

# REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE MANTSOPA LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the accompanying financial statements of Mantsopa Local Municipality, which comprise the statement of financial position as at 30 June 2010, 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 .... to ....

### 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 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 my audit. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Basis for qualified opinion**

### **Trade and other receivables**

- 6 The South African Statement of Generally Accepted Accounting Practice (SA Statements of GAAP), IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* require that accounts receivables be fair valued and impaired if there is any objective evidence that a financial asset is impaired. The municipality made a general provision for bad debts of R28 745 032 (2009: R22 239 639) in the financial statements. In computing the provision for doubtful debts, the municipality did not apply the requirements of SA GAAP Statements. Due to the lack of sufficient and appropriate information on the debtors system, I was unable to calculate what the impairment charge against consumer receivables and bad debts expense would have been had SA Statements of GAAP, IAS 39 been applied correctly.

### **Unspent government grant and subsidies**

7. Paragraph 43(c) of Generally Accepted Municipal Accounting Practice, GAMAP 9, *Revenue* requires that revenue from government grants be recognised to the extent that there has been compliance with any restrictions associated with the grant. As a result any unspent conditional grants at the end of the year are recognised as a liability. The municipality disclosed unspent government grants of R5 796 969 (2009: R10 042 197). A reconciliation of unspent grants was performed and a difference of R1 729 548 was identified. This variance is due to discrepancies in current year municipal infrastructure grant (MIG) receipts and payments used therefore unspent MIG at 30 June 2010 to the amount of R5 796 969, as disclosed in 18.5 was understated by R1 729 969 and government grants and subsidies account overstated by the same amount.

### **Cash flow statement**

8. Included in the cash flow statement is the amount of prior year errors that have been included in the indigent debtors of R16 959 453. However, computation of cash paid to suppliers is only R1 628 483, resulting in a different of R15 330 970 that has been misallocated. This is due to the fact that the effects of prior year errors corrected in the current financial year have been included in the cash flow statement and incorrectly allocated or disclosed.

### **Property, plant and equipment**

9. Certain items of property, plant and equipment were physically verified at year-end, but during the physical verification it was noted that assets were not appropriately identified or described as they did not have sufficient identification such as asset numbers, bar codes or sufficient descriptions. As a result, I was not able to obtain sufficient appropriate audit evidence regarding completeness and existence of the municipality's assets to the value of R276 460 937 (2009: R266 753 871) as disclosed in the statement of financial position and in note 7.1 to the financial statements. No alternative audit procedures could be performed to obtain sufficient appropriate evidence.

### **Investment property**

10. Certain items of investment properties were physically verified at year-end, but during the physical verification it was noted that assets were not appropriately identified or described as they did not have sufficient identification such as asset numbers, bar codes or sufficient descriptions. As a result I was not able to obtain sufficient appropriate audit evidence regarding completeness of the municipality's investment properties to the value of value of R1 446 000 (2009: R 1446 000), as disclosed in the statement of financial position and in note 7.1 to the financial statements. No alternative audit procedures could be performed to obtain sufficient appropriate evidence.

### **Correction of prior period errors**

11. Generally Recognised Accounting Practice: Accounting Policies, Changes in Accounting Estimates and Errors (GRAP 3) recognises that errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. The statement therefore prescribes the treatment, correction, presentation and disclosure of prior period errors. However, evaluation of the financial statements revealed that the municipality did not disclose the amount of the correction of the prior year errors in accordance with the requirements of GRAP 3. No alternative audit procedures could be performed to obtain sufficient appropriate evidence with regard to presentation and disclosure.

### **Qualified opinion**

12. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mantsopa Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the SA Standards of GRAP and in the manner required by the MFMA.

### **Emphasis of matter**

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

#### **Irregular expenditure**

13. As disclosed in note 41 to the financial statements, irregular expenditure to the amount of R2 478 868 was incurred, as proper supply chain management policies were not adhered to.

#### **Fruitless and wasteful expenditure**

14. As disclosed in note 40 to the financial statements, the municipality incurred wasteful expenditure to the amount of R29 986 as a result of interest paid on creditors balances.

#### **Unauthorised expenditure**

15. As disclosed in note 42 to the financial statements, the municipality incurred unauthorised expenditure of R3 302 696 as a result of expenditure exceeding the total amount of the vote.

### **Restatement of corresponding figures**

16. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the year ended 30 June 2010 in the financial statements of the Mantsopa Local Municipality at, and for the year ended, 30 June 2009.

### **Additional matters**

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

### **Unaudited supplementary schedules**

17. The supplementary information set out on pages .... to .... 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**

18. The comparison between the draft annual report and financial statements was done and material inconsistencies were noted due to the fact that the annual report was not updated to align it with the final financial statement issued after the audit adjustments.

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

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 the following key laws and regulations: MFMA, Local Government: Municipal System Act of South Africa, 2000 (Act No. 32 of 2000) (MSA); Division of Revenue Act, 2009 (Act No. 12 of 2009) and financial management (internal control).

### **Predetermined objectives**

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

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

#### **No performance measurement system in place**

20. Section 38 of the MSA requires a municipality to establish a performance management system for performance to be measured, however, in the current year being audited the municipality did not have a complete system for evaluation performance.

#### **Communication of the key performance indicators and performance targets**

21. There is no evidence that the requirements of section 44 of the MSA were complied with. The section requires that the municipality, in a manner determined by its council, make known, internally and to the general public, the key performance indicators and performance targets set by it for purposes of its performance management system.

#### **Lack of system to detect underperformance**

22. Contrary to section 41 of the MSA, there was no system that detects underperformance early in place at the municipality.

#### **Explanations of the method used to determine certain targets not satisfactory**

23. Adequate information on performance was presented; however, explanations on the way and method used to determine certain targets were found not satisfactory or inadequate. As a result, planning and reporting targets appeared aligned.

#### **Usefulness of reported performance information**

24. The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan (IDP), i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

#### **Reasons for major variances between planned and actual reported targets not reliable**

25. For the selected solid waste programmes the planned and reported measures were not verifiable as it was almost impossible to validate the processes that produced and systems that produce the indicator.

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

26. Key performance indicators which include input indicators, output indicators and outcome indicators which are set for each of the development priorities and objectives established by the municipality could not be identified. An assessment of the existing level of development in the municipality and the identification of communities which do not have access to basic municipal services could not be clearly identified. The alignment of the development strategies of the municipality, as stated in chapter 4 of the IDP, with national or provincial sectoral plans and planning requirements binding in terms of legislation could not be identified.

#### **Reliability of information**

27. For the selected objectives the validity, accuracy and completeness of 100% of the reported indicators could not be established as the relevant source documentation could not be provided for audit purposes.

#### **Compliance with laws and regulations**

##### **Approved budget exceeded**

28. Contrary to the requirements of section 32(4)(a) to (c)(i-iii) of the MFMA, the municipality exceeded its approved budget.

##### **Expenditure incurred was made in vain resulting in fruitless and wasteful expenditure**

29. Section 62(1)(d) of the MFMA requires the accounting officer of a municipality to take all reasonable steps to ensure that unauthorised, irregular or fruitless and wasteful expenditure

and other losses are prevented. However, fruitless and wasteful expenditure of R29 986 was incurred as a result of interest paid on creditors' balances.

#### **Contravention of the MFMA and SCM policies resulting in irregular expenditure**

30. Section 62(1)(d) of the MFMA requires the accounting officer of a municipality to take all reasonable steps to ensure that unauthorised, irregular or fruitless and wasteful expenditure and other losses are prevented. However, irregular expenditure of R2 478 868 was incurred as proper supply chain management policies were not adhered to.

#### **Contravention of the MFMA, resulting in unauthorised expenditure**

31. Section 62(1)(d) of the MFMA requires the accounting officer of a municipality to take all reasonable steps to ensure that unauthorised, irregular or fruitless and wasteful expenditure and other losses are prevented. However, unauthorised expenditure of R3 302 696 was incurred as a result of expenditure exceeding the total amount of the vote

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

32. Contrary to the requirements of section 65(2)(e) of the MFMA, payments were identified that were not paid within 30 days as prescribed.

#### **Monthly reports were not submitted on time to the mayor and the provincial treasury**

33. Contrary to the requirements of section 71(1) of the MFMA, it was noted that the monthly reports on the state of the municipality's budget were not submitted to the mayor and the provincial treasury on time.

#### **Information to be placed on websites of municipalities**

34. Contrary to the requirements of section 75(1) of the MFMA on information to be placed on websites of municipalities, it was noted that information on Mantsopa Local Municipality was not complete.

#### **Permission to retain unspent conditional grant**

35. Contrary to the requirements of the MFMA evidence could be submitted that Mantsopa Local Municipality was permitted by the National Treasury to retain unspent conditional grants, nor that they applied to retain unspent conditional grants

#### **Councillors' leave of absence**

36. Contrary to the requirements of the MSA, schedule 1, section 3, which requires councillors to attend meetings of the municipal council and of a committee of which that councillor is a member, councillors were absent in certain meetings and no leave of absence was granted.

#### **Explanations on actual versus budgeted income and expenditure**

37. GRAP requires an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements. A comparison between the actual and the budgeted revenue and expenditure was included in the financial statements, but no explanation of material differences were disclosed.

### **The audit committee was not functioning properly**

38. Contrary to the requirements of section 116(4)(b) of the MFMA, minutes of only two meetings of the audit committee were submitted and therefore the audit committee did not meet at least four times as required.

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

39. Contrary to the requirements of section 63 of the MFMA which requires that the accounting officer maintain a management, accounting and information system that accounts for the assets of the municipality, certain assets were not included in the fixed asset register.

### **INTERNAL CONTROL**

40. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA and DoRA, but not for the purposes of expressing an opinion on the effectiveness of internal control.
41. The matters reported below are limited to the significant deficiencies regarding the findings on the report on predetermined objectives and the findings on non-compliance with laws and regulations.

#### **Leadership**

42. The accounting officer does not at all times exercise oversight responsibility over reporting and compliance with laws and regulations and internal controls.
43. Contrary to the audit charter no evidence could be provided that the council did assess the effectiveness of the audit committee, neither was a self-evaluation performed by the committee.

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

44. The financial statements and other performance information to be included in the annual report were not thoroughly reviewed for completeness and accuracy prior to submission for audit purposes. As a result the financial statements were subject to material amendments resulting from the audit.
45. The entity does not have enough individuals with adequate technical expertise relevant to understanding the financial reporting framework and performance management requirements.
46. General information technology controls are not designed to maintain the integrity of the information systems, i.e. design of manual or automated controls does not always ensure that transactions are accurately processed. There is no proper inventory system in place, resulting in significant deficiencies in stock verification.

#### **Governance**

47. The municipality does not adequately identify risks relating to the achievement of financial and performance information objectives. As a result internal controls are not selected and developed to prevent or detect material misstatement in financial reporting and reporting on predetermined objectives.

48. The audit committee did not fulfil its responsibilities as it did not advise the accounting officer and the management staff of the municipality on matters relating to accounting policies, effective governance, and adequacy reliability and accuracy of financial reporting information
49. Contrary to the audit charter, evidence that the audit committee assessed the effectiveness of the internal audit section during the year under review could not be obtained.

Bloemfontein

02 December 2010



**A U D I T O R - G E N E R A L**  
**S O U T H A F R I C A**

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