation in respect of the costs for the rehabilitation of landfill sites, I was unable to quantify the extent of the understatement of provisions.

#### **Capital commitments**

24. My report was modified in the previous year as sufficient appropriate audit evidence could not be obtained in respect of the completeness of capital commitments. Commitments of R24 825 050 had been identified during the 2008-09 audit and although management had made the necessary adjustment in the disclosure to the financial statements, no evidence could be obtained that management had confirmed the completeness thereof. Accordingly, I was unable to obtain sufficient appropriate audit evidence that capital commitments of R30 650 586 and the corresponding disclosure of R24 825 050, as disclosed in the statement of financial position and note 37 to the financial statements, did not contain significant understatement.

### **Post-retirement obligation**

25. No post-retirement obligations had been recognised or disclosed in the financial statements. In the absence of post-retirement medical aid contracts and actuarial valuations, I was unable to quantify the extent of the understatement of employee costs and payables.

### **Value-added tax**

26. Value-added tax (VAT) payables of R14 187 248 (2009: R6 741 261) were included in the statement of financial position and note 9 to the financial statements. As a result of the matters listed below I could not confirm the existence, completeness, valuation and obligation thereof. The municipality's records did not permit the application of alternative audit procedure and accordingly, I could not confirm the existence, completeness, valuation of, and obligation to, VAT receivable.

- The amount owed by SARS to the municipality based on VAT returns submitted amounted to R596 653 while the general ledger indicated that an amount of R4 874 176 was owed to SARS, resulting in an unexplained difference of R5 470 829.
- I was unable to obtain sufficient appropriate audit evidence for debit journals of R4 486 782 and credit journals of R12 021 592. I was unable to confirm the completeness, accuracy and validity of the journals processed against the VAT accounts.

27. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. It was, however, determined that output VAT declared was calculated based on all receipts and not only VAT-related income. Due to unprocessed receipts of R24 095 837 not being accurately recorded and accounted for in the general ledger, I was unable to quantify the understatement of revenue.

28. My report was modified in the previous year as the completeness and valuation of VAT payable of R6 741 261 could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that VAT payables of R14 187 248 and the corresponding disclosure of R6 741 261, as included in the statement of financial position and note 9 to the financial statements, did not contain significant misstatements.

### **Accumulated surplus**

29. Due to the disclaimer of opinion on the prior year's financial statements and the matters listed below, I could not obtain sufficient appropriate audit evidence to ensure the existence, completeness and valuation of accumulated surplus. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to ensure that accumulated surplus was fairly stated in the financial statements.

- (a) I was unable to obtain sufficient appropriate audit evidence for debit journals of R5 235 057 allocated directly against the accumulated surplus. I was unable to test the completeness, accuracy and validity of these journals processed against the accumulated surplus.

- (b) Due to the disclaimer of opinion on the prior year's financial statements and the lack of sufficient appropriate audit evidence that prior year misstatements and scope limitations had been followed up and resolved, I could not obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of accumulated deficit of R529 244 192 and the corresponding disclosure of R578 147 479 as disclosed in the statement of financial position. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to ensure that accumulated surplus was fairly stated in the financial statements.

#### **Funds and reserves**

30. The valuation and existence of the capital replacement reserve could not be confirmed as sufficient appropriate audit evidence was not submitted to support the amount of R5 044 900 (2009: R6 721 622) as disclosed in the statement of financial position and note 2 to the financial statements. The municipality's records did not permit the application of alternative audit procedures and, accordingly, I could not obtain sufficient appropriate audit evidence to ensure the valuation and existence of these reserves.
31. My report was modified in the previous year as the existence, completeness, valuation, rights and obligations relating to the capital replacement, government grant and capitalisation reserves amounts of R6 721 622, R174 777 871 and R2 380 323 respectively, could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that funds and reserves of R191 296 349 and the corresponding amount of R183 879 816, as included in the note 2, did not contain significant misstatements.

#### **Revenue**

32. Revenue of R123 663 913 (2009: R85 749 430) was disclosed in the statement of financial performance. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, existence and accuracy of revenue of R123 663 913 (2009: R85 749 430). The municipality's records did not permit the application of alternative audit procedures and, accordingly, I could not obtain sufficient appropriate audit evidence to confirm the completeness, occurrence and accuracy of revenue.
- (a) Sufficient, appropriate audit evidence could not be obtained that receipts of R3 559 124 had been deposited into the municipality's bank account. The occurrence of receipts of R3 559 124 could thus not be confirmed.
- (b) I was unable to obtain sufficient appropriate audit evidence for credit journals of R2 915 113 allocated against equitable share income. I was unable to test the occurrence, accuracy and validity of the journals processed against revenue.
33. Accounting policy note 1.15 is not in accordance with SA Standards of GRAP, GRAP 9, *Revenue from exchange transactions* (GRAP 9), since revenue from the sale of prepaid meter vouchers was recognised immediately on receipt of cash and not only at the stage when the entity no longer retains continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold. As a result, the sale of prepaid electricity revenue was incorrectly recognised as revenue, instead of deferred income as required by GRAP 9. Due to the volume of transactions involved and the fact that the system could not provide us with the relevant information, I could not quantify the extent to which revenue is overstated and deferred income understated. No alternative procedures could be performed in this regard.



34. Contrary to the requirements of paragraph 30 of GRAP 1, the municipality did not provide for service charges relating to the period between the last meter-reading date and the year-end date on an annual basis. Based on the estimated consumption calculated at the end of the financial year, consumer debtors was understated by R2 418 848 and the accumulated surplus brought forward from the prior year was understated by R1 455 467. Thus the service revenue for the year was understated by R963 381.
35. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Receipts of R6 589 318 issued could not be traced to the general ledger. Consequently, receivables will be overstated; the municipality's records did not allow me to quantify the understatement.
36. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Grants received totalling R31 354 884 could not be traced to the general ledger. Grants received were thus understated and the positive bank balance understated by R3 354 884.
37. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The undercollections of electricity levies resulted in revenue and receivables being understated by R11 352 864.
38. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The overcollections of water levies resulted in revenue and receivables being overstated by R761 971.
39. Property rates of R13 087 940 were included in note 18 to the financial statements. Improvements to properties of R6 400 940 had not been updated on the system, resulting in the undercollection of rates. Consequently, property rates revenue and trade receivables from non-exchange transactions were understated, but the municipality's records did not allow me to quantify the understatement.

#### **Personnel expenditure**

40. Personnel expenditure included in notes 23 and 24 to the financial statements amounted to R53 247 959. As a result of the audit matters detailed below and because the municipality's records did not permit the application of alternative audit procedures, I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of the personnel expenditure.
  - (a) I was unable to obtain sufficient appropriate audit evidence for debit journals of R51 582 148 and credit journals of R29 859 100. I was unable to test the completeness, accuracy and validity of the journals processed against general expenditure.
41. Payroll suspense accounts with debit balances of R10 746 908 and credit balances of R11 125 692 had not been cleared at year-end as required by section 65(2)(j) of the MFMA. Due to the lack of sufficient appropriate audit evidence the impact of these accounts on employee costs could not be determined. I could not confirm the existence, completeness and valuation of payroll receivables of R13 948 313 as well as the occurrence, completeness and accuracy of the personnel expenditure.
42. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Overpayment of R5 517 525 were identified in respect of employee costs. Consequently, employee costs were overstated and receivables understated by R5 517 525.

43. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Underpayments of R358 103 were identified in respect of employee costs. Consequently, employee costs and payables were understated by R358 103.

#### **Bulk purchases**

44. Bulk purchases of R9 874 027 (2009: R15 677 991) were disclosed in note 29 to the financial statements. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure.

- (a) Supporting documentation could not be obtained in order to confirm payments of R2 740 355, included in the statement of financial performance. I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of expenditure.
- (b) Distribution losses were not monitored and accounted for. The correctness of the units of water and electricity purchased and sold could thus not be determined.

#### **General expenditure**

45. General expenditure of R21 455 199 (2009: R47 111 211) was disclosed in note 29 to the financial statements. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure. The municipality's records did not permit the application of alternative audit procedures and, accordingly, I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure.

- (a) Supporting documentation could not be obtained in order to confirm payments of R5 649 724, included in the statement of financial performance. I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of this expenditure.
- (b) Lease rentals in respect of payments R1 850 343 included under general expenditure in the financial statements could not be obtained. I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of this expenditure.

46. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:

- (a) Payments of R2 634 754 could not be traced to the general ledger, resulting in expenditure being understated by R2 634 754. Cash and cash equivalents are thus overstated by R2 634 754. The municipality's records did not permit me to quantify the understatement of expenditure and the overstatement of creditors.
- (b) Payments of R2 026 674 had only been recorded in the 2010-11 financial year, resulting in the understatement of expenditure by R2 026 674.

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

47. Procurement documentation for expenses amounting to R12 624 927 (2009: R18 511 088) could not be provided and the possible occurrence of irregular expenditure due to non-compliance with the supply chain management policy and Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) could therefore not be evaluated.
48. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:
- (a) The municipality did not disclose fruitless and wasteful expenditure of R444 054 incurred as a result of interest and penalties levied against them due to late payments being made to SARS, as required by section 125(2)(d) of the MFMA.
  - (b) The overpayment to councillors, amounting to R770 496 (2009: R916 617 and 2008: R55 405) constitutes irregular expenditure but was not disclosed as required by section 125(2)(d) of the MFMA.
  - (c) Irregular expenditure incurred due to non-compliance with the supply chain management policy amounting to R42 082 959 (2009: 30 342 175) was not disclosed in the financial statements, as required by section 125(2)(d) of the MFMA.
  - (d) Fruitless and wasteful expenditure of R172 668 was incurred on the development of a performance management system which had not been implemented, but was not disclosed as such as required by section 125(2)(d) of the MFMA.
  - (e) My report was modified in the prior year in respect of an understatement of irregular expenditure of R31 325 050 which had not been reported and accounted for in the financial statements. The corresponding figure of irregular expenditure was restated in note 34.3 to the 2009-10 financial statements by R39 917 770. Contrary to the requirements of GRAP 1, disclosure of the nature and amount of, and the reason for, the reclassification of comparative disclosure of this restatement was not included in note 30 to the financial statements. Management could also not provide me with sufficient appropriate audit evidence to enable me to audit the additional restatement of R8 592 720 of the comparative information. Consequently, I could not perform alternative procedures to obtain sufficient appropriate audit evidence of the occurrence and accuracy of the corresponding figure of irregular expenditure.
  - (f) No evidence could be obtained that the irregular expenditure identified in prior financial years had been investigated and that political office-bearers or officials of the municipality who deliberately or negligently incurred or authorised irregular expenditure were held liable for such expenditure in terms sections 32(1)(c) and 32(2)(b) of the MFMA. Receivables can thus be understated and the accumulated surplus overstated, but due to the lack of supporting documentation the amount could, however, not be quantified.
  - (g) Due to the number of unprocessed transactions, I could not confirm that expenditure was incurred in accordance with the approved budget of the municipality. The amount of the expenditure not incurred in accordance with the approved budget of the municipality could not be quantified.

### **Going concern**

49. As a result of the matters described in the Basis for disclaimer of opinion paragraph, the municipality may be in a worse financial position than the position reflected in these financial statements. In addition to this, the following matters indicate that there is a risk that the municipality may be exposed to serious financial difficulties in terms of section 138 of the MFMA. The financial statements did not disclose any details of the uncertainty and had been prepared on a going concern basis. The municipality's accounting records did not provide me with sufficient appropriate audit evidence that the municipality is able to continue as a going concern.

- The municipality's financial statements reflected a material increase in the accumulated deficit from R2 152 936 to R14 262 488.
- The municipality had an unfavourable current ratio for current assets to current liabilities of 0.39:1 which is below the norm of 2:1
- The municipality was not in the position of paying their creditors timeously.

### **Disclaimer of opinion**

50. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

### **Emphasis of matters**

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

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

52. As disclosed in note 34.2 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R7 297 483 (2009: R0) during the year under review due to the municipality's inability to pay their creditors on time.

53. As disclosed in note 34.3 to the financial statements, the municipality incurred irregular expenditure of R40 649 285 (2009: R39 917 770) during the year under review due to inadequate procurement processes followed.

### **Additional matters**

I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited supplementary schedules**

54. The supplementary information set out on pages [X] to [x] does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

55. As required by the PAA and in terms of *General Notice 1570 of 2009*, issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with key laws and regulations [MFMA, and the Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA)] and financial management (internal control).

### **Predetermined objectives**

56. Material findings on the report on predetermined objectives are reported below:

## **Non-compliance with regulatory and reporting requirements**

### **Submission of annual performance plan**

57. The accounting officer of the Mafube Local Municipality did not submit a performance information plan as required by section 40 of the MFMA.

### **Existence and functioning of a performance audit committee**

58. The Mafube Local Municipality did not have a functional performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

### **Internal auditing of performance measurements**

59. The internal audit processes and procedures did not include assessments of the functionality of the Mafube Local Municipality's performance management system and performance measurements to ensure reliability and compliance with the MSA.

### **Lack of adoption or implementation of a performance management system**

60. The municipality does not have a functional performance management system as required by section 38(a) of the MSA.

### **No reporting against predetermined objectives, indicators and targets**

61. The municipality has not reported performance against predetermined objectives, as required by section 46 of the MSA.

## **Compliance with laws and regulations**

### **Municipal Finance Management Act**

#### **The annual budget was not prepared, tabled and approved in accordance with the applicable laws and regulations**

62. Contrary to section 21(1)(b) of the MFMA the mayor had not tabled the budget to the council at least 10 months before the start of the budget year.

#### **The mayor did not adhere to his legislative responsibilities**

63. The mayor did not comply with the legislative requirements on budgetary control and early identification of financial problems as required in section 54 of the MFMA.

#### **The accounting officer did not adhere to his statutory responsibilities**

64. The accounting officer did not comply with his legislative responsibility of managing the financial administration of the municipality over the financial affairs of the municipality as set out in section 62 of the MFMA.

65. Contrary to section 68(a) of the MFMA the accounting officer did not assist the mayor in performing his budgetary functions.

66. Contrary to section 70(2) of the MFMA the municipality had not informed the National Treasury of their approved overdraft facility.

67. Contrary to the requirements of section 62(1)(c) of the MFMA and Treasury Regulation 27.2.1, the municipality did not have a fraud prevention plan.

68. Contrary to section 64(3) of the MFMA no correspondence between the municipal manager and the National Treasury could be obtained relating the organs of state whose accounts were outstanding for more than 30 days.

**Municipal officials did not adhere to their statutory responsibilities**

69. Contrary to the requirements of section 78(1) of the MFMA, senior managers did not take all reasonable steps to ensure that the system of financial management and internal control established for the municipality is carried out diligently to ensure the accurate and correct recording of all transactions.

**The audit committee was not properly established**

70. The municipality did not have a functioning audit committee, as prescribed by sections 165(2)(b) and 166 of the MFMA.

**The internal audit unit was not properly established or not functioning properly**

71. The internal audit function did not substantially fulfil its responsibilities for the year, as set out in section 165(2) of the MFMA.

72. The internal audit unit of the municipality did not prepare a risk based audit plan and an internal audit program for each financial year.

**Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure**

73. No evidence could be obtained that irregular expenditure identified had been investigated and that political office-bearers or officials of the municipality who deliberately or negligently incurred or authorised irregular expenditure were held liable for such expenditure in terms sections 32(1)(c) and 32(2)(b) of the MFMA.

**Expenditure was incurred otherwise than in accordance with sections 15 and 11(3) of the MFMA resulting in unauthorised expenditure**

74. Expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality.

**The financial statements were not prepared in accordance with applicable legislation**

75. Financial statements were not submitted within two months as required by section 126(1) of the MFMA.

**Expenditure was not paid within the parameters set by the applicable legislation**

76. Expenditure was not paid within the required 30 days from the receipt of an invoice/account, as required by section 65(2)(e) of the MFMA.

**Supply chain management legislative requirements were not implanted or not adhered to**

77. Goods and services were supplied by the provider and payment made to the provider without a written signed contracts as required by section 116 of the MFMA.

78. Contrary to section 19(1)(b) of the MFMA the municipality committed themselves to capital projects without obtaining council approval.

**Municipal Systems Act**

**The annual budget was not prepared, tabled and approved in accordance with the applicable laws and regulations**

Contrary to the requirements of sections 26(c) of the MSA, no link exists between the integrated development plan and approved budget.

### **The accounting officer did not adhere to his statutory responsibilities**

79. Contrary to section 96(b) of the MSA the accounting officer did not a debt and credit control policy had been implemented.

### **Supply chain management legislative requirements were not implanted or not adhered to**

80. Contrary to the requirements of schedules 1 and 2 of the MSA councillors and staff members had declared all their financial interests.

### **Inadequate content of integrated development plan**

81. The integrated development plan of Mafube Local Municipality did not include any of the key performance indicators, as referred to in section 26(c) of the MSA.

82. The key performance indicators set in the integrated development plan of Mafube Local Municipality were not specific and measurable and did not relate to the objectives and strategies as required by sections 4(a) and 41 of the MSA.

### **INTERNAL CONTROL**

83. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA and MSA, but not for the purpose of expressing an opinion on the effectiveness of internal control.

84. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

### **Leadership**

#### *Tone at the top*

- Management's philosophy and operating style do not promote effective control over reporting. They do not lead by example.
- Integrity and ethical values are not developed and understood and do not set the standard for sound corporate governance.
- Accountability to the public is not emphasised.
- Performance is not adequately measured.

#### *Oversight responsibility*

- The accounting officer does not adequately exercise oversight responsibility over reporting and compliance with laws and regulations and internal control.
- Personnel are not aware of the allocation of duties, responsibilities and lines of reporting.
- Human resources policies are only in draft format and do thus not facilitate the training and discipline of personnel.
- Key officials are not available throughout the audit process.
- The commitment to quality is not communicated.
- Not all the systems are documented in the policy and procedures manual and the results of the monitoring process are not routinely communicated to all managers and staff.
- An effective organisational structure that places people with appropriate skills is not established.
- The accounting officer does not evaluate whether management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities.

#### *Corrective action*

- Actions are not taken to address risks relating to the achievement of complete and accurate financial and performance reporting.
- Control weaknesses are not properly analysed, and appropriate follow-up actions are not sufficiently implemented to address root causes.
- Not all internal and external audit findings are addressed.
- SCOPA resolutions have not been substantially implemented.

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

##### *Quality, reliable monthly financial statements and management information*

- Management and staff do not fulfil their duties and responsibilities.
- The municipality does not have sufficient competent individuals who understand the financial reporting framework and performance management requirements.
- Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting.
- The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.
- Requested information was not available and supplied without any significant delay.
- The annual financial statements and annual performance report were not submitted for auditing as per the legislated deadlines.

##### *Adequate financial management systems*

- General information technology controls are not designed to maintain the integrity of the information systems and the security of the data.
- Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.

#### **Governance**

##### *Risk identification and management*

- The entity does not have a formal risk assessment process.
- The entity does not respond to the assessed risks by determining a risk strategy / action plan to manage identified risks.

##### *Fraud prevention, detection and response*

- Segregation of duties to prevent fraudulent data and asset misappropriation is not adequate.
- A fraud prevention plan is not documented and used as per the requirements of applicable legislation.

##### *Internal audit that inspects the adequacy and implementation of internal control*

- Internal audit does not operate in accordance with an approved written terms of reference.
- Internal audit did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice and standards.

##### *Audit committee that promotes independent accountability and service delivery*

- The audit committee did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice.



- Implementation of internal and external audit recommendations is not monitored.
- Financial statements not reviewed prior to submission for audit purposes.

*Auditor-General*

Bloemfontein

20 December 2010



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*