

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 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and 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 South African Standard of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Cash and cash equivalents

4. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents of R16 669 779 (2010: R42 774 596) as disclosed in note 11 to the financial statements. I was unable to perform alternative procedures due to the unavailability of bank reconciliations, sufficient and appropriate audit evidence for debit journals of R68 287 944 and credit journals of R22 807 135. The unreconciled difference of R31 226 984 between the disclosure and the underlying accounting records could also not be substantiated. Debit orders of R5 152 742 in 2008-09 that appeared on the bank statements but had not been processed in the cash book could not be confirmed to be resolved. Consequently I could not determine the rights, valuation, existence, completeness presentation and disclosure of cash and cash equivalents disclosed in the financial statements, nor could I practicably quantify the resulting misstatement.
5. The corresponding figure for cash and cash equivalents as disclosed in note 11 to the financial statements has been restated by R31 033 334 from R11 741 262 to R42 774 596. No supporting documentation could be submitted for the restatement. There is an unreconciled difference of R3 283 095 between the restatement as disclosed in note 41 to the financial statements and the actual restatements that could not be explained. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the cash and cash equivalents corresponding figure of R42 774 596.

6. My report was modified in the prior year as unprocessed deposits and receipts of R56 531 998 were identified which had not been accounted for at year-end. Consequently, accumulated surplus was understated and receivables were overstated. The municipality's records did not allow me to quantify the understatement relating to revenue and the overstatement of receivables. The total unprocessed deposits and receipts for the year under review could not be quantified as no bank reconciliations have been prepared.
7. 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 R1 500 000 has been provided as security to the bank in respect of the municipality's overdraft facility.
8. The SA Standards of GRAP, GRAP2 Cash Flow Statements, requires the municipality to prepares and present a cash flow statement in accordance with the requirements of the standard. The cash flow from operating activities was not prepared and the accuracy and completeness of the cash flow statement could not be confirmed.

Property, plant and equipment

9. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment of R208 542 470 (2010: R208 542 470) as disclosed in note 4 to the financial statements. I was unable to perform alternative procedures due to the unavailability of a complete and accurate asset register, sufficient appropriate audit evidence for the difference of R7 910 685 between the asset register and disclosure, additions of R27 948 734, disposals of R1 040 693 as well as debit journals of R434 601 151 and credit journals of R428 935 099. The unreconciled difference of R5 666 052 between the disclosure and the underlying accounting records and the evaluation of the impairment of assets could also not be substantiated. The descriptions, serial numbers and locations of property, plant and equipment with a carrying value of R36 195 392 (2010: R34 736 041) recorded in the fixed asset register were inadequate to identify the assets. Consequently, I could not determine the rights, valuation, existence, completeness, presentation and disclosure of property, plant and equipment disclosed in the financial statements, nor could I practicably quantify the resulting misstatement.
10. Contrary to the requirements of paragraph 5 of the SA Standard of GRAP, GRAP 16 *Investment Property*, the municipality did not perform an evaluation to determine which properties should be disclosed as investment property. Municipal properties that conform to the definition and recognition criteria of an investment property as stated in GRAP 16 were not disclosed as such in the financial statements and were not included in an investment property register. Due to the lack of sufficient appropriate audit evidence, it was impracticable to determine the total extent of this understatement of investment property and overstatement of property, plant and equipment as disclosed in note 4 to the financial statements.
11. The municipality did not review the residual values and useful lives of property, plant and equipment at each reporting date in accordance with the SA Standard of GRAP, GRAP 17 *Property, plant and equipment*, as property, plant and equipment with a gross carrying amount of R208 542 270 (2010: R208 542 270) was included in the financial statements at provisional amounts and not cost less accumulated depreciation. Erven, that conform to the definition and recognition criteria of property, plant and equipment as stated in paragraph 11 of GRAP 17 and that were identified as municipal property on the municipal valuation roll, were not accounted for as property, plant and equipment in the financial statements. Due to the lack of sufficient appropriate audit evidence, the total financial impact of the misstatement could not be determined. Consequently, I could not

obtain adequate audit assurance as to the valuation and completeness of property, plant and equipment.

12. Paragraph 18 of the SA Standard of GRAP, GRAP1 *Presentation of Financial Statements*, 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 due to calculation errors as well as, property, plant and equipment disclosed in the financial statements exceeding the underlying accounting records by R12 082 231. Property, plant and equipment and the accumulated surplus were therefore overstated by R12 082 231.

Consumer debtors

13. Consumer debtors of R103 805 427 (2010: R86 563 762) as disclosed in note 10 to the financial statements could not be confirmed against sufficient appropriate audit evidence. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for the difference of R405 742 between the age analysis and the disclosure and credit journals of R68 639 625. The unreconciled difference of R18 651 727 between the disclosure and the underlying accounting records, consumer debtor balances of R103 805 427 and government debtors of R1 272 654 (2010: R1 766 925) could also not be substantiated. Consequently, I could not determine the rights, valuation, existence, completeness, presentation and disclosure of consumer debtors disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.
14. The corresponding figure for consumer debtors as disclosed in note 10 to the financial statements has been restated by R36 575 863 from zero to R36 575 863. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the consumer debtors corresponding figure of R86 563 762.
15. South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133), *Financial Instruments: Recognition and Measurement* states that an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. The municipality did not assess the consumer debtors, individually or by category, for any indication that these assets may be impaired. Management raised a general provision of R83 757 128 (2010: R49 987 899) for impairment against these consumer debtors. The recoverability of consumer debtors is doubt as consumer debtors with outstanding balances amounting to R85 090 156 had been outstanding for longer than 90 days. The recoverability is further compromised by the ongoing litigation resulting in payments being withheld by consumers. 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 and valuation of consumer debtors and impairment of debtors.
16. Contrary to the SA Standards of GRAP, GRAP 1, *Presentation of Financial Statements* details in respect of the aging of consumer debtors were not disclosed in note 10 to the financial statements to achieve fair presentation.

Trade and other receivables

17. I was unable to obtain sufficient appropriate audit evidence for trade and other receivables of R43 783 398 (2010: R34 001 491) as disclosed in note 9 to the financial statements. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for debit journals of R102 445 663 and credit journals of R110 563 897. The financial statements exceeded the underlying accounting

records by R4 333 560 and the difference could not be substantiated. Consequently, I could not determine the rights, valuation, existence, completeness, presentation and disclosure of trade and other receivables disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.

18. The corresponding figure for trade and other receivables as disclosed in note 9 to the financial statements has been restated by R20 001 622 from R13 999 869 to R34 001 491. There is an unreconciled difference of R18 042 013 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the trade and other receivables corresponding figure of R34 001 491.
19. My report was modified in the prior year as trade and other receivables of R43 783 398 (2010: R34 001 491) was disclosed in note 9 to the financial statements. Due to the lack of sufficient appropriate evidence and the fact that a journal of R6 195 758 had been processed without sufficient appropriate audit evidence, the existence and rights of 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 and rights of trade and other receivables of R43 783 398 (2010:R7 485 242).

Trade and other payables

20. Trade and other payables of R57 256 314 (2010: R41 053 054) as disclosed in note 18 to the financial statements could not be confirmed against sufficient appropriate audit evidence. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for the payroll suspense accounts with debit balances of R31 472 281(2010: R13 948 313) and credit balances of R26 933 460 (2010: R2 104 581) included in trade and other payables. The difference of R62 660 072 between the supplier list and the disclosure could not be substantiated. Debit journals of R142 916 014 and credit journals of R62 101 980 as well as an unreconciled difference of R81 886 038 between the disclosure and the underlying accounting records could not be substantiated. Consequently I could not determine the rights, valuation, existence, completeness, presentation and disclosure of consumer debtors disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transactions and disclosures.
21. The corresponding figure for trade and other payables as disclosed in note 18 to the financial statements has been restated by R31 281 041 from R9 772 013 to R41 053 054. There is an unreconciled difference of R31 281 041 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the trade and other payables corresponding figure of R41 053 054.
22. In accordance with paragraph 37 of the SA Standards of GRAP's *Framework for Preparation and Presentation of Financial Statements*, the financial statements should be prepared on the accrual basis. Under this basis, transactions are recognised when they occur. Transactions are therefore recorded in the accounting records and reported in the financial statements of the periods to which they relate. However, various payments made to suppliers and/or service providers after year-end pertained to the current year. These payments were not recognised in the current year, resulting in the understatement

of trade payables and expenditure. The municipality's records did not permit me to determine the total extent of this misstatement.

23. My report was modified in the prior year as trade and other payables of R15 453 873 as well as debtors with credit balances of R1 559 672 included in trade payables in note 18 to the financial statements could not be confirmed against sufficient appropriate audit evidence. Accordingly, I was unable to obtain sufficient appropriate audit evidence that trade and other payables of R57 256 314 (2010: R41 053 054) as included in the statement of financial position and note 18 to the financial statements, did not contain significant misstatements.

Expenditure

24. I was unable to obtain sufficient appropriate audit evidence for expenditure of R148 991 812 (2010: R86 747 665) disclosed in the statement of financial performance. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for debit journals of R32 690 390 and credit journals of R71 974 925. The underlying accounting records does not agree with the financial statements by R41 230 266 and the difference could not be substantiated. Payments made amounting to R35 031 701 (2010: R20 124 994) could not be substantiated against sufficient appropriate audit evidence. Consequently I could not determine the occurrence, accuracy, classification, completeness, presentation and disclosure of expenditure disclosed in the statement of financial position, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.
25. The corresponding figure for expenditure as disclosed in the financial statements on the statement of financial performance has been restated by R20 366 348 from R64 482 194 to R84 848 542. There is an unreconciled difference of R13 584 423 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, and accuracy of the expenditure corresponding figure of R86 747 665.
26. My report was modified in the prior year as payments of R2 026 674 had only been recorded in the current financial year, resulting in the understatement of the corresponding disclosure of expenditure by R2 026 674.

Irregular expenditure

27. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality that is not in accordance with a requirement of the act and that has not been condoned in terms of section 170. The following cases of irregular expenditure were identified, which resulted from non-compliance with the municipality's supply chain management (SCM) policy. This irregular expenditure was not disclosed as required by section 125(2)(d) of the MFMA and therefore irregular expenditure as disclosed in note 46 to the financial statements was understated by the following:
- (a) Non compliance with the requirements of the SCM policy, section 65(2)(a) of the MFMA and the Treasury Regulations that resulted in irregular expenditure amounting to R11 578 437.
 - (b) Expenditure amounting to R114 570 incurred as a result of the double payment of consultants due to lack of compliance with the SCM policy.
 - (c) The municipality could not submit sufficient appropriate audit evidence regarding the tender process and as a result the entire tender process and payments made relating to tenders could not be confirmed. Due to the lack of sufficient appropriate audit evidence, the total financial impact could not be determined.

28. Sufficient appropriate audit evidence that all irregular expenditure transactions had been identified, investigated and recorded during the year under review could not be provided. I was unable to perform reasonable alternative audit procedures. Consequently, I could not obtain adequate audit assurance as to the accuracy and completeness of irregular expenditure amounting to R42 118 515 (2010: R40 649 285) as disclosed in note 46 to the financial statements.
29. 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 had deliberately or negligently incurred or authorised irregular expenditure were held liable for such expenditure in terms of sections 32(1)(c) and 32(2)(b) of the MFMA. Trade and other receivables can thus be understated and the accumulated surplus overstated, but due to the lack of supporting documentation the amount could not be quantified.

Revenue

30. Revenue of R147 508 379 (2010: R134 333 052) as disclosed in the statement of financial performance could not be confirmed against sufficient appropriate audit evidence. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence to confirm the income foregone totalling R12 704 333 as disclosed in note 22 to the financial statements. Receipts amounting to R17 213 068 (2010: R6 589 318) could not be confirmed to have been recorded in the accounting records. Debit journals of R24 502 392 and credit journals of R26 557 422 could not be substantiated. Furthermore, there is an unreconciled difference of R4 109 800 between the disclosure and the underlying accounting records. Consequently, I could not determine the occurrence, accuracy, classification, completeness, presentation and disclosure of revenue as disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.
31. The corresponding figure for revenue as disclosed in the financial statements on the statement of financial performance has been restated by R10 661 821 from R123 663 913 to R134 333 052. There is an unreconciled difference of R25 397 905 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, and accuracy of the revenue corresponding figure of R134 333 052.
32. Accounting policy note 1.13 was not in line with the SA Standards of GRAP, GRAP 9 *Revenue from Exchange Transactions*, 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 retained 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 me with the relevant information, I could not quantify the extent to which revenue was overstated and deferred income understated. No alternative procedures could be performed in this regard.
33. In accordance with the SA Standards of GRAP, GRAP 1 *Presentation of Financial Statements*, the financial statements should be prepared on the accrual basis. Under this basis, transactions are recognised when they occur. Various instances of the incorrect application of approved tariffs were identified relating to service charges, specifically electricity and water, prepaid electricity as well as estimates used for electricity and

water. Due to the lack of sufficient appropriate evidence the total financial impact could not be determined. Furthermore, 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. The under collection of service charges due to the incorrect application of tariffs approved and the lack of provision for service charges resulted in revenue and consumer debtors being understated, while the under collection of pre-paid electricity due to the incorrect application of tariffs approved resulted in a loss of income.

34. My reports was modified in the prior year as property rates of R13 087 940 were included in note 22 to the financial statements. Improvements to properties of R6 400 940 had not been updated on the system, resulting in the under collection 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.

Employee Related Costs

35. I was unable to obtain sufficient appropriate audit evidence for employee related costs of R56 167 507 (2010: R53 247 959) as disclosed in note 28 and 29 to the financial statements. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for debit journals of R3 773 779 and credit journals of R195 444. The financial statements exceeded the underlying accounting records by R2 742 644 and the difference could not be substantiated. Furthermore an unreconciled difference of R2 223 422 between the payroll accounting system and the financial statements could not be substantiated. Uncleared payroll suspense accounts with a net debit balance totalling R4 538 821 (2010: (R378 784) could not be substantiated against sufficient appropriate audit evidence. Consequently I could not determine the occurrence, accuracy, classification, completeness, presentation and disclosure of employee related costs disclosed in the statement of financial performance, neither could I practicably quantify the resulting misstatement in other account balances, classes of transactions and disclosures.
36. The corresponding figure for employee related costs as disclosed in the financial statements on the statement of financial performance has not been restated. There is an unreconciled difference of R5 734 817 between the disclosed amount and note 41 to the financial statements that indicates that a prior period error correction was made to the amount of R5 734 817. No supporting documentation was available for the disclosure. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, and accuracy of the employee related cost corresponding figure of R48 776 438.

Remuneration of councillors

37. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Overpayment of R2 204 927 were identified in respect of councillor remuneration included in note 29 to the financial statements this was reported for the past two financial years. Consequently councillor remuneration were overstated with R546 207, accumulated surplus were overstated with R1 658 720 and receivables understated by R2 204 927.
38. The municipality did not disclose the particulars of the salaries, allowances and benefits of the councillors of the municipality, in accordance with section 124 of the MFMA. The particulars of the remuneration of councilors amounting to R4 365 842 as disclosed on the statements of financial performance and note 29 of the financial statements should have been disclosed in detail.

Value-added tax

39. The VAT payable of R5 649 738 (2010: R5 786 711) as disclosed in note 19 to the financial statements could not be confirmed against sufficient appropriate audit evidence. I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence to confirm debit journals of R214 993 and credit journals of R10 464 203. An unreconciled difference of R1 590 797 between the returns submitted and the accounting records could not be substantiated. Furthermore, a difference of R12 591 425 between the underlying accounting records and the third party confirmation could not be substantiated. Consequently, I could not determine the rights, valuation, existence, completeness, presentation and disclosure of VAT payable disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, class of transactions and disclosures.
40. The corresponding figure value added tax payable as disclosed in note 19 to the financial statements has been restated by R8 400 537 from R14 187 248 to R5 786 711. There is an un reconciled difference of R8 400 537 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the VAT payable corresponding figure of R5 786 711.
41. My report was modified in the previous year as the completeness and valuation of VAT payable of R5 649 738 (2010: R5 786 711) could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that VAT payables of R5 649 738 and the corresponding disclosure of R5 786 711, as included in the statement of financial position and note 19 to the financial statements, did not contain significant misstatements.

Accumulated surplus

42. I was unable to obtain sufficient appropriate audit evidence for the accumulated surplus as disclosed on the statement of financial position of R210 747 461 (2010: R267 252 230). I was also unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for debit journals of R400 836 911 and credit journals of R486 177 679. The underlying accounting records exceeded the financial statements by R53 245 414 and the difference could not be substantiated. Consequently, I could not determine the rights, valuation, existence, completeness, presentation and disclosure of the accumulated surplus disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.
43. The corresponding figure for accumulated surplus as disclosed in the financial statements on the statement of financial position has been restated by R281 514 518 from R14 262 288 deficit to R267 252 230 surplus. There is an un-reconciled difference of R166 702 217 between the disclosed restatement and the actual restatement that could not be explained. No supporting documentation was available for the restatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and rights pertaining to the accumulated surplus corresponding figure of R5 786 711.
44. 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 the accumulated surplus of R210 747 461 and the corresponding disclosure of R267 252 230 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.

Unspent conditional grants and receipts

45. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts as disclosed in note 16 to the financial statements of R2 200 692 (2010: R19 192)). I was unable to perform alternative procedures due to the unavailability of sufficient appropriate audit evidence for debit journals of R466 000 and credit journals of R2 239 020. The underlying accounting records exceeded the financial statements by R2 006 020 and the difference could not be substantiated. Furthermore a difference of R5 273 866 (2010: R9 007 009), between the underlying accounting records in respect of operation Hlasela and the third party confirmation for the separate bank account maintained for this purpose, could not be substantiated. 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. Consequently I could not determine the rights, valuation, existence, completeness, presentation and disclosure of unspent conditional grants and receipts disclosed in the financial statements, neither could I practicably quantify the resulting misstatement in other account balances, classes of transaction and disclosures.

Provisions

46. The municipality did not disclose 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 had been evaluated to determine whether they should be disclosed as contingent liabilities or provided for in accordance with the SA Standards of GRAP, GRAP 19, *Provisions, Contingent Liabilities and Contingent Assets*, I was unable to determine if accruals, provisions and contingent liabilities were understated. Third party confirmation letters sent out to the municipality's legal representatives were not responded to and the application of alternative audit procedures could thus also not be performed. Provision was not made for the environmental rehabilitation costs of restoring the municipality's landfill sites. 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. Accordingly, I could not obtain sufficient appropriate audit evidence to ensure the completeness of provisions.

47. I was unable to obtain sufficient appropriate audit evidence for debit journals of R1 658 051 and for credit journals of R829 026. I was unable to confirm the completeness, accuracy and validity of the journals processed against provisions and other account balances or classes of transaction contained in the financial statements.

Contingent liabilities

48. Contingent liabilities of R20 916 762 were identified during prior year audits. This disclosure has not been included in the financial statements, no evidence could be obtained that these cases had been resolved by 30 June 2011 and as a result no assurance could be expressed that contingent liabilities as disclosed in the financial statements were complete.

Fruitless and wasteful expenditure

49. Section 1 of the MFMA defines fruitless and wasteful expenditure as expenditure incurred by a municipality that was made in vain and that could have been prevented had reasonable care been taken and that has not been condoned in terms of section 170. The following cases of fruitless and wasteful expenditure were identified, that had not been disclosed as required by section 125(2)(d) of the MFMA.

Therefore, fruitless and wasteful expenditure as disclosed in note 45 to the financial statements was understated by the following:

- (a) Fruitless and wasteful expenditure incurred as a result of councillor overpayments of R546 207 have not been disclosed.
- (b) The municipality did not disclose fruitless and wasteful expenditure of R537 341 incurred as a result of interest and penalties levied against them due to late payments being made to SARS for employee tax, Skills Development Levy and Unemployment Insurance Fund as required by section 125(2)(d) of the MFMA.
- (c) The municipality did not disclose fruitless and wasteful expenditure of R38 080 incurred as a result of interest and penalties levied against them due to late payments being made to SARS for VAT, as required by section 125(2)(d) of the MFMA.
- (d) Fruitless and wasteful expenditure of R10 400 incurred due to late payment of suppliers were not disclosed.
- (e) The municipality did not disclose fruitless and wasteful expenditure of R3 470 incurred as a result of late payments and traffic fines.
- (f) Expenditure amounting to R30 000 incurred as a result of payments to consultants for an inadequate asset register were not disclosed as fruitless and wasteful expenditure.

Commitments

- 50. The commitments balance of R12 701 718, as disclosed in note 38 to the financial statements, did not agree to the balance of R17 811 327 per the underlying accounting records. The municipality did not reconcile the difference of R5 109 609 between the financial statements and the underlying accounting records. Consequently, the commitments balance was understated by R5 109 609.
- 51. No evidence could be obtained that management had confirmed the completeness of commitments of R12 701 718 (2010: R30 650 586) as disclosed in note 38 to the financial statements. Accordingly, I was unable to obtain sufficient appropriate audit evidence that capital commitments of R12 701 718 (2010: R30 650 586) as disclosed in note 38 to the financial statements, did not contain significant understatement for the year under review. Comparative figures are understated with R81 690 055.

Changes in accounting policy

- 52. Contrary to the requirements of the SA Standard of GRAP, GRAP 3 *Accounting Policies, Changes In Accounting Estimates And Errors*, the municipality did not disclose the write off of funds and reserves amounting to R183 879 771 to the accumulated surplus in terms of accounting policy note 1.24 as a prior period error, but disclosed it incorrectly as a change in accounting policy in note 2 to the financial statements. This is regarded as a prior period error as the funds and reserves should have been written off to the accumulated surplus with the first time adoption of GRAP as there were no subsequent changes to the accounting policy.

Unauthorised expenditure

- 53. Section 1 of the MFMA defines unauthorised expenditure as overspending of the total amount appropriated in the municipality's approved budget. Unauthorised expenditure to the amount of R45 862 732 was not disclosed in the financial statements as required by section 125(2)(d) of the MFMA and therefore unauthorised expenditure was understated by the said amount.

Going concern

54. The municipality incurred an operating deficit of R57 650 940 during the financial year under review and a deficit of R5 662 572 in the prior year. In addition the going concern ratios are regarded as unfavourable. The municipality did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the national and provincial government for its continued sustainability. The municipality is experiencing serious difficulties with regard to debt collection. All of these are indicators of serious financial problems as detailed in section 138 of the MFMA. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements and notes thereto do not disclose this fact.

Disclaimer of opinion

55. 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

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

Material losses

57. As disclosed in note 22 to the financial statements, the municipality suffered significant income rate losses of R12 704 333 during the year under review, due to income foregone relating to the commercial, small holdings and farm rates charged.

Material Impairments

58. As disclosed in note 10 to the financial statements, the municipality incurred material impairments amounting to R83 757 128, mainly due to outstanding consumer debtors. The recoverability of these amounts is doubtful.

Additional matters

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

Unaudited supplementary schedules

60. 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.

Material inconsistencies in other information included in the annual report

61. As the municipality failed to submit a draft annual report for the financial period under view, the consistency and accuracy of information that will be reported could not be verified against actual audited information relating to the municipality.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

62. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages [xx] to [xx] and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

63. Material findings on the report on predetermined objectives, as set out on pages xx to xx, are reported below:

Presentation of information

64. No annual performance report was submitted for the financial period under review. Consequently, the accuracy and completeness of reporting on pre-determined objectives could not be evaluated.

Usefulness of information

65. It could not be confirmed that the municipal performance management framework and policy for the financial period under review had been approved or properly implemented. Consequently, the processes followed to identify, collect, manage and report on information relating to pre-determined objectives could not be verified.

Reliability of information

66. Contrary to section 30 of the Municipal System Act, 2000 (Act No.32 of 2000)(MSA), no committee of councillors was appointed by the municipal council to manage the drafting of the municipality's integrated development plan (IDP), nor could it be confirmed that responsibilities in this regard had been delegated to the municipal manager.
67. The municipal IDP did not include specific information, such as input, output or outcome indicators relating to the local government strategic five-point plan.
68. The municipal budget and the service delivery and budget implementation plan (SDBIP) could not be linked in such a way that gave effect to the municipal IDP. Information relating to budgeted infrastructure as included in the municipal budget and SDBIP could not be linked to the municipal IDP and in some instances were not included in the IDP, which contributed to a lack of clear and transparent inter relationships between the municipal budget, SDBIP and IDP.
69. The municipal IDP did not include input, output or outcome indicators, as prescribed by section 13 (3) of the rules and regulation of the MSA. Key performance indicators and performance targets included in the IDP could not be confirmed to be:
- Specific (the nature and the required level of performance can be clearly identified)
 - Measurable (the required performance can be measured)
 - Achievable (the target is realistic given existing capacity)
 - Relevant (the required performance is linked to the achievement of a goal)
 - Time-bound (the time period or deadline for delivery is specified)

Compliance with laws and regulations

Strategic planning and performance management

70. Reports submitted by the accounting officer regarding to monthly reporting on income and expenditure were not adequate in terms of section 71 and 72 of the MFMA.

Annual financial statements, performance and annual report

71. The accounting officer failed to submit financial statements within the legislative deadline, as prescribed by section 126 (a) of the MFMA.
72. The municipality did not reported performance against predetermined objectives, as required by section 121 of the MFMA and section 46 of the MSA.

73. The accounting officer failed to submit a draft annual report for the financial period under review, contrary to the terms of engagement as agreed upon at the start of the audit engagement, which stated that: 'the draft annual report and all other information that is to be issued with the financial statements should be submitted by no later than 31 August in order for us to determine any inconsistencies with the audited financial statements and report on predetermined objectives. If this information is not received as agreed it may have a significant impact on the audit due to additional time that will be required to review events subsequent to the date of the auditor's report.'

Audit committees

74. The audit committee did not properly function during the financial period as it could not be confirmed that the committee had executed its duties as prescribed by section 166 (1) to 166 (5) of the MFMA.

Internal audit

75. The internal audit function at the municipality was outsourced during the financial period and no adequate audit assurance could be obtained that the internal auditors had executed their duties in terms of section 165 of the MFMA, as no up to date service level agreement could be submitted for audit purposes.

Procurement and contract management

76. Goods and services with a transaction values of between R2 000 and R500 000, totalling R1 112 270, were procured without obtaining the required number of written price quotations from prospective suppliers, as per the requirements of regulations 12 and 16 (GNR. 868 of 30 May 2005)

77. Goods and service with transaction values of R2 000 and above, totalling R986 490, were procured without the proper authorisation to incur the expenditure in terms of section 62 (1)(b) of the MFMA.

Expenditure management

78. The accounting officer did not take effective or appropriate steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as per the requirements of section 62 (1)(d) of the MFMA.

79. The accounting officer did not ensure that expenditure incurred by the municipality, totalling R426 056 was reviewed as proof that the expenditure had been captured on the municipal financial system, contrary to section 65 of the MFMA.

80. VAT claimed on expenditure incurred, totalling R384 167, was based on invoices that did not comply with section 20(4) of the VAT Act.

Revenue management

81. The accounting officer did not review the scale of tariffs for fees and charges at the time of preparing the budget relating to pre-paid electricity, resulting in too little being charged for pre-paid electricity, contrary to section 64(1)(a) to 64(1)(h) of the MFMA.

Asset management

82. The accounting officer did not ensure that a proper control system existed for assets to eliminate theft, losses, wastage and misuse, as per the requirement of section 63 of the MFMA.

83. The accounting officer failed to ensure compliance with the SA Standard of GRAP, *GRAP Property, Plant and Equipment*, as the municipality applied Directive 4 issued by the Auditing Standards Board after the allowed period.

INTERNAL CONTROL

84. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the lack of an annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

85. Key staff members were not available for meetings during the planning phase of the audit, which delayed the execution phase. Attendance of meetings by key staff members improved during the execution and reporting phases of the audit.

86. The council did not develop and establish an information technology committee, risk committee, budget committee, fraud prevention plan, business continuity plan or disaster recovery plan, which lead to a breakdown of internal controls resulting in numerous reporting errors not being identified and addressed in a timely manner.

87. Consultants were used to prepare the financial statements due to a lack of technical expertise in respect of the GRAP accounting framework. The municipality also suffered from capacity problems during the financial period. The consultants appointed did not have the proper competency levels to ensure material reduction in misstatements, nor did the appointed consultants transfer skills to the staff of the municipality. Management did not ensure that adequate and sufficiently skilled resources were in place or that performance was monitored.

88. The municipality did not have documented and approved internal policies and procedures to address planning, implementation, monitoring and reporting processes and events pertaining to performance management and reporting as well as related party transactions.

89. The municipality had not established an information technology (IT) risk management framework or IT governance framework to assist IT in aligning the evaluation and management of IT risks to the overall approach of the municipality.

90. Numerous long outstanding resolutions have not been resolved. Sufficient appropriate audit evidence could not be submitted to determine whether or not these resolutions had been adequately addressed.

Financial and performance management

91. The response time to requests for information and communication of audit findings was slow and not in line with the timeframes agreed upon in the audit engagement letter. This resulted in the bulk of information being submitted for audit purposes towards the end of the audit. The majority of responses to audit findings were also not received within the agreed-upon timeframes, which in turn had a negative impact on timely and effective feedback sessions between the AGSA and the management of the municipality. As a result audit adjustments to the financial statements were made at a very late stage of the audit.

92. Management did not implement the daily and monthly controls as designed for the municipality's business processes as monthly cash and cash equivalents, debtor, creditor and payroll reconciliations were not properly prepared and reviewed.

93. A recurring issue in recent years has been the number of suspense accounts that are not reconciled and cleared in a timely manner.

94. The municipality had not formalised its backup process by designing a backup strategy.
95. The municipal budget could not be confirmed to be consistent with the strategic objectives of the municipality as included in the municipal IDP.
96. Non-compliance with laws and regulations could have been prevented had compliance been properly reviewed and monitored.
97. The municipality failed to submit a report on pre-determined objectives for the financial period ended 30 June 2011, the consistency of information could not be confirmed.

Governance

98. Management had not implemented appropriate risk management activities to ensure that regular risk assessments, including the consideration of IT risks and fraud prevention, would be conducted and that a risk strategy would be developed and monitored to address the risks identified in a timely manner. The municipality did a risk assessment during February 2011 but this was not used to develop and monitor risks during the year under review and only had an impact in the 2012 year.
99. The internal audit unit did not function as intended during the year under review as only a single compliance report was issued during the financial period, consisting of reviews of DORA, procurement, and general compliance focus areas. No other work was performed by the internal auditors.
100. The audit committee did not function throughout the year as only one meeting was held and it could not be confirmed that the audit committee had executed their duties as required by section 166 of the MFMA.

AUDITOR-GENERAL

Bloemfontein

29 February 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence