

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mantsopa Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, and the statements of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

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 Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA) 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. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. 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

Bank and cash equivalents and bank overdraft

4. I was unable to obtain sufficient appropriate audit evidence for bank and cash equivalents and bank overdraft disclosed as R48 130 and R14 339 462, respectively, in the statement of financial position. I was unable to confirm these amounts disclosed by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to these amounts disclosed for bank and cash equivalents and bank overdraft.

Property, plant and equipment

5. The municipality did not apply the deemed cost method correctly and did not review or determine the residual value for property as required by the SA Standards of GRAP, GRAP 17, *Property, plant and equipment*. I have not determined the correct net carrying amount of property plant and equipment or the accuracy of depreciation as it was impracticable to do so. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for property, plant and equipment. In addition, I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment amounting to R707 975 496 (2011: R710 456 734), as disclosed in the statement of financial position and note 7.1 to the financial statements. I was unable to confirm these amounts disclosed by alternative means. Consequently, I was unable to determine whether any

further adjustments were necessary to these amounts disclosed for property, plant and equipment.

Payables

6. I was unable to obtain sufficient appropriate audit evidence for payables disclosed as R24 358 331 (2011: R22 279 452) in note 4 to the financial statements due to an inadequate system of internal control to account for payables and suspense accounts not cleared at year-end. Furthermore I could not confirm the completeness and accuracy of the related expenditure as invoices received before year-end had not been provided for as payables. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for payables, expenditure and employee cost.

Trade receivables

7. I was unable to obtain sufficient appropriate audit evidence to determine the existence and valuation of accounts receivable disclosed as R104 174 151 (2011: R87 424 629) in note 10 to the financial statements as the existence of debtor's could not be verified. I was unable to confirm the existence of these debtors by alternative means. The municipality made a provision of R63 601 512 (2011: R52 891 545) as disclosed in note 10 to the financial statement for the impairment of trade receivables, however, I was unable to obtain sufficient appropriate audit evidence to determine the accuracy of the impairment. I was unable to calculate what the impairment charge against consumer debtors and the impairment losses expense should have been. Consequently, I was unable to determine whether any adjustment relating to trade receivables in the financial statements was necessary.
8. The municipality did not make all the disclosures as required by the International financial reporting standard, IFRS 7, *Financial instruments disclosure*, which states that a municipality shall disclose by class of financial instrument information about the credit quality of financial assets that are neither past due nor impaired. I have not determined the correct disclosures of these receivables as it was impracticable to do so.

Provisions

9. SA Standards of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*, requires that a provision should be made for the municipality's present obligation incurred as a consequence of its past use of landfill sites. I was unable to obtain sufficient appropriate audit evidence for the valuation of the rehabilitation provision amounting to R25 519 511 (2011: R23 293 938) as disclosed in note 15 to the financial statements. I was unable to confirm the valuation by alternative means. Consequently, I was not able to determine the effect on the other account balances and classes of transactions contained in the financial statements.

Accumulated surplus

10. I was unable to obtain sufficient appropriate audit evidence as to the completeness, valuation and allocation of the accumulated surplus amounting to R761 834 274 (2011:R759 306 462) as disclosed in the statement of financial position and in the statement of changes in net assets due to supporting documentation that could not be obtained for the movement in the balance of the prior year corrections and opening balance. The municipality's records and information available did not permit the application of alternative

procedures. Consequently, I was unable to determine whether any adjustment relating to accumulated surplus in the financial statements was necessary.

Employee-related cost

11. I was unable to obtain sufficient appropriate audit evidence as to the occurrence, accuracy and classification of the employee-related cost disclosed as R48 719 193 in the statement of financial performance and note 20 to the financial statements due to supporting documentation that could not be obtained for payments made amounting to R2 476 889 with regards to car allowances and subsidies. The municipality's records and information available did not permit the application of alternative procedures. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustment relating to employee-related costs in the financial statements was necessary.

Employee benefits

12. International Accounting Standard, IAS 19, *Employee benefits*, outlines the recognition and requirements pertaining to employee benefits. Contrary to these requirements, the municipality did not disclose post-retirement benefits and long service awards for the current and prior years. In the absence of appropriate records and information, I was unable to confirm the valuation and allocation and completeness of employee benefits for the current and prior years. Consequently, I was unable to determine the effect on the other account balances and classes of transactions contained in the financial statements.

Value-added tax (VAT) payable

13. I was unable to obtain sufficient appropriate audit evidence pertaining to VAT payable amounting to R2 191 853 as disclosed in note 19 to the financial statements due to the fact that journals processed were not supported by appropriate evidence and journals processed were not duly authorised before they were processed. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustment relating to VAT payable in the financial statements was necessary.

Capital commitments

14. I was unable to obtain sufficient appropriate audit evidence pertaining to capital commitments disclosed as R3 964 344 in note 26 to the financial statements due to the lack of a proper contract management system for the identification and recognition of contracts. I was unable to confirm the amount disclosed by alternative means. Consequently, I was unable to determine whether any adjustment relating to capital commitments in the financial statements was necessary.

Consumer deposits

15. I was unable to confirm that management has properly charged and accounted for all consumer deposits for the current and prior years. Consequently, I was unable to obtain sufficient appropriate audit evidence as to the completeness and valuation of consumer deposits of R1 092 493 (2011: R1 062 312), as disclosed in the statement of financial position, and the related disclosure in note 3 to the financial statements. The municipality's records and information available did not permit the application of alternative audit procedures regarding consumer deposits. Consequently, I was unable to determine whether any adjustment relating to consumer deposits in the financial statements was necessary.

Irregular expenditure

16. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure disclosed as R9 853 284 in note 41 to the financial statements due to the register for irregular expenditure not agreeing with the financial statements and the lack of a proper system to account for and identify irregular expenditure. I was unable to confirm the occurrence, accuracy and completeness of irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustment relating to irregular expenditure in the financial statements was necessary.

Distribution losses and free services

17. Section 125(2)(d)(i) of the MFMA requires that the financial statements of a municipality must disclose particulars of any material losses. I was unable to confirm the completeness and accuracy of distribution losses or free services provided disclosed as R0 (2011: R10 314 184) in note 43 to the financial statements due to the municipality not implementing adequate control measures to reliably calculate these losses. In the absence of sufficient appropriate documents. Consequently, I was unable to determine the total extent of the misstatement in distribution losses.

Cash flow statement

18. I was unable to obtain sufficient appropriate audit evidence to determine whether the cash flow statement and the related notes were fairly stated for the current and prior year. Taking into account the misstatements and scope limitations identified in the financial statements, as set out in this report, I was unable to practically quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine the accuracy, completeness and correct disclosure of the cash flow statement and related notes.

Disclaimer of opinion

19. 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 the financial statements.

Emphasis of matters

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

Restatement of corresponding figures

21. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during the year ended 30 June 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011.

Unauthorised expenditure

22. As disclosed in note 42 to the financial statements, the municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget of R18 611 996 (R45 094 398), in contravention of section 15 of the MFMA.

Fruitless and wasteful expenditure

23. As disclosed in note 40 to the financial statements, fruitless and wasteful expenditure of R410 014 was incurred due to creditors not being paid within 30 days and VAT 201 forms being submitted after the closing date.

Additional matters

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

Unaudited supplementary schedules

25. The supplementary information set out on pages xx to xx 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

26. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the annual financial statements.

Financial sustainability

27. As a result of the matters described in the basis for disclaimer of opinion paragraphs, the municipality may be in a worse financial position than the position reflected in these financial statements. The difficulties being experienced by the municipality in recovering its consumer debtors, the potential negative effect of this tendency on the cash flows of the municipality and the inability to settle accounts payable within an acceptable period 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 as per note 1.4 to the financial statements and have been prepared on a going concern basis.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

PAA REQUIREMENTS

28. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

29. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

30. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMPPPI).

The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

31. The material findings are as follows:

Usefulness of information

Presentation

32. Improvement measures in the annual performance report for a total of 54% of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

33. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 24% of all planned indicators specified in the integrated development plan (IDP) for the year under review. This was due to lack of or limited review and monitoring of the completeness of reporting documents by management.

Additional matter

34. I draw attention to the following matter. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

35. Of the total number of 173 targets planned for the year, 87 targets were not reached during the year under review. This represents 50% of total planned targets that were not reached during the year under review. This was as a result of the institution not considering relevant systems and evidential requirements during the annual strategic planning process.

Compliance with laws and regulations

36. I performed procedures to obtain evidence that the municipality had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

37. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan (IDP) before the plan was submitted to the council for adoption, as required by regulation 15(3) of the Municipal planning and performance management (MPPM) regulations.
38. The municipality did not:
 - set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its IDP,
 - take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the Municipal Systems Act (MSA).

Budgets

39. Expenditure was incurred that was not budgeted for or in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
40. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

Annual financial statements, performance report and annual report

41. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.
42. The accounting officer did not make public the council's oversight report on the 2010/11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
43. The annual report for the year under review does not include the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote and the report of the audit committee, as required by section 121(3)(f) and (j) of the MFMA

Audit committees

44. The audit committee did not advise the council, accounting officer and the management staff on matters relating to internal financial control and internal audits, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
45. The audit committee did not advise the council, accounting officer and the management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

46. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
47. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by MPPM Regulation 14(4)(a)(ii).
48. The audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPM Regulation 14(4)(a)(iii).

Internal audit Unit

49. The internal audit unit did not function as required by section 165(2) of the MFMA, in that:
 - it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review
 - it did not report to the audit committee on the implementation of the internal audit plan
 - it did not advise the accounting officer and the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
50. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.
51. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and MPPM Regulation 14(1)(a).
52. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by MPPM Regulation 14(1)(b) (i) / (ii) / (iii).
53. The internal audit unit did not audit the performance measurements on a continuous basis or submit quarterly reports on their audits to the municipal manager and the audit committee, as required by MPPM Regulation 14(1)(c).

Procurement and contract management

54. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations as required by Supply Chain Management (SCM) Regulation 17(a) and (c).
55. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as required by SCM Regulations 19(a) and 36(1).
56. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).

Expenditure management

57. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
58. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.
59. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
60. Unauthorised, irregular as well as fruitless and wasteful expenditure was not investigated and as a result it was not recovered from the liable person, as required by section 32(2) of the MFMA.

Financial misconduct

61. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA due to the fact that unauthorised, irregular as well as fruitless and wasteful expenditure was incurred but was not investigated.

Revenue management

62. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
63. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
64. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

Asset management

65. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
66. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

67. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
68. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Human resource management

69. The competencies of the chief financial officer and SCM officials were not assessed promptly in order to identify and address gaps in competency levels, as required by the Municipal Regulations on Minimum Competency Levels, regulation 13.
70. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and the relevant provincial treasury, as required by the Municipal Regulations on Minimum Competency Levels, regulation 14(2)(a).
71. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the Municipal Regulations on Minimum Competency Levels, regulation 14(2)(b).
72. The performance agreements of the chief financial officer, senior managers and head of SCM, who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by the Municipal Regulations on Minimum Competency Levels, regulation 16(2).
73. The performance agreements of the financial officials and SCM officials who did not have the minimum competencies, did not include the attainment of minimum competencies as a performance target, as required by the Municipal Regulations on Minimum Competency Levels, regulation 16(1).
74. An acting senior manager was appointed for a period of 40 months, in contravention of section 54A(2A)(a) of the MSA.

Environmental

59. The municipality operated its waste disposal site(s) without a waste management licence or permit, in contravention of section 20(b) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008) and section 20(1) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989).

Internal control

75. I considered internal control relevant to our audit of the financial statements, and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for disclaimer of opinion. The findings on the annual performance report and the findings on compliance with laws and regulations are included in this report.

Leadership

76. The leadership of the Mantsopa Local Municipality neglected to evaluate whether management had implemented effective internal controls by gaining an understanding of how senior management members had met their responsibilities in terms of preparing bank reconciliations, ensuring proper records management, maintaining an asset register and preparing the annual financial statements.

77. The leadership did not take appropriate action to address the lack of discipline in the finance and SCM directorates. This resulted in non-compliance with procurement legislation, which in turn gave rise to the high level of unauthorised and irregular expenditure incurred in the financial statements.
78. The leadership of the municipality did not ensure that internal control procedures were developed, implemented and monitored to ensure that daily disciplines were performed and reviewed.
79. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evidenced by the failure of management to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause. This resulted in prior year audit findings recurring in the current year.
80. The leadership failed to implement adequate controls to ensure compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.

Financial and performance management

81. Due to oversight on the part of the senior management group of the municipality the regular review and monitoring of compliance with laws and regulation were not sufficiently prioritised. As a result, material non-compliance issues were noted that could have been prevented
82. Due to time pressure brought about by the fact that the process of preparing the financial statements was only started late in the financial year, sufficient time was not available for the chief financial officer to properly review such statements for completeness and accuracy prior to submission thereof for auditing. This resulted in many findings relating to incorrect disclosure which were subsequently corrected.
83. The municipality did not have the capacity to address backlog issues and financial system problems, resulting in the need to appoint consultants. Consultants assisted with the preparation of an asset register and financial statements.
84. Staff within the finance directorate of the district municipality had an insufficient understanding of the accounting framework. This contributed towards the errors that were subsequently corrected in the financial statements of the municipality.

Governance

85. The financial statements contained numerous inaccuracies, which are attributable to weaknesses in the design and implementation of internal control in respect of financial management and financial reporting, and weaknesses in the information systems.
86. Although the municipality had an internal audit unit, it was not adequately resourced and functioning to identify internal control deficiencies and provide recommendations. The implementation of external audit recommendations was not monitored. This resulted in the prior year audit findings not being substantially addressed.

87. An audit committee did not evaluate and monitor responses to risks and provide oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations.

AUDITOR - GENERAL

Bloemfontein

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence